Position Paper

Insurance Europe comments on the EC Proposal for a Regulation amending EMIR

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Summary

Insurance Europe welcomes the opportunity to share its views regarding the European Commission's proposal for amendments to the EMIR regulation. The insurance industry is the largest institutional investors in Europe with total assets of approximately €9.9tn. Derivatives are key for insurers in their risk and efficient portfolio management. The insurance industry continues to support the underlying objectives of EMIR, including on collateralisation and reporting obligations.

Insurance Europe welcomes the recent EC proposal amending EMIR and in particular the following changes:

- Removing the requirement for dual-side reporting of exchange-traded derivatives. Insurance Europe supports the EC proposal for CCPs to be solely responsible for reporting the details of such transactions (*new paragraph 1a in Article 9*).
- Clarifying that the obligation to centrally clear may be temporarily suspended by ESMA, thus ensuring that insurers are not exposed to liability in cases of CCP failure or exit from providing clearing services for particular contract types (*new Article 6b*).
- Attempting to address the access issues which small- and medium-size insurers face when trying to secure arrangements with clearing members for the provision of central clearing services (*new paragraph 3a in Article 4 (3)*).

However, Insurance Europe believes that several concerns raised by the insurance industry in the past with respect to EMIR are still outstanding and should be addressed as part of this review. These include:

- In the area of intragroup transactions, the burdensome procedures around exempting OTC intragroup transactions from collateralisation requirements should be simplified.
- In the area of reporting, single-side reporting should be introduced for all centrally cleared transactions, and not only for exchange-traded derivatives, as currently proposed.

In addition, the industry remains concerned by the practical application of EMIR, which requires insurers to post cash when centrally clearing. As highlighted in the past, the industry has significant concerns over the potentially high need for cash to cover variation/initial margin needs. While EMIR recognises the cash challenge faced by pension scheme arrangement (PSA), it fails to recognise that the same challenge applies to all insurers with

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long-term business. Insurance Europe welcomes the EC's decision to delay variation margin posting obligations on PSAs. Furthermore, it welcomes the proposed mandate for the European Supervisory Authorities (ESAs) and the ESRB to investigate and assess whether further measures are necessary to facilitate clearing solutions for PSAs. Insurance Europe looks forward to contributing to this work, and believes that any investigations should also cover the concerns of the insurance industry and any solutions found should also be considered for the insurance industry.

General comments

Intragroup transactions

Insurance Europe supports that all intragroup derivative transactions should be exempt from collateralisation requirements, provided that there are no legal or practical impediments to the repayment of liabilities. Insurance Europe further believes that procedures around the exemption should be simplified, in particular the requirement to apply for the exemption should be removed.

Insurance Europe believes that the current approach applied to OTC intragroup transactions between counterparties established within the same member state (see *Article 11 (5)* of EMIR) should be extended to all transactions. Specifically, all OTC intragroup transactions should be exempted from collateralisation requirements, without the need of a formally granted exemption by the national competent authorities (NCA), and as long as no practical or legal impediments to the prompt transfer of funds exist. From a supervisory perspective, transparency for supervisory purposes would be ensured by counterparties being required to notify their NCAs about their exemptions.

Insurance Europe believes that, as currently foreseen, procedures for applying for the exemption are work-intensive and burdensome and disproportionate to potential benefits. In fact:

- The unequal treatment of transactions at a national level on the one hand, and European and international transactions on the other is structurally inconsistent. The considerations that justify the exemption of intragroup transactions between counterparties within the same EU jurisdiction also apply to transactions involving two EU jurisdictions or one EU jurisdiction and one non-EU jurisdiction.
- Intragroup derivative transactions only affect the internal parties involved without any impact on the external derivative market, placing them outside of the scope of EMIR's objectives around derivative market stability. Intragroup transactions do not change or enhance the risk profile of the group.
- The collateralisation of OTC intragroup derivative transactions has far reaching negative effects on the efficiency of group-wide risk management. Mandatory collateralisation leads to a fragmented and rather complex risk mitigation structure, thus introducing additional layers of operational and administrative risks.

As a minimum, any application rule that foresees an approval for exempting OTC-intragroup transactions should at least consider the following principles:

- Only one unique approval by one NCA should be required. The parallel application and approval of two member states' authorities leads to an inadequate and unnecessarily burdensome solution within the European Union.
- The following groups of OTC-intragroup contracts, should be exempted from the collateral requirement:
  - Below certain pre-specified thresholds or
  - Intragroup transactions which are used as part of remuneration schemes

This provision could help designing the existing exemption rules in a more proportionate and practical way.

Dual-side reporting

Insurance Europe welcomes the exemption from dual side reporting foreseen for exchange traded derivatives. However, Insurance Europe believes that in addition, all dual-side reporting (DSR) requirements should be removed for transactions which are centrally cleared. One-sided reporting would offer the same, if not better, quality of data, while removing some of the practical and administrative challenges and costs associated with dual-side reporting.

Dual-side reporting requires both counterparties to pair and match their reports in order to avoid double-counting. The requirement in EMIR for both counterparties to ensure no duplication in transaction data is not easily applicable in practice. The reconciliation of data is difficult by variations in how counterparties report trades, due to differences in the exact elements and level at which counterparties' systems capture the components of a trade. This is further complicated by a lack of a globally agreed approach on the generation and exchange of unique trade identifiers (UTIs). On the last point, Insurance Europe welcomes the mandate given to ESMA to develop implementing technical standards regarding data formats and reporting, but believes these should apply to just one side of each trade.

EMIR and non-cash collateral requirements

Due to their long-term business model and long-term liabilities, insurers typically hold limited amounts of cash on their balance sheets. A higher than normal financial market volatility may lead to requirements for cash holdings increasing significantly and over short periods of time to meet margin calls. Insurers' desire to further hedge may also exacerbate the cash issue. In such cases, insurers will have the following suboptimal alternatives:

1. Hold more cash for covering potential future cash needs. This will carry a significant opportunity cost and will not be in line with strategic asset allocation, especially for life business with limited exposure to cash.
2. Perform forced sales of assets when cash is needed. This would expose insurers to potential losses, especially in periods of market stress when prices of assets will reflect significant discounts. This can potentially have a pro-cyclical effect.
3. Monetise assets via the repo market[1]. This market is under significant pressure already, not least due to emerging regulatory rules on the banking side such as minimum leverage and NSFR ratio requirements[2]. Consequently, clearing members have been offering collateral transformation services at unreasonable prices. This has a disproportionate effect for insurers with a limited volume of activity, who would be forced to reduce their use of important hedging tools due to the excessive costs.

As a general comment, it is also important to be aware that in a situation where the markets are stressed and the repo markets do not function optimally, there can be a significant risk that companies may default on their margin obligations solely because they cannot cover their cash needs fast enough. This could create a systemic liquidity risk, causing significant challenges for insurers despite the fact that they comply with the formal EMIR requirements.

The above points should be investigated in the upcoming work by the ESAs and the ESRB to investigate and assess whether further measures are necessary to facilitate clearing solutions for PSAs, and Insurance Europe believes this work should also cover life insurers' hedging activities via derivatives.

Insurance Europe is the European insurance and reinsurance federation. Through its 35 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of €1 200bn, directly employ over 985 000 people and invest nearly €9 900bn in the economy.

[1] Some national jurisdictions do not allow insurers to monetise assets through repo business, further reinforcing the potentially negative influence of EMIR, as outlined in 2. above. This is the case in eg Germany (*§ 15 German Act on the Supervision of Insurance Undertakings*).

[2] A more detailed report on the issue as well as practical examples are contained in ICMA's report, titled "*Closed for buisness: A post-mortem of the European repo market break-down over the 2016 year-end*". A copy of the report can be found here.