BDI DEUTSCHES AKTIENINSTITUT VERBAND DEUTSCHER TREASURER

Comment of DAI, BDI and VDT on the BCBS/IOSCO Consultation Document on "Margin requirements for non-centrally-cleared derivatives" (Second Consultative Document)

Frankfurt a.M. / Berlin, 15 March 2013

Deutsches Aktieninstitut (DAI)[1], Bundesverband der Deutschen Industrie (BDI)[2] and Verband Deutscher Treasurer (VDT)[3] welcome the opportunity to comment on the BCBS/IOSCO Second Consultation Document on "Margin requirements for non-centrally-cleared derivatives". Our answers represent the view of non-financial companies using derivatives almost exclusively to mitigate risks related to their commercial or treasury finance activities.

It is of utmost importance that BCBS and IOSCO take into account appropriately the specifics of non-financial companies. In general, the great majority of German non-financial companies does not clear or collateralise their derivatives for the following reasons:

- Liquidity provided as collateral (initial and variation margins) will no longer be available for operative purposes. The necessity to block funds for such non-core purposes will in any case reduce the financial flexibility of non-financial companies;

- Non-financial companies do not have access to central bank's liquidity facilities – they are therefore more cash-constrained than financial institutions. Furthermore, if central clearing or collateralization became mandatory liquidity reserves would become less predictable and would be far more volatile.

Against this background we appreciate that some of our concerns raised in our first position paper (dated from 28 September 2012) are addressed in the second consultative document.

In particular we welcome the clarification that transactions of non-financial companies which are not systemically important should be out of the scope of the margin requirements as these entities are not obliged to clear their derivatives. We also welcome that the treatment of inter-affiliate transactions should be consistent with the regulatory framework enacted in the jurisdiction the non-financial company is domiciled. This will allow European non-financial companies to apply for an exemption from the requirements of bilateral collateralisation regarding their intra-affiliate transactions.

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1 Deutsches Aktieninstitut e.V. (DAI, www.dai.de) is the association of German exchange-listed stock corporations and other companies and institutions which are engaged in the capital markets development.

2 Bundesverband der Deutschen Industrie e.V. (BDI, www.bdi.eu) is the umbrella organisation of German industry and industry-related service providers. It represents 38 industrial sector federations and has 15 regional offices in the German Länder. BDI speaks for more than 100,000 private enterprises – 98 % small and medium sized – employing around 8 million people. Membership is voluntary.

3 Verband Deutscher Treasurer e.V. (VDT, www.vdtev.de) is the official German association of Corporate Treasurers representing more than 950 treasury professionals from 450 companies.

Nevertheless, some additional work remains in order to adequately reflect the specifics of non-financial companies exceeding the clearing thresholds:

- Transactions of non-financial companies exceeding the clearing threshold should also be exempted from the margining requirements as long as the respective derivatives are used for risk reducing purposes, because they do not pose any systemic risk. Additionally, initial margins should not be imposed at all as this would over-stretch liquidity reserves of non-financial companies;

- The proposed standards should adequately reflect current collateralisation standards of those non-financial companies which already collateralise parts of their derivatives. Hence, (1) the exchange of variation margins should not be required more frequently than once a month, (2) thresholds and minimum transfer amounts should be applied for initial *and* variation margins and (3) re-hypothecation of collateral should be allowed.

Please find below our answers to the questions. We would appreciate if the BCBS and the IOSCO could take our comments into consideration.

Q1. Given the particular characteristics of physically-settled FX forwards and swaps, should they be exempted from initial margin requirements with variation margin required as a result of either supervisory guidance or national regulation? Should physically-settled FX forwards and swaps with different maturities be subject to different treatments?

It would be consequent to exempt physically-settled FX- forwards and swaps from both, variation and initial margins, as the counterparty credit risk involved is very small (due to the very short average maturity of the contracts) and settlement risks are very well addressed especially through the widespread use of payment-versus-payment arrangements. This would also contribute to a global level-playing field and avoid regulatory arbitrage as for example the U.S.-legislator has also proposed such an exemption.

The exemption should not be restricted to a specified maturity as this will lead to an artificial accumulation of FX swaps and forwards with a maturity which is relevant for the exemption. For example, limiting the exemption to a 365 day maturity will lead to an accumulation of activity in instruments with a tenor of 364 days. Hence, the exemption should simply be defined per product type.

Q2. Should re-hypothecation be allowed to finance/hedge customer positions if re-hypothecated customer assets are protected in a manner consistent with the key principle? Specifically, should re-hypothecation be allowed under strict conditions such as (i) collateral can only be re-hypothecated to finance/hedge customer, non-proprietary position; (ii) the pledgee treats re-hypothecated collateral as customer assets; and (iii) the applicable insolvency regime allows customer first priority claim over the pledged collateral.

Assets should be allowed to be re-hypothecated. Otherwise, liquidity reserves of non-financial companies would be over-stretched.

Q3. Are the proposed phase-in arrangements appropriate? Do they appropriately trade off the systemic risk reduction and the incentive benefits with the liquidity, operational and transition costs associated with implementing the requirements? Are the proposed triggers and dates that provide for the phase-in of the requirements appropriately calibrated so that (i) the largest and most systemically-risky covered entities would be subject to the margining requirements at an earlier stage so as to reduce the systemic risk of non-centrally cleared derivatives and create incentive for central clearing, and (ii) the smaller and less systemically risky covered entities would be allowed more time to implement the new requirements? Should the phase-in arrangements apply to the exchange of variation margin, in addition to the exchange of initial margin as currently suggested? Or, given that variation margin is already a widely-adopted market practice, should variation margin be required as soon as the margin framework becomes effective (on 1 January 2015 as currently proposed) so as to remove existing gaps and reduce systemic risk? Do differences of market circumstances such as readiness of market participants and relatively small volumes of derivatives trading in emerging markets require flexibility with phase-in treatment, even for variation margin?

For reasons of consistency the phase-in arrangements should apply for the requirements for variation margins *and* initial margins. Until the standards enter into force and are applicable for the respective counterparty in accordance with the phasing-in schedule non-financial companies should be allowed to apply their own rules on collateral which would be consistent with the approach chosen by the European Commission under EMIR.