Jonathan Hill, Lord Hill of Oareford
Commissioner for Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de la Loi / Wetstraat 200
1049 Brussels
Belgium

26 January 2016

Dear Lord Hill,

RE: The Corporate End-User Community and EMIR

The signatories to this letter are companies and organisations that represent companies that use derivatives to hedge real economic business risks and that contribute significantly to Europe's economy, including by employing millions of people throughout the EU.

We have joined together in this letter to urge the Commission, in connection with its ongoing review of the European Market Infrastructure Regulation ("EMIR") and the Capital Markets Union Cumulative Impact Assessment, to propose adjustments to EMIR's reporting requirements for non-financial counterparties ("NFCs") below the clearing thresholds ("NFC-minuses").

We have serious concerns that **corporates using derivatives for hedging purposes today are unnecessarily and disproportionately burdened by such requirements.** The use of derivatives to hedge commercial risk has key economic benefits. It allows businesses—from manufacturing to healthcare to agriculture to energy to technology—to improve their planning and forecasting, manage unforeseen and uncontrollable events, offer more stable prices to consumers and contribute to economic growth. Imposing unnecessary burdens on these hedgers restricts job growth, decreases investment and undermines our competitiveness in Europe—leading to material cumulative impacts on corporate end-users and our economy.

It is also important to recall that **these corporates do not pose systemic risk and did not cause the financial crisis.**

While we support EMIR's reforms to enhance derivatives market transparency and reduce systemic risk, **we remain concerned that the dual-sided reporting regime and the requirement to report intragroup transactions place disproportionate, costly and unnecessary burdens on end-users** and do not provide regulators or markets with any discernible benefit.

Illustrating this point, EMIR's dual-sided reporting obligations created approximately 134,000 new reporting counterparties, of which nearly 104,750 are NFC-minus corporates. **Currently,**

NFC-minuses represent approximately 76% of the total reporting counterparties under EMIR; however, they constitute a mere 2% of the total notional amount of derivatives reported under EMIR, and significantly less if intragroup transactions are excluded.[1]

Intragroup transactions of end-user hedgers do not increase systemic risk, either by creating counterparty credit risk or increasing interconnectedness between financial institutions. Requiring NFC-minuses to comply with the same reporting requirements for intragroup transactions as those required for external derivatives transactions burdens corporates without any corresponding benefit. **We urge the Commission to recommend changes to EMIR to exclude intragroup transactions of NFC-minuses from the EMIR reporting obligations.**

Dual-sided reporting has created significant initial and ongoing operational, legal and cost burdens for end-user companies. The issues with data quality suggest there must be a better way for regulators and the market to get the data they need without imposing duplicative and burdensome reporting requirements on "real economy" companies.

We believe that more accurate derivatives transaction data can be achieved through single-sided reporting and by relying on straight-through-processing and the existing confirmation and reconciliation processes in the market, which are the legal means through which NFC-minuses and other market participants agree on and verify terms of their derivatives transactions. **We urge the Commission to recommend changes to EMIR to allow single-sided reporting for transactions with NFC-minuses.**

Finally, we are aware that regulators have recently contemplated adjusting the threshold calculation for determining when NFCs exceed the clearing thresholds by including "hedging transactions" in such calculation. Such a "hedging penalty" would result in "real economy" companies losing clearing and margin exemptions, which would needlessly divert capital and liquidity away from economic growth, resulting in a direct negative impact on job growth in the EU and reduced participation in our markets.

The Coalition for Derivatives End-Users, which represents the views of end-user companies that employ derivatives primarily to manage risks, including many of the signatories on this letter, conducted a survey[2] that found a 3% initial margin requirement could reduce capital spending by as much as €4.7bn (USD5.1bn) to €6.2bn (USD6.7bn) among S&P 500 companies alone and cost 100,000 to 130,000 jobs. **We strongly oppose changes to include hedging transactions in the NFC threshold calculations.**

We would like to thank you for your consideration of these issues, which are of significant importance to the end-user community, and we would be pleased to discuss them in greater detail at your convenience.

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[1] European Securities and Markets Authority, EMIR Review Report no. 1: Review on the use of OTC derivatives by non-financial counterparties, 7, 12, 14 (13 August 2015), *available at* https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1251_-_emir_review_report_no.1_on_non_financial_firms.pdf.

[2] The Coalition for Derivatives End-Users' Survey on Over-the-Counter Derivatives (11 February 2011), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/Coalition-for-Derivatives-End-Users-OTC-Derivatives-Survey_Final-Version-2-11-11.pdf.

We have provided additional information on these issues in the attached Appendix. Should you have any questions or comments, please do not hesitate to contact Michael Bopp, Counsel to the Coalition for Derivatives End-Users, at mbopp@gibsondunn.com.

Sincerely,

ABB
Airbus Group
Air Liquide
ATEL (Association des Trésoriers d'Entreprise à Luxembourg)
Ball Corporation
Belmond Ltd.
BP plc
British American Tobacco plc
Chatham Financial Corp.
Coalition for Derivatives End-Users
CNH Industrial N.V.
Cummins Inc.
Deere & Co.
The Dow Chemical Company
Financial Executives International's Committee on Corporate Treasury
FMC Corporation
Ford Motor Company
General Electric Company
General Motors Company
GMR Capital Ltd
Honeywell International Inc.
IBM Corp.
IGTA (The International Group of Treasury Associations)
JLA Ltd.
Johnson Controls, Inc.
KAZ Minerals PLC
KME Group
Mondelēz International, Inc.
National Association of Corporate Treasurers
National Association of Manufacturers
Novelis Inc.
Owens-Illinois, Inc.
PPD
Rolls-Royce plc
Sally Beauty Holdings, Inc.
Simon Property Group, Inc.
Time Warner Inc.
U.S. Chamber of Commerce
United Technologies Corporation
VimpelCom Ltd
Vodafone
Volvo Group

Copies: Paulina Dejmek-Hack (President's CAB); Miguel Gil-Tertre (Katainen CAB); Jan Ceyssens (Dombrovskis CAB); Lee Foulger (Hill CAB), Ioana Diaconescu (Moscovici CAB); Fabrice Comptour (Bieńkowska CAB); Olivier Guersent (DG FISMA), John Berrigan (DG FISMA), Martin Merlin (DG FISMA), ECON Committee European Parliament, Member States, ESMA

APPENDIX

Eliminate Reporting Requirements for NFC-minus Intragroup Transactions

Many corporate end-users utilise a centralised treasury unit structure in which they transact among affiliates in order to more efficiently manage the internal risks of the corporate group. Centralised treasury units help to reduce market risk, counterparty risk and operational risk by allowing corporate groups to consolidate internal risks, often resulting in far fewer external transactions. Fundamentally, a centralised treasury unit structure is a risk-reducing best practice that should be encouraged by regulators. As a result of this risk-reducing structure, corporates can have a significantly greater number of intragroup than external transactions.

Requiring NFC-minuses to comply with the same reporting requirements for intragroup transactions as those required for external derivatives transactions creates unnecessary and disproportionate costs and burdens on NFC-minuses without any corresponding benefit. Corporates that use a centralised treasury unit hedging structure particularly feel the impact of intragroup reporting requirements. Additionally, dealer counterparties are generally unwilling to accept delegation of the reporting requirements for intragroup transactions, further increasing costs and burdens to NFC-minuses.

The reporting of intragroup transactions will not reveal greater market threats or trends as these transactions are used for managing a company's internal risk and do not pose external risk. Regulators currently exempt transactions between two desks or two branches within the same legal entity;[3] in practice this is no different than a transaction between a parent and its wholly owned subsidiary, particularly in the context of NFC-minuses. Further, other jurisdictions have recognised that intragroup transactions are of little empirical value to the public and to regulators.[4] We note that all NFC-minuses are mandated to maintain records of all transactions, including intragroup transactions, and such transaction data are always available to regulators. Accordingly, we ask the European Commission to recommend changes to EMIR to exclude intragroup transactions of NFC-minuses from the EMIR reporting obligations.

Enable Single-Sided Reporting for NFC-minuses

It is clear that dual-sided reporting is a costly and duplicative process resulting in NFC-minuses disproportionately bearing the costs of compliance, with such disproportionate impacts further intensified by the requirement to report intragroup transactions. Even NFC-minuses that delegate their external reporting obligations face considerable burdens as they are required to verify that counterparties have reported such information. The parallel process created by dual-sided reporting that requires each counterparty to convert and report data to a repository after the terms of the transaction are agreed to, rather than having financial counterparties ensure the agreed-upon data is directly sent to the trade repository is, as other jurisdictions have recognised, an unnecessarily complex and burdensome approach that does not ensure the availability of quality data to regulators.

We believe that more accurate derivatives transaction data can be achieved through single-sided reporting and by using the existing confirmation processes in the market, which are the legal means through which NFC-minuses and other market participants agree on terms to their derivatives transactions. End-users, and we expect other market participants, do not use trade repository data as a "source of truth" for regular settlements, coupon payments and lifecycle

[3] *See* EMIR: Q&A, p. 52 (last updated: December 20, 2013), *available at* http://www.esma.europa.eu/system/files/2013-1959_qa_on_emir_implementation.pdf.

[4] *See, e.g.*, CFTC Letter No. 13-09; Ontario Securities Commission Staff Notice 91-703.

events, among other things. Data quality in trade repositories will only improve by increasing the use of electronic confirmations with straight-through-processing of confirmation data to trade repositories. Straight-through-processing allows for the trade process—from execution to confirmation to reporting—to be conducted electronically, increasing speed and accuracy while reducing errors.

We would suggest that trade repositories receive data on economic terms of derivatives executed directly from electronic trade confirmation platforms, where available. Other counterparty data could be provided by an NFC-minuses' dealer counterparty for reporting purposes, or otherwise submitted through a common means or system. The errors resulting from the current dual-sided reporting of economic and non-economic terms would be reduced. Article 11 of EMIR contains specific tools to sufficiently and accurately address the data quality concerns: data reconciliation provisions, timely confirmation of OTC derivatives contract terms, dispute resolution procedures and the daily valuation of outstanding derivatives transactions. Article 11 of EMIR, coupled with a single-sided reporting regime, would reduce regulatory overlap and burdens imposed by the current dual-reporting obligations.

There would be considerable benefits to the "real economy" if the EU were to move to a single-sided reporting regime for NFC-minuses, as end-users that do not contribute to systemic risk would no longer be required to divert resources to comply with such reporting requirements. Accordingly, we ask the European Commission to recommend these changes to EMIR.

<u>Do Not Recalibrate the NFC Clearing Thresholds</u>

Regulators have contemplated removing the hedging definition and including such hedging transactions when determining whether an NFC exceeds the clearing thresholds.[5] Such a "hedging penalty" would increase costs and discourage activities that did not contribute to the financial crisis and that are designed to protect businesses from risks and make the global economy more stable. This is especially true as recalibration at the moment is unnecessary in light of the economic reality of the risks posed by derivatives generally and NFC hedges specifically, as they represent only 2% of the total notional amount of derivatives and significantly less when one considers that a significant portion of the 2% represents intragroup transactions.

As indicated in a recent position paper by the European Association of Corporate Treasurers, the systemic risk posed by hedging activities is minimal as "the mark-to-market of hedging transactions will be offset at NFC level by an underlying exposure related to their core activity."[6] As a result, large price movements in asset classes have little impact on the results of current NFC-minuses and "are unlikely to cause default of that NFC, let alone cause a financial crisis."[7] In contrast, were the hedging exemption removed, EACT posits that up to EUR 203 billion of investment in the real economy would be removed should current NFC-minuses have to mobilise the estimated 6% that NFCs would set aside from their notional value of their derivatives portfolios.

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[5] European Securities and Markets Authority, *EMIR Review Report no. 1* (August 13, 2015), *available at* https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-1251_-_emir_review_report_no.1_on_non_financial_firms.pdf.

[6] European Association of Corporate Treasurers, *EACT Position on ESMA Review on the use of OTC derivatives by non-financial counterparties* (October 6, 2015), *available at* http://www.eact.eu/docs/EACT-Position-ESMA-Report-NFCs-Use-of-OTC-Derivatives-Oct15.pdf.

[7] *Id.*

Current NFC thresholds reflect reasoned debate and consideration of the stability of the financial marketplace, and serve as an explicit declaration that the commercial hedging activities of end-users promote economic growth and job creation and do not create systemic risk. The recalibration and incorporation of NFC hedges would result in capital scarcity, reduce market security and liquidity, and drive business abroad. Non-EU NFCs would likely move business from European bank counterparties and organise treasury centers outside of the EU in order to avoid the punitive consequences of such a change in threshold calculations.

Unnecessary changes would lead to end-user companies losing the clearing and margin exemptions, which would needlessly divert scarce capital and liquidity away from economic growth. The resulting costs would have a direct impact on job growth in the EU. Indeed, accounting for non-speculative transactions in NFC threshold calculations is an unsound policy that would increase end-user commercial risks without concrete systemic risk reduction and discourage commercial hedging transactions that promote economic growth and jobs in the real economy.

Changes to NFC determinations, in addition to destabilising risk mitigation and stifling job growth, would discourage and reduce market participation throughout Europe. Regulators should be encouraging, not discouraging, corporate end-users' use of proven business risk mitigation techniques. Accordingly, we strongly oppose changes to the NFC threshold calculations that would lead improperly to corporate end-users that are hedging or mitigating risks and do not pose any systemic risk to become subject to costly clearing and margin requirements intended for entities that pose systemic risk.