insurance europe

To: Mr Steven Maijoor, Chair of ESMA
Mrs Verena Ross, Director General, ESMA

CC: Mr Gabriel Bernadino, Chairman of EIOPA
Mr Carlos Montalvo, Executive Director, EIOPA

Our reference: ECO-INV-13-172

Subject: **Insurance Europe reaction to the implementation of EMIR central clearing exemption for retirement scheme arrangements**

Brussels, 1 October 2013

Dear Mr Maijoor,
Dear Mrs Ross,

The European insurance industry is the largest European institutional investor, with around €8.4trn of assets under management at the end of 2012. This large amount of investment is made to back future claims, many of which are long-term in nature, such as those resulting from insurers' pensions, savings and other long-term products.

Derivatives are a key component of insurers' long-term risk management.
Derivatives are often a key part of insurers' risk management strategies, especially for long-term business where derivatives are used to hedge risk exposures by matching the profile of liabilities or securing a pay-off promise made to policyholders.

Preparation for central clearing has significant asset allocation…
Current practice in the central clearing environment indicates that central counterparties (CCPs) will only accept cash as collateral and there is no indication that they will expand the acceptable collateral to other highly liquid assets, as allowed by EMIR. At the same time, EMIR appropriately recognises that retirement scheme arrangements "typically minimise their allocation to cash in order to maximise the efficiency and the return for their policyholders".

European insurers providing pensions products that will not be eligible for the central clearing obligation risk being forced either to hold unnecessary amounts of cash (to the detriment of long-term investments), to perform forced asset sales when cash is needed or to monetise assets via the repo market. Hence, the central clearing obligation would have important implications for insurers' investment decisions. In addition, the forced sales of assets encourage pro-cyclicality and threaten the significant countercyclical role of insurers in periods of market stress.

…and operational implications.
Central clearing requirements will involve a lot of effort on the part of the insurance industry to define appropriate internal frameworks and processes, to create relationships with clearing members and build/update IT tools. Insurers therefore need time to design and implement appropriate frameworks before a central clearing obligation becomes effective.

European insurers are concerned about delays in the implementation of the pension scheme arrangements exemption.
In cases where pension scheme arrangements are covered by Solvency I/II, the exemption for the relevant type of entity or arrangement must be granted by the NCA, which has to receive ESMA's opinion as well. We understand that ESMA is proposing to receive notifications from NCAs regarding the exemption of pension scheme arrangements from central clearing only after the first CCP is authorised, which is currently estimated to be in March 2014. Such a delay causes uncertainty for non-IORP schemes providing retirement products, as they will not know in advance of CCPs being approved whether they will qualify for the exemption or not. In addition, if ESMA plans to accept notifications from NCAs only after the authorisation of the first CCP, this means that more than half of the three-year exemption (started in August 2012) will have elapsed before its scope has been clarified.

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Potential frontloading obligations challenge investment choices regarding derivatives and further amplify the need for certainty regarding pension scheme arrangements' eligibility for the central clearing exemption.
In addition to the operational and asset/cash allocation implications highlighted above, delays create an additional risk for non-IORP retirement schemes as they could potentially have to backload OTC transactions into clearing once ESMA has finally agreed the categories for exemption. In practice, this is likely to result in significant costs for non-IORP schemes, which would be required to close out bilateral positions and replace them with clearing eligible transactions. Such a requirement could also generate a need to retrospectively adjust year-end accounts in the event that backloading OTC positions into clearing has a material impact on valuations and the use of collateral.

We believe that ESMA should make every effort to minimise uncertainty around central clearing for non-IORPS.
Against this background, it is difficult to see how a pension scheme arrangement could enter into an OTC derivative contract that is potentially subject to frontloading obligations without certainty that it will benefit from the exemption. Given the uncertainty and significant costs generated by a potential clearing obligation, pension scheme arrangements would basically have to either: 1) hedge risks with centrally-cleared derivatives — and implicitly hold cash to the detriment of long-term assets (which is actually against EMIR's intention) or 2) remain un-hedged until certainty is received around central clearing obligations.

We understand that ESMA and EIOPA have recently launched a "pilot" exercise for the exemption process of pension scheme arrangements. We also understand that this "pilot" exercise would provide some indication of the eligible pension scheme arrangements that are likely to be within the scope of the exemption, including the criteria for such exemptions.

We therefore urge ESMA to accept notifications of types of entities or arrangements that have been granted exemptions from NCAs as soon as possible.
We strongly recommend that ESMA commence with formal implementation of the pension scheme arrangements exemption process shortly after the pilot exercise has been concluded.

Yours sincerely,

Olav Jones
Director, Economics & Finance / Deputy Director General