



Lord Jonathan Hill
Commissioner
Financial Stability, Financial Services
and Capital Markets Union
European Commission
Rue de la Loi 200
B-1049 Brussels
BELGIUM

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Dear Commissioner,

Use of derivatives for risk mitigation: Proposed changes to EMIR

Thank you for following up so quickly with concrete plans to build a Capital Markets Union. The action plan contains an impressive set of proposals that can play an important role in helping resolve current problems with respect to the financing of investment.

I would like to draw your attention to a more specific issue that is also of importance for companies. As you know, the European Securities and Markets Authority (ESMA) proposes to change the European Markets Infrastructure Regulation (EMIR) and set the clearing thresholds irrespective of the hedging or non-hedging nature of the underlying derivative transactions.

ESMA effectively proposes to remove the exemption contained in EMIR forcing non-financial companies to collateralize their derivative transactions and to undergo central clearing also in cases where they use these instruments for risk mitigating purposes only.

Considering that non-financial companies use 'over-the-counter' (OTC) derivatives in conjunction with risk mitigation of underlying real economic risks, i.e. from their operative businesses, it is crucial that the existing exemptions for non-financial companies in EMIR are upheld. End-users should not be discouraged from entering into OTC derivative transactions. Reduced hedging due to the related sharp increase in costs would increase not only the risk for the single corporation concerned but also for the economy as a whole. It will also lead to a different risk assessment of the non-financial companies themselves by capital markets which will negatively affect the cost of equity and financing.

This is of course why the legislator granted the exemption for non-financial companies which use derivatives in conjunction with risk mitigation of underlying "real economy" risks, not only in EMIR but also in the revised Markets in Financial Instruments Directive/Regulation (MiFID II). Forcing companies to post margins for all these trades and requiring them to raise such liquidity will significantly increase costs whilst the liquidity posted will not be available for much needed investments, slowing down the recovery of the EU economy.



Providing intra-day cash collateral is not feasible for market participants that have no access to Central Bank liquidity, so, to avoid the risk of illiquidity under extreme circumstances, non-financial companies would need substantial additional credit lines to cover tail-risks which would be hard and costly to obtain. The use of a clearing agent does in principle not significantly reduce the amount of counterparty risk for markets in total. As a corporate needs to secure additional liquidity for collateral, counterparty risk only moves over to the provider of such lines. From a financial markets point of view, default risk will not be reduced but only redistributed.

ESMA's proposal challenges important elements of existing EU rules. These rules should not be changed as they are key for an effective functioning of the EU economy. Also, removing the exemptions would distort the global level playing field in particular with respect to the US where similar hedging exemptions are in place.

We hope that you share these concerns and that future work on EMIR will ensure that the legislation will function effectively, encouraging growth and preventing damage to businesses in the wider economy. We remain at your disposal should you wish to discuss this subject further.

Yours sincerely,

Markus J. Beyrer