PensionsEurope's position paper on the proposal for the EMIR review.

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General comments

For many European Pension Scheme Arrangements (PSAs), an integral part of their investment approach is to use derivatives to manage their financial solvency risk as their liabilities are often long-dated, one-directional and linked to interest rates. It is important to note that Article 19.1(e) of the IORP II Directive (2016/2341/EC) stipulates that "investment in derivative instruments shall be possible insofar as such instruments contribute to a reduction in investment risks or facilitate efficient portfolio management".

Robust risk management is required by regulators, and it reduces the burden on PSAs' members and beneficiaries, or corporate (or other) sponsors. PSAs invest in European government and other high-quality bonds to hedge their liability risks, but their ability to hedge such risks completely with these bonds is limited as the amount of bonds that can be used to match long-dated liabilities is limited in the European capital markets. Derivatives have the advantage of being available for longer maturities. Moreover, they can also be tailored to match the dates of PSAs' liabilities more accurately, which is not generally possible with bonds. Finally, pension funds may also manage currency risks through derivatives.

Liquidity challenges

PSAs, i.e. IORPs and other pension funds, were granted an exemption from central clearing under EMIR, but this exemption is set to expire in June 2023. The reason for the exemption was to provide time to find a solution for the challenge posed by the requirement of CCPs to post cash variation margin (VM), instead of bonds. This solution has not been found to date.

Pension funds are asset rich and often do not have an allocation towards cash, but they do typically have a large allocation to government and other high-quality bonds, usually matching the currency of their liabilities. Pension funds, therefore, wish to carry on posting variation margin in government and other high-quality bonds that form part of their investment portfolio. Holding cash or near-cash buffers reduces returns and exposes pension funds to credit risks, as in many cases those bonds may be safer than cash deposits at banks. Having to post cash instead will have significant implications for pension funds' investment portfolios, and investment returns that are important for pension outcomes.

The autumn 2022 stress in the bond markets in the UK showed that the liquidity stress on pension funds stemming from margin calls can have wider ramifications. PensionsEurope is convinced that the likelihood of a similar scenario unfolding within the Eurozone is very small, due to different operational structures (with treasury functions and derivative trading integrated within a single mandate). Pension funds that use derivatives also play a less dominate role in the Euro bond markets and therefore are less likely to set off the negative feedback loop observed. Nevertheless, pension funds in the EU have closely observed the developments in the UK and in some cases have updated their internal liquidity stress testing processes. In addition, many pension funds ensure they have sufficient access to cash collateral for VM by holding liquid assets and making use of the repo market access cash. However, margin calls, especially VM, could under certain situations be a problem for which no solution has still been presented.

In general, PensionsEurope has supported a structural solution, involving central bank liquidity. Central clearing houses in Europe would suffice to provide (indirect) central bank liquidity utilizing their cleared repo platform. Therefore, the solution would be that the European central clearing houses could provide central bank liquidity to PSAs in times of stress to convert high-quality government bonds into cash. More generally, central banks could mitigate liquidity risk by ensuring that repo markets remain open during stress periods.

Active EU account, including the requirement of certain /fixed proportions of clearing with EU CCPs

PensionsEurope supports the requirement for an active account with an EU CCP. European pension funds can have multiple accounts, to be able to enjoy the best market conditions. However, we remain skeptical of the requirement to clear a certain fixed minimum proportion with an EU CCP.

Instead, criteria could be developed to verify that accounts are 'active' and do not exist merely on paper. For example, it could be possible to require small annual test trades. Supervisors would then be able to verify that European market participants would be able to switch all new trades to an EU CCP, should market circumstances require this action.

PensionsEurope believes that certain fixed proportions may lead to unintended consequences, poorer market conditions and operational challenges for institutional investors. Therefore, we propose that EMIR could avoid requiring a certain fixed proportion, but a verifiably active account with an EU CCP. We think that a fixed proportion would likely have unforeseen consequences and lead to worse outcomes for end-users. Furthermore, pension funds want to be able to enjoy the best market conditions and choose the best swap rate available. Having to pick suboptimal market conditions might reduce returns.

In addition, a requirement of certain fixed proportions would not be in line with the principle of proportionality. Smaller pension funds may only conduct a few trades per year and any fixed percentage could lead to a situation where there is very little flexibility due to the interest rate policy changes during the year. Therefore, there should be no requirement of certain proportion to be cleared with an EU CCP for smaller pension funds.

Reporting

EC's proposal of amendments in Article 38 entails new requirements for market participants regarding reports to authorities. PensionsEurope believes that this proposal would increase the administrative burden for pension funds, especially the smaller ones. Instead of adding more reporting requirements existing reports that are provided to the authorities should be used.

Changes to the Investment Company Directive

PensionsEurope recognizes that the EC's proposed changes in the Investment Firm Directive aim to avoid an inappropriate concentration risk because of exposure to a limited number of CCPs, particularly systemically important CCPs in non-EU countries. However, for investment companies, there may be increased management requirements for governance and planning, as well as related supervisory attention to derivative positions due to the EC's proposed changes of the Investment Firm Directive. As a result, those changes may entail a significant increase in the administrative burden associated with calculating, managing and reporting. on derivative trades and positions in investment subsidiaries.

About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace and other funded pensions. Some members operate purely individual pension schemes. PensionsEurope has **25 member associations** in 18 EU Member States and 4 other European countries[1].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people.** Through its Member Associations PensionsEurope represents **€ 7 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

PensionsEurope also has **20 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

What PensionsEurope stands for

- A regulatory environment encouraging workplace pension membership;
- Ensure that more and more Europeans can benefit from an adequate income in retirement;
- Policies which will enable sufficient contributions and good returns.

Our members offer

[1] EU Member States: Austria, Belgium, Bulgaria, Croatia, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden. Non-EU Member States: Iceland, Norway, Switzerland, UK.

- Economies of scale in governance, administration and asset management;
- Risk pooling and often intergenerational risk-sharing;
- Often "not-for-profit" and some/all of the costs are borne by the employer;
- Members of workplace pension schemes often benefit from a contribution paid by the employer;
- Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment;
- Good governance and alignment of interest due to participation of the main stakeholders.

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