

- **Consultative Document „Strengthening the resilience of the banking sector“ of the Basel Committee on Banking Supervision**
- **The Commission Services Staff Working Document on “Possible further changes to the capital requirements directive”**

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Background information

The undersigned corporates make use of bilaterally cleared, uncollateralized OTC derivatives to hedge risks arising from foreign exchange, interest rates and commodities / energies. In general we centrally deal with many banks (in most cases 30 or more) and manage our counterparty risk with bank limits. Most of us make use of hedge accounting under IAS 39 and use OTC derivatives exclusively to hedge underlying financial risk from operative business.

General

The financial market crisis was not triggered by OTC derivatives from corporate hedges. Having said this we believe that the CDS market has to be seen differently, specifically with regards to transparency and price building.

Therefore any kind of regulation on OTC derivatives should be thoroughly analyzed for its impact also on the corporate sector in order to avoid disproportional cost increases when hedging bilaterally and uncollateralized (increased capital requirement for banks) or cost implied for credit lines to facilitate collaterals (“comprehensive impact assessment”). Both effects could reduce the amount of corporate hedging and thus lead to negative effects to the shareholders, the economy, and the tax payer.

We understand that the methodologies used in the Quantitative Impact Study (QIS) differ from the ones used for this consultation paper.

In contrast to banks corporates normally hedge an underlying business risk where market value of the derivative and underlying offset each other. Here we see a big

difference to derivatives where both counterparties are financial institutions. If for instance a currency transaction risk is hedged by an exporter and the hedged currency appreciates afterwards, the market value of the derivative will become negative, whereas the underlying which is not marked-to-market will benefit. Moreover since neither 100 % of the transaction risk nor the translation risk is hedged in our case our general company risk (default risk) will go down as stronger foreign currencies versus the Euro would lead to a higher profitability ceteris paribus.

Corporates deal only in liquid markets and choose instruments which can be easily evaluated and measured, as stipulated by their internal treasury guidelines. Since many corporates apply hedge accounting under IAS 39 the instruments eligible for hedge accounting are limited so that use of complex derivatives is practically zero.

Therefore we suggest to also group derivatives by the risk they contain as we understand that the methods under investigation do not differentiate this aspect.

We would welcome any increase of transparency on outstanding derivatives by group and instrument. Today's statistics of BIS do not fully achieve this. To us this would be the way to clarify whether the outstanding positions of corporates are of systemic relevance. Therefore the reporting on outstanding derivatives should be extended in order to better identify holders of derivatives (corporates and governments in different groups) and nature of holding the derivative (held for hedging purposes vs. open trading book).

Section 21/114

In our opinion the evidence that exposures of banks to corporates are different to the exposure within the financial sector should justify a different risk weight for this group with regards to counterparty risk. As stated above in contrast to banks corporates will always hedge an underlying risk. Thus a negative market value development of the derivative will always be accompanied by a positive market value development for the underlying (example: export receivable in foreign currency or purchase of jet fuel oil). If no explicit price rulings for the group of corporate end-users as counterparty are made we fear that banks will use the opportunity to unreasonably increase the price of hedging for uncollateralized bilaterally cleared OTC derivatives.

In the QIS one of the possible methods under investigation is the bond equivalent method. According to an external assessment for which we contracted a well known treasury/bank consultancy firm this method will have the strongest negative impact for OTC derivatives used by corporates. An increase of the equity portion (BBB rating) of 300 to 400 % for these derivatives would force us to reduce our hedging activities and would therefore lead to a significantly increased risk to our business model as our competitiveness in the global marketplace would be severely reduced.

Section 112/ 116 Incentives to use CCPs

Banks shall be incentivized to move away from bilaterally cleared OTC derivatives by setting a zero percent risk weight for collateralized, CCP cleared derivatives. As a result these derivatives may become too cheap compared to bilaterally cleared non-collateralized derivatives for banks. Thus corporates will be forced to negotiate collateral credit lines as the smaller of two evils, not considering the availability and the price of these credit lines in the current environment. In addition these new credit lines would have an impact on existing refinancing credit lines (negative pledge / pari passu clauses) and further limit bank's lending ability, as they already face additional capital requirements for their lending business.

The primary concern of end users from collateralization is the increased risk of default that arises due to uncertainty from increased cash flow volatility from market movements and the limited access that companies have to funds. The regulator's primary focus on cost differential between non-collateralized and collateralized deals is misplaced. Costs should be considered but are not the driver. Access to funding is limited at a number of levels for end users: (i) there are usually hard borrowing limits imposed under a company's articles of association or under its existing borrowing facilities, (ii) even if there were no hard limits banks will not lend limitless sums even at any cost and (iii) as we have seen firsthand during the crisis banks themselves may not be in a position to lend. In addition, the ability for end users to secure new funding takes weeks or months unlike banks which have access to depositors and central banks and can therefore react very quickly for emergency funding calls.

Corporates are hedging revenues or costs for a number of years forward. Thus, the collateral requirements compound to a current liquidity risk that increases the risk of default. This liquidity risk incurred under collateralization will certainly have a negative impact on the credit risk of a corporate and put the rating at risk.

We regard the cost analysis that 'cost of funding is the interest cost of the net margin required' as too simplistic: (i) variation margin received would be deposited typically at Libid – x bp while variation margin paid by the end user would be funded at Libor + y bp (credit spread). (ii) More importantly, end users are unlikely to benefit from much netting, unlike banks who play both sides of the market, as end user exposures tend to have one-sided exposures to a few limited currencies/commodities. Hence the opportunity for netting and/or negative correlation effects is far more limited.

Sections 28/29 Reducing Procyclicality

In times of an economic downturn or crises collateralization may have procyclical effects. If for instance the oil price drops an airline company may be forced to put liquidity into the margin accounts for outstanding jet fuel hedges when at the same time the operating result will suffer from decreasing flight ticket sales. Also AIG has shown that collateralization may function as an accelerator and should therefore be considered carefully with regard to its procyclical effects.

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