OTC derivatives, central counterparties and trade repositories (EMIR, European Market Infrastructure Regulation)

2010/0250(COD) - 03/02/2015 - Follow-up document

In accordance with Regulation (EU) No 648/2012 on over-the-counter (OTC) derivatives, central counterparties and trade repositories (EMIR), the objective of this Commission report is to assess the progress and effort made by central counterparties (CCPs) in developing technical solutions for the transfer by **pension scheme arrangements** (PSAs) of non cash collateral as variation margins, as well as the need for any measures to facilitate such solution.

In order to assess the current situation fully, the Commission ordered a baseline study on this issue which was prepared by Europe Economics et Bourse Consult.

Current provisions of the EMIR Regulation: the EMIR Regulation, which entered into force on 16 August 2012, is designed to improve the stability of the over-the-counter (OTC) derivative markets throughout the EU. Under EMIR, OTC derivatives that are standardised (i.e. that have met predefined eligibility criteria), including a high level of liquidity, will be subject to a mandatory central clearing obligation and must be cleared through central counterparties (CCPs).

Under current arrangements, PSAs – which encompass all categories of pension funds – would have to source cash for central clearing. Given that PSAs hold neither significant amounts of cash nor highly liquid assets, imposing such a requirement on them would require very far-reaching and costly changes to their business model which could ultimately affect pensioners' income.

Pension Scheme Arrangements (PSAs) in many Member States are active participants in the OTC derivatives markets. **A specific exemption in the Regulation states that 'pension scheme arrangements' are exempt from the clearing obligation of certain derivatives until August 2015.** The exemption can be extended by up to a further three years in total. This transition period was explicitly provided for under EMIR in order to provide further time for CCPs to develop technical solutions for the transfer of non-cash collateral to meet VM calls.

Pension Scheme Arrangements: the report noted that at this stage, only one CCP has demonstrated any notable effort to develop a solution for the posting of non-cash assets in order to meet variation margin calls. The relevant CCP is actively developing a service (the PSA repo service) which could address PSAs' needs to use non-cash assets in order to meet the cash VM calls it requires.

As the PSA repo service is still under development, **certain important questions as to the viability of such a service remain at this stage**. This potential service is still under development. It is planned to be launched in the first half of 2015. The Commission will continue to engage with the CCP in question and PSAs as the service comes to the market in order to assess its ability to serve the needs of PSAs.

Other technical solutions: as the proposed service is yet to be launched, the Commission has explored additional potential technical solutions in order to identify whether there are other measures which might be taken by CCPs in enabling PSAs to post non-cash assets to meet variation margin calls. These potential technical solutions are outlined below:

- 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;
- collateral Transformation by Clearing Members;
- agency stock lending;
- secured lending by non-financial entities.

Progress and efforts made: the report noted that, with the exception of the proposed PSA repurchase service, no sufficient progress appears to have been made by CCPs in order to develop technical solutions for the transfer of non-cash collateral as variation margins.

None of the infrastructure based potential alternative solutions analysed in the report appear to be being pursued by any CCPs. It can be concluded that this is due to the obstacles that this report identifies. Nonetheless, **CCPs should continue to consider ways in which the obstacles identified to the implementation of the potential alternative solutions could be overcome in practice**.

However, the Commission recognised that, in the absence of a solution, PSAs will ultimately be required to substitute securities for cash in order to maintain a sufficient cash buffer to meet potential variation margin calls, from **August 2018** at the latest.

In conclusion, the Commission recommended an **extension of the three-year period of EMIR by two years** through means of a Delegated Act.

The Commission shall continue to monitor the situation with regards to technical solutions for PSAs to post non-cash assets to meet CCP VM calls in order to assess whether this period should be extended by a further one year.