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IACT response to ESMA consultation on EMIR technical standards

The Irish Association of Corporate Treasurers (IACT) appreciates the opportunity to comment on the ESMA "Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories".

The IACT supports the overall aim of the technical standards being the reduction of risk through the use of sound and resilient practices and appropriate risk mitigation techniques. However, we are concerned that there are a number of aspects of the proposals which, if applied in the context of a non financial counterparty ("NFC") may not achieve the stated goals above.

Our NFC members concerns centre about three broad issues

1. Definitions

While the draft proposals recognise that non-financial counterparties primarily use OTC derivatives to protect themselves against commercial risks directly linked to their commercial activities or treasury financing activities ("a hedge"), the IACT is concerned that the draft proposals do not provide an appropriate level of clarity as to what would be considered to be a hedge for the purpose of the regulations. Specifically, the draft proposals do not address

- Whether the proposals will apply at a consolidated level or at an individual company/entity/branch level. The IACT believes that the proposals should clarify that for a NFC, the appropriate measure is the mitigation of risk from a consolidated point of view and not solely on an individual entity level. Many corporate groups take a consolidated approach to managing risk, especially in relation to group-wide risks such as interest rate or FX exposures.
- Whether the requirements surrounding the ability to move liquidity from the risk taking entity to the Treasury function should be considered in a group context when determining the effectiveness of any risk mitigation technique. Specifically, in the context of a group, it is the capacity to transfer cash to the central treasury from elsewhere in the group that is relevant. There are a number of valid risk mitigation strategies employed by NFC's where the exposure being managed is not represented by liquid cash resources in the underlying entity. These include
 - Hedging FX exposures for group entities that operate in jurisdictions where there are restrictions on the transfer of funds outside of the jurisdiction, for example some emerging market countries.
 - Hedging the future purchase of a fixed asset within a group entity. At the time the hedge is entered into, there is no physical asset on the group balance sheet. Even when acquired, the fixed asset is not likely to be convertible into liquid cash at short notice.

- Hedging of the net assets of a foreign subsidiary where there is no intention or practical ability to liquidate the assets into cash at short notice.

The IACT understand that such factors are only applicable to those NFC's that have already breached the threshold for central clearing and are therefore not applicable until such threshold is breached.

- What is meant by the “jurisdictions with similar or equivalent regulations” in the context of the intergroup transactions exemption. The IACT would consider that in the context of a intergroup derivatives within a global group, it is the jurisdiction of the group that is relevant.
- An OTC derivative contract is deemed to be objectively measurable as reducing risk, when it
 - a) reduces the potential change in value of assets that it owns, sells or leases in the ordinary course of its business, or mitigates potential changes resulting from fluctuation of interest rates, inflation or foreign exchange rate ***or***
 - b) when the accounting treatment of the derivative contract is that of a hedging contract pursuant to IFRS.

We would welcome clarification as to the nature of evidence that would be expected that a NFC would retain to demonstrate compliance with aspect a) of the definition and whether such compliance would be required to be demonstrated on initiation of the hedge or on an ongoing basis. It is typical that, from a governance and monitoring perspective, this would be addressed by an NFC through a board approved risk mitigation policy. IACT would consider that individualised documentary evidence or modelling for each and every transaction is neither warranted nor efficient.

The IACT would also note that there are a number of valid hedging strategies that are not designated as hedges under IFRS and as such would be against any modification of the current definition within the proposals which would introduce a requirement for IAS 39/FAS133 hedge compliance as a requirement for demonstrating the above.

- We understand that once breached, the requirements for central clearing remain with the corporate entity in perpetuity. In addition to the observations above as to what is intended by “the entity”, we would welcome a debate as to whether there is to be a “cleansing period” after which the requirements could revert. Such a provision would cater for situations where a group were deemed to have triggered the requirements as a result of a once off corporate event which is ***not*** considered probable to re-occur (e.g. a corporate restructuring or other M&A activity).

2. Reporting Requirements

It is the view of our NFC members that the provision of daily mark to market valuations of derivatives would introduce an unnecessary and potentially unworkable operational burden. A typical small to medium non-financial counterparty does not routinely have a commercial requirement for intra-day mark to market data and therefore may not have prioritised the investment in such systems and data feeds.

The IACT would also be concerned that the external reporting of fair values without the necessary context of the underlying risks being hedged might disclose commercially sensitive information.

Clarity is also required as to whether the reporting obligations extend to inter-group deals. Duplication of reporting in the context of a group should be avoided

3. Timelines

IACT NFC members would be concerned over the proposed timelines for the implementation of the proposals. There will be a number of system and resource issues to be dealt with to ensure that the reporting requirements can be met within the required timeframes. Possible renegotiation with external service

providers may also be required. In the absence of specific final guidance covering inter alia, reporting fields and methodologies, it is difficult to scope and implement an appropriate transition plan.

The proposed changes may also have knock-on implications into existing ISDA and CSA agreements with financial counterparties.

The IACT would support the possibility to delegate the reporting requirements to the other counterparty. We note that the current proposal document seems to contain contradictory wording on this aspect.

If you have any questions, please contact Barry Dempsey at info@treasurers.ie

Yours faithfully

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