THE EUROPEAN ASSOCIATION OF CORPORATE TREASURERS

21 March 2022

Response to the European Commission’s consultation on the review of the central clearing framework in the EU

A) Clearing obligation for PSAs

Question 1 – What measures (legislative or non-legislative) do you think would be useful in order to make clearing in the EU more attractive for PSAs?

As non-financial companies, some of our members have pension funds to manage employees’ pensions and these pension funds also have hedging needs and will use derivatives to meet those needs.
While the exemption for pension funds from the clearing obligation is expected to lapse in June 2023, pension funds within non-financial corporate groups should remain exempted from the obligation to centrally clear. Indeed, the requirement to post variation margin in cash remains difficult to meet for pension funds, in spite of recent work to improve collateral conversion services. This is also particularly due to the fact that
pension funds’ derivatives portfolios are unidirectional which would lead to disproportionately high margin requirements should they be forced to clear at a CCP. In addition, liquidity tied up in margin requirements might put redemptions for pensioners at risk.
In the context of the post-COVID recovery and the ongoing economic uncertainty given geopolitical events, it is more important than ever to maintain a stable environment allowing non-financial corporates to efficiently manage their cash.

B) More clearing by private entities that do not access CCPs directly

Question 4 – If you do not currently clear other OTC derivatives at a CCP, are you considering/would you consider approaching a CCP to clear them? – <u>No</u>

Question 4.1 – What are the considerations that drive/would drive your decision? Please explain providing, where possible, quantitative evidence and examples.

Corporates use derivatives to manage specific risks linked to their business operations – and many products which meet the standardisation criteria to be cleared in CCPs do not meet these specific needs in terms of maturity and flexibility.

D) Broaden the product scope of the clearing obligation

Question 1 – Is the range of products currently subject to the clearing obligation wide enough while safeguarding financial stability? - <u>Yes</u>

Question 1.1 – Please explain your answer to question 1 providing, where possible, quantitative evidence and examples:

The current scope of products subject to the clearing obligation (CO) is wide enough. With regards to financial stability, recent stresses have proved that the existing balance functions well.

An extension of the CO to other products (combined with potential changes to the scope of counterparties included in the scope of the CO) would be extremely detrimental to European NFC's capacity to hedge their commercial risks and execute basic treasury functions needed for the health of their businesses, which would be ultimately detrimental to the stability of the European economy.. It is important that products that are not suitable for clearing are not subject to the clearing obligation.
The cash requirements associated with the posting of margins would create serious liquidity risks which would be detrimental to the European economy.
For example, the hedging of a USD 1Billion with EUR/USD cross currency swap would require the posting of over half of the total value of the bond in collateral in the event of a 20% swing in the exchange rate. This scenario would potentially force a corporate to issue an additional bond solely for the purpose of raising sufficient collateral. This would clearly be an un-economical and inefficient system. Furthermore, these scenarios are not uncommon, the recent volatility in the commodities derivatives markets and their impact on margin calls is a very recent reminder of the challenges.

Question 4 – If a product is available for clearing but not subject to an obligation are there instances where you would still choose to trade bilaterally? - <u>Yes</u>

Question 4.1 If you answered yes to question 4, please specify in which cases providing, where possible, quantitative evidence and examples, and explain the rationale to do so.

Central clearing presents significant challenges for European non-financial companies as liquidity allocated for margining cannot be used for main business operations.
Bilateral agreements are preferable in order to reduce counterparty risk as the terms and conditions can be negotiated between both parties allowing for the reduction of liquidity and other risks.

Question 5 – In light of the EMIR framework for the clearing obligation, is the definition of OTC derivatives in EMIR clear enough? <u>Yes</u>

Question 6 – Is the procedure to determine whether a non-financial counterparty should be subject to the clearing obligation under Article 10 clear enough? - <u>Yes</u>

Question 6.2 – **How should intragroup transactions be taken into account in the procedure?**

Intragroup transactions should not count toward the calculation of the clearing threshold.

Question 6.2 – Should the clearing thresholds be recalibrated based on cleared versus noncleared rather than OTC versus ETD? The clearing thresholds do not need to be recalibrated.

Question 7 – Should the thresholds for the clearing obligation continue to be linked to the application of margin requirements? - <u>Yes</u>

Question 7.1 – Please explain your answer to question 7 providing, where possible, quantitative evidence and examples including on potential costs and benefits.

European NFCs support the application of risk mitigation measures and have it in their best interest to manage their contracts with financial counterparties well. Most corporates enter into voluntary bilateral CSAs which allow them to manage counterparty credit risks in a tailored way and in relation to their business reality. It is important that NFC- that are exempted from the clearing exemption continue to remain exempted from bilateral margining requirements which present the same challenges as posting cash on daily basis when clearing at a CCP. Forcing NFC- to meet bilateral margin requirements would be detrimental to the economic stability of European companies and their ability to manage liquidity in an efficient manner. EU corporates should however remain subject to risk mitigation techniques.