To whom it may concern,

We appreciate the publication of the European Commission’s (EC) consultation document “Public Consultation on Derivatives and Market Infrastructures”.

Given the massive impact that the financial crisis had on the automotive sector and our company, the BMW Group clearly supports the European Commission’s focus on strengthening financial stability and welcomes any initiative that can lead to greater efficiency and stability of financial markets.

We do however have some concerns about the implications of major aspects of the consultation document on non-financial institutions such as the BMW Group. While appreciating the readiness of the Commission to differentiate between financial and non-financial institutions we see the need to also implement this differentiation in a manner that ensures in its practical implementation that the core objectives of the legislative project, protecting the real economy from risks generated in the financial sector, is truly achieved.

The BMW Group supports the consultation documents submitted by the EACT (European Association of Corporate Treasurers) and BDI (Bundesverband der Deutschen Industrie). Arguments presented in these documents fully apply to the BMW Group.

We very much appreciate the opportunity to discuss possible initiatives in detail and are also happy to present a detailed proposal of a future CCP derivative regulation scheme which takes the differentiation needs of corporate end-user into consideration.

Core of the proposed multi-step approach is to proof the legitimacy and risk mitigation purpose of derivatives in contrast to speculative derivatives. IAS 39 and other hedge-derivatives should not be subject to any clearing obligation while non-hedge derivatives may be subject to clearing. Rather than applying an automated threshold, a qualitative assessment process is presented that combines IAS 39 attestation, self-commitment and additional auditor assessment.
BMW Group comments in response to European Commission Consultation document “Public Consultation on Derivatives and Market Infrastructures”.

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I. Nature of derivative usage at the BMW Group / relevance to systemic risk.

• The BMW Group does not use derivatives for speculative reasons, but exclusively for reasons of risk reduction in combination with an existing or planned underlying operative transaction which is no threat to financial stability.

• The BMW Group, like many so called “corporates”, has financial services operations in order to support sales activities. Some of these financial services operations have a banking license; nevertheless they are an integral part of the corporates’ business and have no link to speculative activities of banks which have triggered the financial crisis. In this context we apply to follow the U.S. approach concentrating on companies which are “predominantly engaged in financial activities” and include these financial service operations in a possible exemption scheme.

II. BMW Group policy proposal based on the nature of derivatives in use.

The following arguments refer to section 4 of the EC’s consultation paper issued on June 14th 2010 but with cross reference to the three policy options outlined in the EC’s consultation paper issued on April 16th 2010.

• Due to the nature of derivatives, a differentiation of regulative measures between the financial and non-financial sector is appropriate. If derivatives are executed in conjunction with risk mitigation of underlying real economic risks, there is no systemic risk relevance and thus no need to central clearing.

• Because the BMW Group uses derivatives exclusively for hedging purposes, a complete exemption would be reasonable according to option 1 in the consultation document of April 16th 2010. However, in light of recent financial turbulences, the BMW Group understands that a complete ex ante exemption for the entire corporate sector would not meet regulative requirements and political expectations.

• Although a general threshold, above which clearing is required, is rather easy to monitor and straightforward, such legislation would oversimplify reality. There should be further differentiation of derivative product classes and their motives of execution. Differentiation based on the purpose and nature of derivatives – speculative vs. non-speculative- is also proposed by the the Report of the European Parliament’s Committee on Economic and Monetary Affairs (“Langen Report”).

• The BMW Group therefore proposes a differentiated approach in accordance with policy option 2. (a) of April 16th paper – investigation threshold without an automatic direct second intervention threshold above which an direct obligation to clearing is enforced.

• Instead, the result of the authorities’ investigation should determine whether clearing is made mandatory or not. If a corporate, like the BMW Group is able to demonstrate that it does only use derivatives exclusively for mitigating underlying risks and there is no speculation in place, hence any need to central clearing irrespective of the nominal derivative volume would not be applicable.
To facilitate and transparently structure the decision whether derivative use is non-speculative we propose a multi step approach (refer to appendix on page 5):

- The proof for non-speculative use of derivatives is the hedging character. The first step would be to filter out all derivatives which are compliant with IAS 39 hedge accounting prerequisites. These have a direct relation to specific underlying transactions and would not be relevant to a CCP.

- However, hedge accounting applicability (IAS 39) should not be the single determinant for non-speculative derivatives as there are numerous derivatives which are used for economic hedging of underlying risks but do not qualify for IAS 39 due to various formalities.

- The second step to proof the hedging nature would be a reviewable self-commitment stating that all derivatives are exclusively used as hedging instruments. To support the self commitment, we would invite the authorities to carry out sample inspections and would also be prepared to disclose all relevant information on derivatives as well as underlying transactions.

- To reinforce the self-commitment, if necessary, the non-speculative use could be certified by an independent external auditor.

- Following the proposed multistep approach allows differentiation between derivatives with the purpose of risk mitigation and speculation. The latter should be included in a clearing obligation, but not the former.

- We are convinced that a clearing obligation and liquidity requirement for “all” positions once the threshold is exceeded is neither methodologically correct nor practicable as existing trades cannot be shifted to a CCP after exceeding the threshold. Any requirement should just affect the derivatives exceeding the threshold.

III. Assessment of current policy proposals.

We understand that the current policy proposal of the EC as outlined in section 4 of June 14th’s paper follows policy option 2. (c.) of April 16th’s paper.

- In regards to the intervention threshold, the proposed option causes major concerns to the viability of the BMW Group’s hedging strategy. The BMW Group believes that the intervention threshold which is simply based on derivative volumes will most likely only allow small / medium sized corporates to be exempt from mandatory CCP clearing and substantially reduce the risk mitigation possibilities for larger corporates such as the BMW Group.

- The resulting significant adverse effects of de facto mandatory clearing are, among others, additional liquidity needs to satisfy up front collateralisation and ongoing margin calls.

  - Corporates’ profitability and solvency would be affected by rising interest expenses and indebtedness, while banks benefit from the system (as lender and arranger of capital market transactions).
Collateralisation would imply transferring counterparty risk to liquidity risk which could even increase the default probability in times of financial distress. In order to stay within the intervention threshold, there exists an incentive to significantly reduce hedging activity which would lead to real economic risks being left unhedged. This increased economic risk would lead to more overall distress of the real economy.

- Stability in the real economy is especially important in the automotive sector given the role of manufacturers like BMW play as a cornerstone of a vast and tightly knit value chain including many small and medium sized enterprises (some of which have been strongly affected by the recent financial crisis).

- Including (non-speculating) corporates into the same system with financial counterparties, effectively takes the risk transfer function of the banking system away and transfers the risk burden on the shoulders of the real economy while the benefits (margins arising from the banking business model) remain within the banking sector. The real sector would pay for risks undergone by banks with the costs of excess liquidity and financial instability - a reversal of the roles and responsibilities of the financial and non-financial actors in the recent crisis.

- Standardised contracts would limit the flexibility to custom made hedging instruments tailored to the underlying risks. Less tailored derivatives would lead to disqualification of IAS 39 hedge accounting prerequisites and would cause increased P&L volatility. The purpose of hedging would be undermined.

- The above would result in substantially reduced hedging activity, increased risk positions, increased cost of refinancing and equity as well as negative effects for corporate and economic stability.

For these reasons by presenting the above proposal we seek to contribute to a solution which ensures full transparency of all activities potentially contributing to the destabilization of the financial markets while avoiding unintended negative effects on industry. We offer our continued professional collaboration and support to further detail such a regulatory framework.

Sincerely yours,

Bayerische Motoren Werke Aktiengesellschaft

ppa. i.V.

Norbert Mayer Dr. Thomas Becker
IV. Appendix: Illustration of BMW policy proposal.

Proposal for OTC-Regulation.
Multi step approach.

Clearing Obligation - Multi step approach:
Proof of legitimate & risk reducing hedging purpose.

1. IAS 39 Derivatives
2. Other Hedges (verified by self-commitment & auditor assurance)
3. ESMA Intervention
   • Non-hedging derivatives limited in size and/or not inherently risky.
   • No CCP
   • CCP obligation for relevant trades only.

Derivatives (total)