Update for the OPSG on the European Market Infrastructure Regulation (EMIR): current status on IORP's exemption on central clearing

Introduction

In the summer of 2014, the OPSG, together with the IRSG, issued an opinion on the European Market Infrastructure Regulation (EMIR)[1]. This brief paper describes the current status of the EMIR regulation and the IORPs exemption in particular. Furthermore, it elaborates the conclusions of the report published in this very item by the European Commission earlier this year.

EMIR is aiming for increased transparency, reporting practices and creating safe and resilient OTC derivatives markets. To this end, a mandatory clearing system will be put in place and OTC derivatives transactions, cleared and uncleared, will have to be collateralised. This will have considerable impact on IORPs.

Last year, the European Commission was urged by the legislator (Parliament and Council) to adequately accommodate the position of IORPs and their dedicated service providers in the EMIR framework because of the IORPs' low risk profile and the eminent social task of the European IORPs. A temporary carve-out from the clearing obligation was subsequently granted, thus aiming to prevent excessive costs and a possible risk transfer[2] to IORP participants and beneficiaries.

EMIR: state of affairs

The EMIR legislation entered into force on August 16 2012. This regulation has direct legislative force in all EU member states. Over the coming months, the various obligations arising from the regulation will be phased in. On September 27 2012, ESMA and EBA proposed technical standards in level 2 regulations that elaborate on the EMIR rules at a higher level of detail. These technical standards are approved by the European Commission on December 19 2012, but are still subject to approval by the European Parliament and the Council.
The foregoing has no bearing on the detailed rules on non-cleared OTC-derivatives (level 2) as these rules still have to be formulated, for which further international coordination is necessary.

Temporary exemption: IORPs have been granted a three year exemption from the clearing obligation in article 89 of EMIR (provided the transaction has been entered in order to reduce investment risk that directly influence their solvency). This exemption applies as of August 2012 and is counting. Article 85 of EMIR provides for an extension of this exemption by the EC in consultation with EIOPA and ESMA by 2 years and subsequently by another year. However, the exempted OTC-derivative transactions are caught by the detailed rules on non-cleared transactions that enter into force on the basis of article 11 of EMIR (and for which the level 2 regulations have not yet been drafted). Current EU law provides for a temporary exemption from the clearing obligation for certain contracts. The exemption is set to expire in August 2015. The EC report presented on February 3rd 2015 recommends extending it for another two years. This takes form of a delegated act which is presented on June 5th 2105.

At the same time, the European Commission launched a further consultation of EMIR without giving specific reference to the IORPs' exemption specifically.

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[1] See 'Combined IRSG/OPSG Response on draft regulatory technical standards on risk-mitigation techniques for OTC derivative contracts not cleared by a CCP under Article 11(15) of EMIR Regulation (EU) No 648/2012', EIOPA-OPSG-14-05, July 2014.

[2] Possible extra risk is imposed by the introduction of the role of the clearing member.

Conclusion of the European Commission

Central counterparties need more time to find appropriate solution

The European Commission published a report[3] on the February 3rd 2015 that recommends granting IORPs a further two-year exemption from central clearing requirements for their over-the-counter (OTC) derivative transactions. The report, which is based on an extensive study requested by the European Commission, concludes that central counterparties (CCPs) need this time to find solutions for IORPs. The conclusions can be listed as follows:

- The Commission examined the efforts of CCPs, and concluded those efforts were insufficient. It then examined the adverse impact of central clearing on pensioners, and the Commission concluded the impact remained very significant: recent estimates show that the costs for obliging IORPs to clear their OTC derivative portfolios would range from € 2.3 billion to € 2.9 billion annually and the expected impact could be up to 3.66% of pension income per annum over 20-40 years on retirement incomes across the EU;
- So the EC concluded overall that "*the necessary effort to develop appropriate technical solutions has not been made at this point in time and that the adverse effect of centrally clearing derivative contracts on the retirement benefits of future pensioners remains unchanged*". The Commission therefore intends to propose an extension of the three-year period referred to in Article 89(1) of EMIR by two years through means of a Delegated Act.
- Last, the Commission does not exclude a further extension of the exemption by another year, depending on market developments. Whether the criticism levelled at CCPs will be addressed by market parties involved, especially clearing members and CCPs, over the next two years will be essential for the next Commission decision. In that respect, the Commission states that it "*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*."

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Niels Kortleve, chair OPSG subgroup on solvency issues

[3] 'Report from the Commission to the European Parliament and the Council under Article 85(2) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, 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', COM(2015) 39 final, February 3rd 2015.