# The European Association of Corporate Treasurers

Interest Representative Register ID: 9160958318-89

### Comments in response to

## *Strengthening the resilience of the banking sector*

*Issued by the Basel Committee on Banking Supervision, 17th December 2009*

## The European Association of Corporate Treasurers (EACT)

The EACT is a grouping of national associations[1] representing treasury and finance professionals in 17 countries of the European Union. We bring together about 8,100 members representing 4,600 groups/companies located in the EU. We comment to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe. We seek to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.

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Our contact details are provided on the final page of this document.

## Our response

The EACT has submitted a response to the European Commission's consultation on 'Possible Further Changes to the Capital Requirements Directive'. We recognise the inter-connectedness between this Basel Committee consultation and the Commission's exercise. We consider that the issue on which we are focused in our submission to the Commission – the arguments against using bank capital requirements to force bilateral OTC derivative transactions into central clearing – should equally be the one that we address with the Basel Committee. We are therefore limiting this response to the wording we have given to the Commission. What follows is the full text of that submission.

[1] The members of the EACT are listed in Appendix 1

**Comments in response to**

# *Consultation document: Possible Further Changes to the Capital Requirements Directive*

*Issued by European Commission, 26th February 2010*

## The European Association of Corporate Treasurers (EACT)

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## Overview of the issue

The EACT continues to support the European Commission's focus on strengthening financial stability and welcomes all initiatives that, with due consideration of any adverse consequences, reduce the risk of a further global financial crisis.

We do however have a major concern that the proposals in this consultation would reverse what we expect to be a sensible outcome in the detailed work on the scope of regulation for OTC derivatives. We believe that there is increasing acceptance that it would be a policy error to use the new derivatives regulatory framework to force non-financial end users of OTC derivatives into central clearing, unless there is demonstrable evidence of systemic risk associated with the actions of a particular end user.

It is clear from this consultation and the work of the Basel Committee that it is intended to use the capital requirements regime to strongly encourage bilateral derivative transactions into central clearing. The effect of this approach – if adopted – would be to remove the economic benefit of the exemption that we are optimistic will be granted in the regulatory approach on OTC derivatives.

That economic benefit is directly linkable to economic stability. Companies in the 'real economy', that use derivatives purely to mitigate identified business risk such as on the cost of their raw materials and to ensure that long-term finance is raised on the best terms, will be faced with a set of choices in which there is no preferred selection from an economic or financial stability perspective. These choices will be to:

- pay a punitively high cost for a bilateral transaction (because of the proposed new capital requirements);

- produce cash for the margin requirement of clearing and hold almost unlimited reserves of cash to meet future margin calls;

[2] The members of the EACT are listed in Appendix 1

- elect not to mitigate the underlying business risk, thus leaving the company fully exposed to future changes in market prices (of currencies, interest rates and commodities); and

- raise finance in less cost effective and possibly riskier, ways because the preferred but unusable options rely on the use of derivatives as an integral part of the transaction

## Our conclusion

We strongly urge the Commission to commit to ensuring that the outcome of the work of the Basel Committee – and therefore the eventual changes to the Capital Requirements Directive – supports rather than negates the approach taken to regulation of OTC derivatives insofar as non-financial end users are impacted. We would like to see an appropriate 'read across' from the regulatory to the capital requirements drafting, such that it remains economically feasible for companies in the 'real economy' to mitigate the risk that arises within their businesses.

## Formal response to consultation

We are limiting our response to Section IV of the consultation document and our comments address part of the subject of Question 31.

The Commission's approach – and that of the Basel Committee – is based on a premise that the use of OTC derivatives by non-financial end users gives rise to systemic risk. The EACT does not believe there is any substantive data available to support this premise in respect of the activities of such end users. The end users that we refer to are those manufacturing and service companies whose risk management activities (correctly in our view) fall outside the existing scope of financial sector regulation.

Where non-financial end users are engaged in trading as opposed to risk mitigation – with the difference defined by whether or not the end user makes a market in the risk instrument concerned – the EACT would support the view that such activity should fall within regulatory scope and therefore central clearing for OTC transactions.

We do not consider there are any proven and material advantages from mandating central clearing for transactions involving the overwhelming majority of non-financial end users that use derivatives solely to mitigate their underlying business risks. By extension therefore the intention to use capital requirements as an incentive to move these end user transactions into central clearing brings no incremental benefits to financial stability and is wrong in principle.

Paragraph 207 of the Commission's document makes clear that it supports using capital requirements in this way, stating:

> *The objective of these amendments…would be to…provide additional incentives to move OTC derivative contracts to central counterparties, thus helping reduce systemic risk across the financial system.*

There are substantial costs associated with the proposal and these will adversely impact economic activity and therefore employment, capital (fixed and working) investment, growth and the raising of tax revenues. These costs arise from the requirement to provide liquidity – both immediate and anticipated future – to meet margin requirements; and from the probability that the burden of this liquidity demand will be such that many end users will reduce or eliminate entirely their risk mitigation through OTC derivatives.

We believe that the proposals for the regulation of OTC derivatives are likely to be modified in both the European Union and the United States to recognise the adverse consequences of a blanket requirement that all such derivatives be centrally cleared. Whilst there is no certainty in our view of the outcome, the EACT considers that the arguments advanced by

non-financial end users have been understood by the Commission and accepted in principle.

The EACT therefore encourages the Commission to consider amending its approach to reflect the concept of exemption for non-financial end users (other than those identified by regulators as giving rise to systemic risk) from the proposed OTC regulation. This would best be expressed by ensuring that bilateral derivative transactions (ie those not centrally cleared) should not attract punitive capital requirements. If this approach is not adopted the adverse economic consequences – which we believe are accepted by those working on the OTC regulation proposals – would be confirmed by the future capital requirements regime and this result is inherently illogical and unwelcome.


## The European Association of Corporate Treasurers

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**Appendix 1**

## EACT Member Associations

ACT, The Association of Corporate Treasurers (United Kingdom)

ACTSR, Association of Corporate Treasurers in Switzerland

AFTE, Association Française des Trésoriers d'Entreprise

AITI, Associazione Italiana Tesorieri d'Impresa

ASSET, Asociacion Espanola de Financieros y Tesoreros de Empresa

ATEB, Association of Corporate Treasurers in Belgium

ATEL, Association des Trésoriers d'Entreprise au Luxembourg

CACT, Croatian Association of Corporate Treasurers

CAT, Czech Association of Treasury

DACT, Dutch Association of Corporate Treasurers

FACT, Finnish Association of Corporate Treasurers

GEFIU, German Financial Executives Institute (Gesellschaft fûr Finanzwirtschaft in der Unternehmensführung e.V.)

HTC, Hungarian Treasury Club

IACT, Irish Association of Corporate Treasurers

ÖPWZ, Forum Finanzen (Austria)

PCTA, Polish Corporate Treasurers Association

SACT, Swedish Association of Corporate Treasurers (Industrins Finansförening)

SAF, Slovak Association of Finance and Treasury

SCTA, Slovenian Corporate Treasurers Association

VDT, Verband Deutscher Treasurer