PENSIONS EUROPE

PensionsEurope feedback to the EC on draft Delegated Regulation on pension scheme arrangements exemption from clearing obligation (1-year extension)

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1. PensionsEurope feedback to the EC on draft Delegated Regulation on pension scheme arrangements exemption from clearing obligation (1-year extension)

PensionsEurope thanks the EC for the opportunity to comment on the draft delegate providing 1-year extension of pension scheme arrangements (PSAs) exemption from clearing obligation. We welcome this delegated act, and we expect that another extension of a year will be still needed (i.e. until June 2023), as implementation of market-based solutions and preparation for the clearing market for the end of the pension fund clearing exemption will take time.

As an integral part of their investment approach, many PSAs use OTC derivatives to manage their financial solvency risk as their liabilities are often long-dated, one-directional and linked to interest rates. The PSAs are substantially invested in assets and the return on these assets must be maximised to meet future pension liabilities (pensioners' retirement income). They typically invest in high-quality European government bonds to hedge their (euro) 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 unavailable in the capital markets. Derivatives have the advantage of being available, and for longer maturities. Moreover, they can also be tailored to match the dates of PSAs' liabilities more accurately, which is not generally possible with government bonds. Furthermore, derivatives (such as interest rate swaps) are also the best matching asset for PSAs', as their pension liabilities are discounted using swap rates. Finally, they also may manage currency risk through derivatives.

The current bank capital rules have led to a dramatic reduction in the number of banks willing to provide liquidity to PSAs on non-cleared derivatives where PSAs post high-quality government bonds as margin. Due to this development, in combination with the fact that the clearing exemption will expire in 2023 at the latest, PSAs have started to prepare for clearing. The ESMA report of December 2020 finds that significant volumes of trades are being cleared (for example 32% of Dutch pension funds and 42% of Danish pension funds). Nevertheless, most trades are not cleared centrally because the negative consequences of cash VM remain. It therefore remains of the utmost importance that a long-term robust solution is found for the cash VM issue.

In its report, ESMA sets out a market-based solution for the cash VM issue. While PensionsEurope is disappointed that ESMA does not see a way forward for our preferred solution with some form of central bank liquidity as a backstop for normal market-based access to cash (reverse repo), we do recognise that the solutions proposed by ESMA would be a step in the right direction. ESMA notes that the EU could support these market-based solutions by making regulatory changes, but it is not clear if and when these changes will happen. The discussions in the PSA stakeholder group are also still ongoing.

Even when this uncertainty about how the exact solution (or combination of solutions) will look like is resolved, PSAs will need time to prepare both for the solution for the cash VM issue and clearing itself. PensionsEurope and its members are committed to raising awareness amongst members about the necessary steps that will have to be taken to prepare. Nevertheless, we believe that more than one year is needed to fully prepare the entire sector for clearing and to gain access to the relevant liquidity and collateral transformation mechanisms.

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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 **24 member associations** in 17 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 more than **€ 4 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 **25 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

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