

APRIL 2020

# REGULATORY UPDATE

## ESMA REPORT ON CENTRAL CLEARING AND PENSION SCHEMES

THE EUROPEAN SECURITIES AND MARKETS AUTHORITY (ESMA) HAS PUBLISHED ITS FIRST REPORT AND CONSULTATION ON CENTRAL CLEARING SOLUTIONS FOR PENSION SCHEME ARRANGEMENTS. WE WELCOME THE REPORT AND ITS RECOGNITION OF THE KEY CHALLENGES THAT FACE PENSION SCHEMES CONSIDERING CENTRAL CLEARING.

Insight Investment, in collaboration with European pension fund stakeholders, has actively engaged with European policymakers and regulators for several years over the introduction and implementation of central clearing for derivatives, particularly over the implications for pension funds.<sup>1</sup> Insight has also been an active participant in the European Commission's expert group on finding long-term solutions to the pension fund clearing exemption.

Insight firmly supports the principles behind central clearing and has made significant investments into clearing-related infrastructure. However, we have worked to highlight important factors which regulatory bodies need to consider and address before European pension funds are required to clear. Given these issues, we advocated for the original exemption for pension scheme arrangements from clearing, to prevent market dislocations and ensure the needs of pension funds are met.

**We believe the report marks a significant step forward and encourage European pension funds to engage with the consultation.**

### KEY ISSUES HIGHLIGHTED FOR PENSION FUNDS

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We are encouraged that the report from ESMA<sup>2</sup> recognises a range of issues we have highlighted in recent years. These include:

- Central counterparties (CCPs) require variation margin be posted as cash, which would force pension funds to either materially increase their cash allocations, or to establish access to short-term liquidity by other means that could introduce more risks and costs
- Operational and legal barriers prevent CCPs from accepting non-cash collateral as variation margin
- Bank capital rules, particularly the leverage ratio, have discouraged bank intermediation in the repo market – reducing overall liquidity and therefore the ability of pension funds to access needed liquidity via the repo market
- The repo markets have experienced episodes of stress in recent history, demonstrating that pension funds cannot rely upon them in stressed market conditions
- A potential solution that could be explored would be for central banks to provide emergency liquidity arrangements in stressed market conditions to ensure pension funds can access liquidity when required

### NEXT STEPS: CONSULTATION RESPONSE

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Insight will respond to the consultation. We are also preparing a joint response in collaboration with European pension stakeholders. We remain an active member of the European Commission's expert group.

- **UK pension fund clients:** Solutions developed by European policymakers will not apply to UK pension schemes in the future due to Brexit, but we expect European developments will help to set the direction for UK regulations. We are engaging with UK policymakers directly to establish a formal structure under which we might discuss relevant issues as the UK leaves Europe.

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<sup>1</sup> For a range of past communications and policy responses from Insight, including on issues related to central clearing, please see <https://www.insightinvestment.com/uk/responsible-investment/ri-literature-library/>.

<sup>2</sup> <https://www.esma.europa.eu/press-news/esma-news/esma-consults-clearing-solutions-pension-scheme-arrangements-under-emir>

- **European Union pension fund clients:** We encourage European pension funds using over-the-counter derivatives to read the report and consider responding to the consultation, as developing an effective solution to mitigate the issues outlined above will have a material impact on pension funds' ability to manage and mitigate risks effectively.

Insight will collaborate with relevant stakeholders and industry bodies to ensure an effective and consistent approach to the consultation. If you have questions about these issues or about how you might respond to the consultation, please contact us.



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