Commissioner Mairead McGuinness
Directorate-General for Financial Stability, Financial Services and Capital Markets
European Commission
1049 Brussels

Subject: Pension Scheme Arrangements' clearing with the UK CCPs

19 October 2021

Dear Commissioner McGuinness,

We would like to thank the European Commission for having granted temporary and conditional equivalence to UK central clearing counterparties (CCPs) until 30 June 2022 to avoid cliff edge risks after the end of the Brexit transition period. In the equivalence decision, the Commission has clearly outlined its expectations for market participants to reduce their exposure to UK CCPs and to build up clearing capacities in the EU until the temporary equivalence elapses. While the European Pension Scheme Arrangements (PSAs) have actively acted accordingly, they are afraid that the June 2022 will come too soon to be able to fully switch to use only non-UK CCPs.

Now, as the European umbrella organisation representing pensions in Europe[1], we would like to provide our expertise to clarify why from PSAs' perspective it would be better to further extend the equivalence decision for UK CCPs by one year.

Why pension funds use derivatives

For many PSAs, an integral part of their investment approach is to use over-the-counter (OTC) derivatives to manage their financial solvency risk as their liabilities are often long-dated, one-directional and linked to interest rates and/or inflation. PSAs use these derivatives to reduce the risk of retirees not receiving pension income. Prudent risk management is encouraged by regulators and reduces the burden on PSAs' corporate (or other) sponsors. PSAs also 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.

[1] PensionsEurope represents national associations of pension funds and similar institutions for workplace and other funded pensions. PensionsEurope has 24 member associations in 17 EU Member States and 4 other European countries. 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.

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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".

Concerns if PSAs could not continue clearing with the UK CCPs after June 2022

The main concerns to PSAs to fully switch to clear only with the EU CCPs include the costs related to switching exposures and transition risks. Switching exposures can be costly, as the exposures in UK CCPs have different market values than in the EU CCPs. PSAs need to bear this transition risk when transferring exposure from UK CCPs to EU CCPs, and there are also fixed operational costs in doing transitions.

Many PSAs are also worried that there is still no liquid market for interest rate swaps (IRS) in small currencies and other currencies denominated derivatives outside the UK. These derivatives are important for PSAs to manage interest rate risk and other risks, which are mainly in Member States outside the Eurozone.

While PensionsEurope appreciates the Commission's objective of growth of EU-financial market infrastructures and supports the growth of derivatives transaction clearing in EU CCPs, we also believe that the development of EU CCPs should be mostly voluntary and market-driven and needs to be given sufficient time.

To conclude for all the reasons explained, we would like to request the Commission to grant one year extension to the current equivalence decision in relation to UK CCPs. In exchange, PSAs are willing to continue actively reducing their exposures to UK CCPs, and open and hold active accounts within the EU based CCPs.

We thank you in advance for taking into consideration our concerns and we remain at your disposal should you have any questions or need any further information.

Yours sincerely,

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CEO, Secretary General of PensionsEurope

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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[2].

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 **22 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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[2] 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.