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## **PensionsEurope's answer to the European Commission's public consultation on the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories**

### **General remarks**

First and foremost, Pension Scheme Arrangements (PSAs, which in this document we use as a synonym of pension funds) need a stable financial system. PensionsEurope supports regulation which reinforces the stability of the financial system. PensionsEurope sees the benefits of EMIR, however it is crucial that PSAs get an appropriate treatment. A robust solution needs to be found for the cash variation margin (VM) issue. Otherwise, applying EMIR towards PSAs will not increase the stability of the financial system, but will affect long term investments by PSAs and hence will increase the costs of pensions.

### ***Why and how PSAs use derivatives***

PSAs use OTC derivative contracts for risk management purposes. PSAs use (OTC) derivatives to manage their risks in their balance sheet and liabilities by hedging – among others – their interest rate, inflation or currency risks. The IORP Directive explicitly allows pension funds to use derivatives for mitigating investment risks or and for efficient portfolio management.

PSAs are long-term investors who engage in long dated derivative instruments to hedge their long-term liabilities in order to limit their investment risk. It is furthermore important to note that PSAs are not leveraged or only to a very limited extent and exclusively for liquidity purposes on a temporary basis in line with the requirements of the IORP Directive. Moreover, both at EU and national level, regulations impose the management of the PSA in a prudential basis and set out an extensive set of rules regarding their solvency and liability coverage ratios. Among others for these reasons PSAs are highly creditworthy, and the probability of a PSA bankruptcy is very low. The PSA would however be able to further mitigate

such risk by, for instance, the funding and/or backing from its sponsor company and other available tools such as pension protection funds and benefit reduction mechanisms.

### *The impact of EMIR on PSAs*

The implementation of EMIR as it currently stands leads to substantially higher costs for PSAs as a result of the fees to counterparties, higher costs in execution and running the fund (also administration and communication) and loss of return on (cash) collateral, which will yield lower than other assets. It should be noted that according to the research report adopted by the European Commission on 3 February 2015, “the cumulative cost in the 100 bps simulation is up to 3.1 per cent of [retirement] incomes in the Netherlands and 2.3 per cent in the UK. The estimated impact across the EU28 is a 1.1–2.2 per cent reduction”.

Most importantly, central clearing can lead to higher liquidity risk and a liquidity squeeze since more liquid assets are needed as collateral for derivatives transactions. This could impact long term assets allocation (LTI) negatively due to the switch to more liquid assets to comply with EMIR requirements.

### *PSA exemption on central clearing*

The recognition of the special position of PSAs has been translated via the 3-years exemption from the clearing obligation of OTC derivatives. The Commission has proposed to extend this exemption by 2 more years (until August 2017) to provide Central Counterparties (CCP) enough time to find an alternative to cash variation margin. PSAs are fully invested which means that in principle no cash pool is available to post as variation margin. The cash variation margin requirement will make PSAs highly dependent on the repo market or other forms of collateral transformation. CRDIV and CRR restrict the liquidity on the repo market<sup>1</sup>. It is uncertain if these markets are still open and liquid in times of stress when liquidity is needed most<sup>2</sup>.

As the undesired consequences for PSAs are not yet solved, we call on the Commission to reconsider whether the market can propose fit for purpose clearing solutions meeting the needs of PSAs and to require that CCPs accept among others non-cash assets as collateral to meet Variation Margins.

**PensionsEurope calls on the Commission to maintain the exemption for PSAs from the central clearing obligation in place until a suitable clearing solution has been found.** The market has not yet developed a practicable and efficient process for central clearing of pension scheme’s OTC derivative transactions. In addition to this, the existing exemption has not delivered a relief from mandatory clearing for three to six years as originally envisaged, as the clearing obligation is still not effective.

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<sup>1</sup> *The reduction in repo activity revealed by the latest survey was widely expected and is seen as reflecting subdued business conditions and the impact of leverage and liquidity regulations aimed at reducing the reliance of banks on short-term wholesale funding*”. Page 4, International Capital Market Association, European repo market survey, number 28 conducted December 2014, published February 2015.

<http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/repo/latest/>

<sup>2</sup> Baseline report on solutions for the posting of non-cash collateral to central counterparties by pension scheme arrangements: a report for the European Commission prepared by Europe Economics and Bourse Consult (referred to as the Europe Economics and Bourse Consult report in the following footnotes), p. 10.

Consequently, the European Commission should address the issue of the transitional provision under Article 89(1) for pension scheme arrangements (PSAs), consider revising the basic parameters of the transitional measure and amend the Level 1 text in order to exempt PSAs until cost-acceptable non-cash collateral solutions for PSAs are available.

At the same time, PensionsEurope urges the Commission to review every three years whether a suitable central clearing process has been developed during the maintenance of the exemption in case a solution has not been found by 2018. If a review found that a satisfactory process was available, then the exemption could fall away at that point, however not before.

PSAs stand ready to engage with EU policymakers and CCPs in order to find suitable solutions.

## Answers to specific questions

### 2. Your opinion

#### *Question 1.1: CCP Liquidity*

*Article 85(1)(a) states that: "The Commission shall ..... assess, in cooperation with the members of the ESCB, the need for any measure to facilitate the access of CCPs to central bank liquidity facilities".*

*There are no provisions under EMIR facilitating the access of CCPs authorised under EMIR to additional liquidity from central banks in stress or crisis situations, either from the perspective of the members of the ESCB or from the perspective of CCPs. However, it is recognised that in some member states, CCPs are required to obtain authorisation as credit institutions in accordance with Article 6 of Directive 2006/48/EC. Such authorisation creates access to central bank liquidity for those CCPs. On the other hand, other member states do not require CCPs to obtain such an authorisation.*

Is there a need for measures to facilitate the access of CCPs to central bank liquidity facilities?

Yes, such measures are needed as facilitating the access of CCPs to central bank liquidity will increase financial stability and therefore it will serve to the ultimate objective of EMIR and of the G20 OTC derivatives reforms.

Facilitation of access of CCPs to central bank liquidity facilities has the potential of decreasing liquidity risk for CCPs and subsequently the counterparty risk for CMs and their clients on CCPs significantly.

If your answer is yes, what are the measures that should be considered and why?

Indeed, there is a need for measures to facilitate (unlimited) access of all CCPs to central bank liquidity facilities, especially in times of market stress or crisis situations. The system of central clearing concentrates risks within a small number of CCPs. Measures are needed to guarantee the financial stability and solidity of CCPs. Many countries have already provided CCPs (limited) access to central bank

liquidity for financial stability reasons, or because certain CCPs have a bank status. Central bank liquidity should however be available to all CCPs.

CCP defaults may lead to VM haircuts, breaking up of positions, or other measures that are likely to significantly and negatively impact CMs and their end users such as PSAs, and of course financial stability. Liquidity problems are among the most realistic threats to CCP stability, but also for example the default of several CMs at once. In reality, the use of the existing default funds by CCPs could prove insufficient to uphold financial stability in Europe. Thus, providing central bank liquidity to CCPs is in the interest of all financial market participants. Without such access, a CCP is likely to rely on a few large (investment) banks, which also might be CMs, and therefore could increase systemic risk.

For end users such as PSAs, contractual arrangements with their CMs define their rights in case of a CCP default. CMs pass as much as possible these (liquidity) risks onto the end user. A CCP or CM default thus has potential detrimental consequences for end users such as PSAs. Enabling CCPs to access central bank liquidity will thus decrease the counterparty risk they pose to other market participants.

#### *Question 1.4: Procyclicality*

*Article 85(1)(d) states that: "The Commission shall...assess, in cooperation with ESMA and ESRB, the efficiency of margining requirements to limit procyclicality and the need to define additional intervention capacity in this area."*

*CCPs authorised in the Union must take into account potential procyclical effects when calculating their margin requirements. The specific factors that must be considered to avoid disruptive movements in margin calculations are provided for under Article 41 EMIR and Article 28 of Commission Delegated Regulation (EU) No 153/2013.*

(a) Are the requirements under Article 41 EMIR and Article 28 Regulation (EU) No 153/2013 adequate to limit procyclical effects on CCPs' financial resources?

Please refer to our answer to question 1.5(b). Please refer to our answer to question 1.5(b). The margin policies of CCPs may mitigate risk from a CCP point of view, but we have concerns about the effect of those policies in stressed market conditions specifically when a CCP would suddenly change its eligibility criteria which could create an obligation to substitute potentially big amounts of securities posted as initial margin with other securities (substitution risk). In general we feel that any sudden material increase of initial margin (or haircuts) and a limitation of the list of assets which are defined as eligible should be avoided.

We also note that EMIR only looks at the relationship between CCPs and its CMs but does not focus on the procyclical risks in the relation between the CM and its clients. Clearing members tend to impose contractual rights on clients in order for them to ask for additional margins, increase haircuts and eligibility criteria at discretion which further restricts the possibilities for clients to meet margin calls thus creating procyclical effects.

If your answer is no, how could they be improved?

Please refer to our answer to question 1.4 (a) and 1.5(b)

### *Question 1.5: CCP Margins and Collateral*

*Article 85(1)(e) states that: “The Commission shall...assess, in cooperation with ESMA the evolution of CCP’s policies on collateral margining and securing requirements and their adaptation to the specific activities and risk profiles of their users.”*

*Collateral collected by way of initial and variation margin requirements is the primary source of financial resources available to a CCP. Title IV of EMIR and Commission Delegated Regulation (EU) No 153/2013 provide detailed requirements for the calculation of margin levels by CCPs as well as defining the assets that may be considered eligible as collateral.*

(a) Have CCPs’ policies on collateral and margin developed in a balanced and effective way?

No, as only cash is accepted by CCPs as variation margin.

If your answer is no, for what reasons? How could they be improved?

Not with regard to variation margin. CCPs accept only highly liquid assets, generally cash, as collateral to meet variation margin (VM) calls in order to allow for a rapid liquidation in the event of a default. This causes high liquidity risks for PSAs that are generally fully invested. As highlighted in the Commission’s report<sup>3</sup> assessing the progress and effort made by CCPs in developing technical solutions for the transfer by pension scheme arrangements of non-cash collateral as variation margins, as well as the need for any measures to facilitate such solution. PSAs generally minimise their cash positions, instead holding higher yielding investments such as securities in order to ensure strong returns for their beneficiaries – retirees (...)” and therefore “the costs of central clearing would therefore ultimately reduce the retirement income of the relevant pensioners if PSAs were required to post cash to meet VM calls”.

In order to post VM for cleared OTC derivatives, PSAs need to obtain cash. Selling assets to generate cash would cause a performance drag on PSAs. By entering the repo markets to generate cash, PSAs will also become exposed to counterparty credit risk under those repos, and this goes against EMIR’s ultimate goals. PSAs are generally fully invested and would be faced with a high liquidity risk in stress scenarios when repo markets don’t function well.

Three years after the introduction of the transition period for PSAs, CCPs have not yet been able to develop adequate technical solutions for the transfer of non-cash collateral to meet VM calls and that as noted by the Commission’s report “the adverse effect of centrally clearing derivative contracts on the retirement benefits of future pensioners remains unchanged.”

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<sup>3</sup> Idem

A repo service is still under development, however the viability of such services in the future remains unpredictable. Also, as noted by the Commission, “at this stage of development, the costs for PSAs of using the potential repo service are unknown”.

In addition to this, any of the alternative solutions to the repo services including collateral transformation by CCPs, Direct acceptance of non-cash assets with pass through to receivers of VM, Acceptance of non-cash assets with security interest passed through to receivers of VM, Quad-party collateral for VM security interest and Collateral Transformation by Clearing Members would have an impact on IOPRs’ yields and would have prohibitive costs.

PensionsEurope disagrees that a combination of collateral transformation could work as a solution neither that, in absence of a solution, PSAs should be required to substitute securities for cash in order to maintain a sufficient cash buffer to meet potential VM calls, from August 2018 at the latest.

PensionsEurope is of the view that the European Commission should extend further the exemption period for PSAs until an acceptable solution for PSAs has been found for the non cash VM issue. During the duration of the exemption, the PSAs sector will be open to discuss with CCPs suitable solutions in order to solve all issues with cash variation margin. Measures such as allowing PSAs to post assets (securities) for variation margin purpose by mandating CCPs to accept these assets or developing a guaranteed repo service offered by CCP’s to PSAs should be considered.

With respect to Initial Margin, PensionsEurope’s Members note that creditworthiness is not taken into account. This means that a highly leveraged risk taking institution has to post the same amount of initial margin as a non-leveraged pension fund would. Furthermore bigger pension funds are likely to face CCP multipliers which mandate them to post even more initial margin than the risk taking institutions because of the size of their positions.

(b) Is the spectrum of eligible collateral appropriate to strike the right balance between the liquidity needs of the CCP and its participants?

Not for variation margin.

If your answer is no, for what reasons? How could it be improved?

Although EMIR does not prescribe it, CCPs require cash-only variation margin to be posted to them. In market stress scenarios, PSAs may not be able to raise or transform enough cash to meet their VM calls and thus face a substantial liquidity risk. Although the PSA would still be solvent, this could lead to the closing out of positions and cause pro-cyclical effects. We urge the Commission to consider the pro-cyclical effects and liquidity risk for PSAs of limiting the posting of VM to cash only.

It should be noted again that according to the research report adopted by the European Commission on 3 February 2015, “the cumulative cost in the 100 bps simulation is up to 3.1 per cent of [retirement]

incomes in the Netherlands and 2.3 per cent in the UK. The estimated impact across the EU28 is a 1.1–2.2 per cent reduction”.

Furthermore, as institutional investors with a long term investment horizon, PSAs aim to be fully-invested. As such, holding cash for collateral/VM purposes reduces the amount of capital they can “put to work” in the real economy – the latter being a major objective of the Commission’s CMU initiative. The current collateral policies limit the extent to which PSAs can invest in a long term way and reduces their options with regard to the Capital Markets Union’s initiative. Holding larger amounts of cash will reduce PSAs’ return on investment. This return on investment is needed to provide retirement income to their beneficiaries.

## Part II - General questions

### *Question 2.2: Clearing Obligations*

*Under EMIR, OTC derivatives transactions that have been declared subject to a clearing obligation must be cleared centrally through a CCP authorised or recognised in the Union. ESMA has proposed a first set of mandatory clearing obligations for interest rate swaps which are yet to come into force. Counterparties are therefore in the process of preparing to meet the clearing obligation, to the extent that their OTC derivatives contracts are in scope of the requirements.*

(a) With respect to access to clearing for counterparties that intend to clear directly or indirectly as clients; are there any unforeseen difficulties that have arisen with respect to establishing client clearing relationships in accordance with EMIR?

Yes, PensionsEurope’s members have observed a cease or reduction of clearing activities by clearing members. Consequently, the choice of services of clearing members is very limited and this entails that users are often obliged to accept unfavorable conditions and bigger risks are created for financial stability.

PSAs notice that there are issues with the clearing capacity. Because PSAs typically have large long dated one directional position they would have to clear very large portfolios while the required amount of clearing capacity is often not available. Moreover, typically clearing members are not contractually obliged to accept derivative transactions for clearing within the clearing arrangement which leads to t significant uncertainty to the access to central clearing. Although understandably, the CM’s ability to terminate the clearing agreement upon a certain time’s notice as part of a complete termination of its clearing business will result in additional uncertainty to such availability in a market where the numbers of CM is limited and declining. Consequently PensionsEurope would like to call on the Commission to investigate whether the amount of clearing capacity that end users require is actually available at CM and CCP level and how Capital Requirements Regulation (CRR) interlink with EMIR. CRR creates serious issues regarding the access to central clearing as it makes it economically prohibitive from a capital perspective for clearing members to offer clearing services to clients. Given the fact that EMIR intends to

implement a clearing obligation for market participants, the capital rules should not discourage offering such services.

If your answer is yes, please provide evidence or specific examples. How could these be addressed?

PSAs have very limited direct access to CCP's, due to difficulty to fulfil for PSAs such as the default contribution, valuing of big portfolios, bidding on portfolios etc., and they must appoint clearing members to clear OTC derivatives. This causes several issues for PSAs:

1. Limited number of CCPs and CMs

Only a limited number of CCPs and CMs currently service the market for central clearing services. Clearing houses set high requirements (e.g. systems requirements, intellectual capital, etc.) to CMs, which results in a limited number of available CMs to the market. CMs have stepped away from offering clearing due to regulation like CRDIV (leverage ratio punitive to client clearing), which will most probably reduce the already limited amount of CMs that offering client clearing even more. CMs that offer client clearing will be even more selective who they want to provide the clearing services. This will create concentration risks for market participants.

Nonetheless, availability of clearing members is necessary for access to the OTC derivatives markets. It is not sure that the clearing capacity required by end users is available at the level of CCPs and CMs. Therefore, the Commission should investigate whether there is enough capacity for the market to meet their clearing obligations. In doing so, it should take into account that additional limits are needed in case of defaults, to enable porting. International harmonisation, i.e. the mutual recognition of regimes, is likely to positively impact clearing capacity.

2. Limited access to clearing members and adverse clearing conditions

For some PSAs it is difficult to get access to clearing members. Small and medium sized PSAs are therefore dependent on 'indirect client arrangements'. As such they make use of a bigger end user (e.g. a bank) that does have direct clearing access to a CM. Indirect client arrangements are still under development, and therefore this issue needs further attention and investigation.

The number of clearing members that offer clearing services is low and declining. As a consequence, the market for clearing services is not healthy and competitive which further deteriorates the negotiation position of (especially smaller) PSAs. Some PSAs experience difficulty finding clearing members that are willing to offer their clearing services on reasonable terms or at all. This may force PSAs and other end users to accept unmanageable risks and higher cost levels. Clearing members impose additional conditions, on top of the conditions of the relevant CCP, such as with respect to clearing limits, additional collateral, haircuts, termination rights, etc. Although understandably, the CM's ability to terminate the clearing agreement upon a certain time's notice as part of a complete termination of its clearing business will result in additional uncertainty to such availability in a market where the numbers of CM is limited and declining.



End users are limited in clearing by the risk limits that are set by CMs, and in turn by CCPs for CMs. CMs are often reluctant to allocate sufficient clearing limits to PSAs. Due to PSAs' large one-directional positions, used to mitigate/hedge investment risks, they tend to have large portfolios that need clearing. Not only do CMs retain the right to refuse clearing, they also retain the right to decrease clearing limits on relatively short notice. In times of stress, PSAs cannot be certain of clearing options.

In the contractual agreement CMs reserve the right to terminate the relationship within a certain timeframe without a reason. With a limited amount of clearing members this cause problems for high users of derivatives to port to another clearing member taking into account that CM do not guarantee porting in of the whole position.

### 3. Interlinkage with CRD IV/CRR

Although PSAs are exempt from the clearing obligation, their counterparties have a strong clearing incentive under the CRR. Banks can apply a much lower risk weighing to cleared OTC derivatives, than to non-cleared OTC derivatives. PSAs do not have the same clearing incentive, which creates a misalignment of interest between banks and PSAs. Some PSAs anticipate a divergence between the pricing of cleared and non-cleared OTC derivatives, the reality of which could ultimately force PSAs to start clearing OTC derivatives. As stated in our answer under question 1.5., this would have negative consequences for pension outcomes in case the cash VM requirement is maintained and no viable solution is in place for PSAs.

Banks are also anticipating the leverage ratio under CRD IV, which causes them to be more reluctant to enter into new OTC derivatives transactions. The different requirements create (dis)incentives that are inconsistent and incoherent, and in case of CRR even surrounded with ambiguity. We therefore welcome the European Commission's consultation of stakeholders on the "possible impact of the CRR and CRD IV on bank financing of the economy" and urge the Commission to analyze the impact of capital requirements across the spectrum of European regulation.

For a clearing exemption to be effective, sufficient liquidity is required in the non-cleared markets. CRD IV/CRR should not undermine these markets in forcing parties into clearing through economic incentives (capital requirements). For example, the CVA-charge exemption for non-cleared transactions with PSAs should remain in place.

(b) Are there any other significant ongoing impediments or unintended consequences with respect to preparing to meet clearing obligations generally in accordance with Article 4 of EMIR?

Yes.

If your answer is yes, please provide evidence or specific examples. How could these be addressed?

The clearing obligation may lower credit risk to some extent, but introduces significant liquidity issues for PSAs. The CRR liquidity coverage ratio and net stable funding ratio for credit institutions increases liquidity risk as repo markets shrink while they are increasingly necessary. The CRR encourages the use of cash VM for non-cleared OTC derivatives, which adds to the liquidity risks. The Commission should

therefore assess the cumulative impact of regulation on both the bilateral and cleared derivatives markets, and the liquidity risks they impose on end users.

### *Question 2.3: Trade reporting*

*Mandatory reporting of all derivative transactions to trade repositories came into effect in February 2014. The Commission services are interested in understanding the experiences of reporting counterparties and trade repositories, as well as national competent authorities, in implementing these requirements. As noted above, ESMA recently conducted its own consultation on amended versions of these standards. This consultation does therefore not seek any views with respect to the content of either Regulation No. 148/2013 and Regulation No. 1247/2012 nor the proposed amended versions.*

Are there any other significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations in accordance with Article 9 of EMIR?

Yes.

If your answer is yes, please provide evidence or specific examples. How could these be addressed?

The trade reporting obligations are costly to implement for end users. Operational burdens are high and at the same time, the reported data often lacks quality, as errors are still common. In the United States, data reporting quality was improved by having brokers report on trades instead of end users. This option could be considered under EMIR. The matter could be resolved in a similar way to Article 25 MiFID I, which waives the reporting obligation if transactions are reported to the competent authority by a trading platform or an approved trade-matching or reporting system.

#### **Examples specific unintended consequences are:**

- UTI generation and dissemination

It is difficult to agree with counterparties on UTIs and the way in which the UTIs are provided. Different parties make use of a variety of ICT systems, as market standards have not (sufficiently) developed.

Article 9 EMIR requires that all derivative transactions are assigned an UTI in order to avoid duplications and to ensure that they can be accurately identified. However, EMIR does not determine which counterparty of a derivative transaction must generate the UTI, essentially leaving market participants to decide it on their own. As a result, and although EMIR's reporting obligation entered into force on 12 February 2014, several PensionsEurope's Members continue experiencing significant difficulties to orderly and timely fulfill their reporting obligations. This is essentially due to the absence of uniform and enforceable standards applicable to the generation and retrieval of UTIs.

Most PensionsEurope's Members, similar to the majority of other buy-side counterparties, have opted for UTI generation by the sell side when bilaterally trading OTC derivatives. However, experience has shown that the UTI generation of these kinds of trades on the one hand, and meeting the reporting deadline on the other, is still far from being satisfactory<sup>[1]</sup>. PSAs and their asset managers are experiencing serious difficulties to obtain the proper UTI in time. Often the UTI is generated with significant delays. The entrance into force of the valuation reporting requirement on 12 August 2014 has aggravated this situation.

ESMA's not-binding guidelines on this matter<sup>[2]</sup> have proven to be insufficient. We would therefore kindly ask you to issue additional standards to resolve this situation. In particular, we suggest focusing your attention on the following areas:

- UTI generation: In those derivative transactions that are not subject to specific arrangements between the counterparties and which do not take place on exchange trading platforms automatically generating UTI's, sell-side counterparties should bear the responsibility of generating the UTI and sharing it with their counterparties.
  - Valuation reporting: This new reporting requirement significantly increases the reporting complexity and therefore leads to further delays and compliance difficulties. Due to the problems experienced in trade repository reporting up to date, the valuation reporting requirement should be postponed until the new clear and unambiguous processes and rules are in place.
  - Trade repositories: These institutions have a central role / position in the trade reporting process. We consider that the Commission should (jointly) work together with the trade repositories in order to enhance their functions and responsibilities on the UTI generation process.
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- FX definition
- There is no clarity on how to define FX spot transactions. We urge the Commission not to impose a back loading of obligations because of a retro-active effect of a future definition.
- Mapping TR versus EMIR
- Trade repositories should be asked to make sure that their systems incorporate the data fields required under EMIR , in order to enable clients to easily map the TR and EMIR data fields. At present this is very difficult.
- Reporting timing

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<sup>[1]</sup> See Article "Missing UTIs will cause reporting chaos, corporates warn", Risk.net, 6 February 2014 [\[Link\]](#)

<sup>[2]</sup> ESMA, EMIR Questions and Answers, 10 July 2014 [\[Link\]](#)

T+1 reporting can be challenging if a chain of intermediaries in different time zones are involved. The definition of Business Day needs clarification.

#### *Question 2.4: Risk Mitigation Techniques*

*Risk mitigation techniques are provided for under Articles 11(1) and 11(2) of EMIR and further defined in Commission Delegated Regulation (EU) No 149/2013. Risk mitigation techniques began entering into force in March 2013 and apply to OTC derivative transactions that are not centrally cleared. They include obligations with respect to transaction confirmation, transaction valuation, portfolio reconciliation, portfolio compression and dispute resolution.*

Are there any significant ongoing impediments or unintended consequences with respect to meeting risk mitigation obligations in accordance with Articles 11(1) and (2) of EMIR?

Yes.

If your answer is yes, please provide evidence or specific examples. How could these be addressed?

In general, risk mitigation techniques function quite well. There are some concerns regarding dispute resolution. End users need to be able to check margin calls for accuracy. Some disputes are hard to resolve because different internal valuation models are used, which are often not publicly disclosed. This issue will become all the more relevant when the obligation to exchange bilateral IM enters into force for larger market participants. The Commission could help by incentivising the use of standardised publicly disclosed valuation models.

#### *Question 2.5: Exchange of Collateral*

*Article 11(3) of EMIR mandates the bilateral exchange of collateral for OTC derivative contracts that are not centrally cleared. Article 11(15) mandates the ESAs to further define this requirement, including the levels and type of collateral and segregation arrangements required. The ESAs consulted publicly on their draft proposals in the summer of 2014.*

*The ESA are now in the process of finalising these draft Regulatory Technical Standards. It is therefore recognised that the final requirements are not fully certain at this stage. The Commission services are not seeking comment on the content on the proposed rules published by the ESAs. Nonetheless the Commission services welcome any views from stakeholders on implementation issues experienced to date.*

Are there any significant ongoing impediments or unintended consequences anticipated with respect to meeting obligations to exchange collateral in accordance with Article 11(3) under EMIR?

Yes.

If your answer is yes, please provide evidence or specific examples. How could these be addressed?

Broker-dealers are expected to prefer their internal models, which end users could be pushed to use by favourable pricing. This could lead to a wide variety of initial margin models being used in the market and which are bilaterally agreed upon by counterparties. Implementation processes would become burdensome and costly. Adequate market standards could prevent additional costs to counterparties.

In its Second Consultation ESMA recognises that obtaining legal opinions may lead to an excessively burdensome process. There needs to be sufficient legal assurance regarding the effectiveness and enforceability of the segregation structures. The use of standardised documentation and generic legal opinions published with respect to the relevant countries and custodians/(I)CSDs would help tackle these issues. In reality most custodians/(I)CSDs provide standard (triparty) documentation. Publication of standardised opinions regarding their documentation by custodians/(I)CSDs would be positive. In addition, industry bodies could publish additional opinions with respect to the various countries.

### *Question 2.8: Requirements for CCPs*

*Titles IV and V of EMIR set out detailed and uniform prudential and business conduct requirements for all CCPs operating in the Union. CCPs operating prior to EMIR's entry into force are required to obtain authorisation in accordance with the new requirements of EMIR, through the EU supervisory college process.*

(b) Are the requirements of Titles IV and V sufficiently robust to ensure appropriate levels of risk management and client asset protection with respect to EU CCPs and their participants?

No.

If your answer is no, for what reasons? How could they be improved?

One of the most important shortcomings and concerns to end users is the lack of guaranteed portability. Most PSAs are skeptical about the feasibility of default porting. The lack of clearing capacity and clearing certainty also means that portability is not a viable option that can be contractually agreed as envisaged in the current EMIR text.

In case of a default, a PSAs' portfolio of cleared OTC-derivatives would have to be ported to one single other CM, in one set. This would require that end users open multiple accounts with different CMs in order to be able to port every portfolio, should a CM default. If a PSA cannot port, it would lose market exposure and find itself at risk of potentially large losses. This situation further increases demand for the limited amount of CMs available, resulting in higher prices and costs for PSAs.

Before recognising non-EU CCPs as qualified CCPs, segregation possibilities – especially individual client segregation – should be taken into account.

### *Question 2.10: Additional Stakeholder Feedback*

*In addition to the questions set out above, the Commission services welcome feedback from stakeholders on any additional issues or unintended consequences that have arisen during the implementation of EMIR which are not covered by those questions.*

Are there any significant ongoing impediments or unintended consequences with respect to any requirements or provisions under EMIR and not referenced in the preceding questions that have arisen during implementation?

Yes.

If your answer is yes, please provide evidence or specific examples. How could these be addressed?

The recognition of the special position of PSAs has been translated via the 3-years exemption from the clearing obligation of OTC derivatives. The Commission has proposed to extend this exemption by 2 more years (until August 2017) to provide Central Counterparties (CCP) enough time to find an alternative to cash variation margin. PSAs are fully invested which means that in principle no cash pool is available to post as variation margin. They minimise their allocations to cash in order to maximise return and efficiency for pensioners. Cash variation margin makes PSAs highly dependent on the repo market or other forms of collateral transformation. It is highly uncertain if these markets are still open and liquid in times of stress when liquidity is needed most. Nowadays banks use the repo market for funding, but Basel III regulation restricts the use of the repo market. This makes it doubtful banks will (be able to) provide liquidity to the repo market under all circumstances. Finally, using repos would introduce other risks including counterparty credit risk, liquidity risk and roll (or maturity transformation) risk.

As the undesired consequences for PSAs are not yet solved, PensionsEurope call on the Commission to reconsider whether the market can propose fit for purpose clearing solutions meeting the needs of PSAs and to require that CCPs accept a wide range of non-cash assets as collateral to meet Variation Margins.

PensionsEurope's calls on the Commission to maintain the exemption for PSAs from the central clearing obligation in place until a suitable clearing solution has been found. The market has not yet developed a practicable and efficient process for central clearing of PSA's OTC derivative transactions. In addition to this, the existing exemption has not delivered a relief from mandatory clearing for three to six years as originally envisaged, as the clearing obligation is still not effective.

Consequently, PensionsEurope's Members call on the European Commission to address the issue of the transitional provision under Article 89(1) for pension scheme arrangements (PSAs), consider revising the basic parameters of the transitional measure and amend the Level 1 text in order to exempt PSAs until non-cash collateral solutions for PSAs are available.

PensionsEurope urge the Commission to review on an ongoing basis the suitability of the central clearing solution for PSA. If a review determines that a satisfactory solution is available, then the exemption could fall away at that point, however not before.

PSAs stand ready to engage with EU policymakers and CCPs in order to explore suitable solutions.