



Brussels, 23.9.2020  
COM(2020) 574 final

**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, as amended by Regulation (EU) No 834/2019, assessing whether viable  
technical solutions have been developed for the transfer by pension scheme  
arrangements of cash and non-cash collateral as variation margins and the need for any  
measures to facilitate those viable technical solutions**

# **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, as amended by Regulation (EU) No 834/2019, assessing whether viable technical solutions have been developed for the transfer by pension scheme arrangements of cash and non-cash collateral as variation margins and the need for any measures to facilitate those viable technical solutions**

## **1. INTRODUCTION**

The European Market Infrastructures Regulation (EMIR)<sup>1</sup>, which introduced in the EU in 2012 the G20 reforms on over-the-counter (OTC) derivative contracts, granted a temporary exemption from the central clearing obligation to entities operating pension scheme arrangements (PSAs), in relation to certain types of OTC derivatives<sup>2</sup>.

Under the Regulation, PSAs include Institutions for Occupational Retirement Provisions (IORPs) as defined under Art. 6(a) of Directive 2003/41/EC, the occupational retirement provision businesses of institutions under Art. 3 of that Directive, the occupational retirement provision of insurance undertakings covered by Directive 2002/83/EC (provided that the assets and liabilities associated with such a business are segregated from the other activities of the insurance undertaking), as well as any other authorised and supervised entity or arrangement operating on a national basis whose primary purpose is to provide retirement benefits.

The temporary exemption was granted in order to take into account the specific features of the business model of such entities and the impact mandatory clearing could have on pensions: as recalled in Recital 26 EMIR, entities operating pension scheme arrangements “typically minimise their allocation to cash in order to maximise the efficiency and the return for their policy holders. Hence, requiring such entities to clear OTC derivative contracts centrally would lead to divesting a significant proportion of their assets for cash in order for them to meet the ongoing margin requirements of CCPs”. Clearing OTC derivatives centrally requires adequate amounts of cash available in order to meet the margin requirements of central counterparties (CCPs). As the EMIR framework recognises, holding large amounts of cash in order to meet potential variation margin calls could impact negatively the retirement income of pensioners.

An independent study provided to the Commission by the Europe Economics and Bourse Consult in 2014 estimated the potential variation margin EU pension funds could be required to pay in the event of a 1% shift in rates. While the study still covered

---

<sup>1</sup> Regulation (EU) No. 648/2012.

<sup>2</sup> The exemption concerns OTC derivative contracts which are objectively measurable as reducing investment risks that directly relate to the financial solvency of pension scheme arrangements and to entities established to provide compensation to members of such arrangements in case of default, and PSAs which encounter difficulties in meeting the variation margin requirements (Art. 89 EMIR).

the UK, the results excluding the UK showed that such an amount would range between 106 and 133 billion euros, further increasing in more stressed scenarios.

More recently, further studies were carried out by the Eurosystem<sup>3</sup> and the Danish central bank<sup>4</sup>. Such studies suggest that the potential variation margin of Dutch and Danish pension funds – which account for around 52% of EU pension funds’ financial assets (excluding the UK)<sup>5</sup> – under the same stress scenario (1% shift in rates) would be below EUR 53 billion and DKK 106 billion (or around EUR 14 billion) respectively, hence somewhat lower than the corresponding figures<sup>6</sup> of the aforementioned independent study. On the basis of available cash balances, the aggregate cash shortfall could amount up to 17 billion euros for all euro area pension funds.<sup>7</sup>

Similar moves in rates, costs and risks would not be specific to PSAs only, but would impact other financial firms which clear centrally as well (e.g. investment funds, insurance companies), and risks of default for lack of eligible collateral can arise also in the case of bilateral derivatives trading, not only in the central clearing world. However, as ESMA recognises in its first report on this topic, PSAs seem to be more constricted in their capacity to mitigate these risks through flexibility in investment strategies, availability of investments matching their liabilities, access to sources of liquidity, as discussed in the following sections.

The temporary exemption was intended to provide the time needed in order to find a suitable technical solution, which would allow PSAs to clear centrally at CCPs while avoiding materially adverse effects on pensioners’ income. Within the EMIR framework, the OTC derivative business of PSAs is already subject – under the relevant thresholds - to the operational risk mitigation and margin requirements for uncleared OTC trades set out in Article 11, which started applying in 2017 according to a phase-in<sup>8</sup>: these requirements aim at addressing the risks related to non-centrally cleared derivatives, while also providing incentives to clearing centrally. PSAs are also subject to the EMIR reporting obligations.

Although discussions with PSAs and other stakeholders confirm that PSAs want to clear trades at CCPs, and indeed already do so in certain cases, mandatory clearing has continued to pose challenges. The central clearing exemption has therefore been extended over the years, since no viable technical solution had emerged. EMIR Refit,

---

<sup>3</sup> European Central Bank, Financial Stability Review, May 2020. Estimates for Dutch pension funds are in the range of 36 to 47 billion euros; given that Dutch pension funds hold around 89% of interest rate swaps of euro area pension funds, the margin call on all euro area pension funds is estimated to range between 40-53 billion euros.

<sup>4</sup> Danmarks Nationalbank, “Pension companies will have large liquidity needs if interest rates rise”, November 2019.

<sup>5</sup> According to Euro Area Accounts at the end of 2019.

<sup>6</sup> The corresponding figures amounted to approximately 60 and 27 billion euros for Dutch and Danish pension funds respectively.

<sup>7</sup> Estimates for the cash shortfall of Dutch pension funds are in the range of 6 to 15 billion euros. Given that Dutch pension funds hold around 89% of interest rate swaps of euro area pension funds, the cash shortfall on all euro area pension funds could be up to 17 billion euros.

<sup>8</sup> Commission Delegated Regulation (EU) No. 2016/2251.

entered into force in June 2019, extends the exemption until June 2021, with a further potential extension through Commission delegated acts twice, each time by one year maximum. The ultimate aim of the Regulation, however, remains central clearing for PSAs as soon as possible, considering that current regulatory and market developments should enable market participants to develop appropriate solutions (EMIR, Recital 30). CCPs, clearing members and PSAs are required to make their best efforts to contribute to the development of such solutions.

Article 85 of EMIR Refit requires the Commission to prepare yearly reports until the final extension of the exemption, assessing “whether viable technical solutions have been developed for the transfer by pension scheme arrangements of cash and non-cash collateral as variation margins and the need for any measures to facilitate those viable technical solutions”.

The Regulation also establishes that ESMA, in cooperation with EBA, EIOPA and the ESRB, shall submit annual reports to the Commission assessing the issue. The first report by ESMA was received by the Commission in April 2020. Together with the report, ESMA launched a public consultation in order to gather further input from stakeholders and submit a second, more comprehensive report to the Commission by December 2020. ESMA's comprehensive report is therefore not available in time to be incorporated into this report from the European Commission.

EMIR Refit also mandated the Commission to set up an expert group including representatives of the relevant stakeholders, so as to monitor their efforts and assess the progress made towards finding viable technical solutions. The expert group, which continues the work of its predecessor (Commission High Level Group on Pension Funds) includes representatives of CCPs, clearing members, PSAs, central banks and other relevant stakeholders; it met twice, in October 2019 and in April 2020 (via conference call) and will continue meeting every six months. The Commission continues to build on the group's work for its reports to the co-legislators.

## **2. PURPOSE OF THE REPORT**

With this Report the Commission fulfils its obligation under Article 85 of EMIR.

This Report duly takes into account the first report by ESMA, as well as the discussions which took place within the expert group. As explained, the results of the public consultation launched by ESMA will feed into the second Commission report, to be issued next year.

This Report provides an analysis of the main issues identified by stakeholders around PSAs' central clearing, as well as of the solutions explored thus far. As mentioned, the PSA exemption from central clearing is in force until June 2021: in view of that deadline, this report aims at updating the European Parliament and the Council as to the progress made in this field, also in view of identifying the aspects to be explored further in order to favour a feasible and sustainable central clearing solution.

### **3. MAIN ISSUES IDENTIFIED**

#### **3.1 Background on PSAs' business model and use of derivatives**

European PSAs, especially in some Member States such as the Netherlands and Denmark, are active participants in the OTC derivatives market. They use such derivatives to hedge their liabilities from a number of risks, including interest rate and inflation volatility, and ultimately protect themselves from financial solvency risks. Pension funds' liabilities towards current and future pensioners have long maturities, which need to be matched with long-term assets; such assets are typically government and corporate bonds; however, fully hedging liabilities with bonds does not seem feasible for EU PSAs, given the limited availability of bonds with the appropriate characteristics; in addition, derivatives can offer a better match for PSAs' liabilities because swaps are often used to discount such liabilities for valuation purposes. As reported by ESMA, the situation of EU PSAs in this regard is different from that of US pension funds, which rely more on long-dated assets such as corporate and government bonds for hedging purposes: US pension funds tend to have a shorter duration of liabilities relative to EU PSAs, their liabilities are typically discounted using AA-corporate bond yields, and the US corporate bond market is deeper. As such, as ESMA recognises, PSAs seem to have a structural need for engaging in OTC derivatives.

The derivatives portfolio of PSAs is typically large, long-dated and unidirectional, with the aggregate position of the industry representing, according to ESMA, a potential systemic risk.

As to the types of derivatives, PSAs are extensive users of long-term interest rate swaps: according to 2015 EMIR data from DTCC, about 20% of interest rate swaps with at least one counterparty as an insurer or a pension fund in the EU had a maturity of 30 years, compared to a global average of less than 10%<sup>9</sup>. Interest rate swaps are the class of derivatives subject to the clearing obligation under EMIR. PSAs trade their derivatives bilaterally, or clear centrally at CCPs generally as clients of clearing members.

It is worth noting that pension schemes and markets are rather diverse across the EU: in some Member States second pillar pension systems are more developed than in others, and defined-benefit pension funds are more widespread; in others, the defined-contribution model is prevalent. The largest PSAs markets in the EU are to be found in the Netherlands, with an average ratio of assets to GDP of 173.3%, and Denmark, with a ratio of 198.6%, according to end-2018 data. Ireland also has similar schemes in place. In such countries, private pension schemes play an important role in providing retirement income to pensioners.

#### **3.2 The issue with PSAs' central clearing**

---

<sup>9</sup> European Systemic Risk Board, Occasional Paper Series 11, 2016.

The main issue identified with regard to PSAs' central clearing concerns the fact that clearing at CCPs requires posting variation margin in cash; the discussions held in the Commission stakeholder group have shown that this is problematic for PSAs in case of stressed market conditions.

In the central clearing model, CCPs ask variation margin to their participants, so as to compensate for the changes in the market value of the derivative positions they manage. In this way, CCPs are always covered from market movements and market participants do not build-up large losses over time in relation to their centrally cleared portfolio. Losses and gains are calculated by the CCP and exchanged daily through the marking-to-market process. Cash can best serve the purpose of variation margining, because it minimises any risk of value losses and its transfer is final. Passing through cash as variation margin is also operationally less complex and is compatible with the approach to CCP liquidity risk management set out under EMIR<sup>10</sup>.

This means that clearing participants have to be able to cope with such requests through appropriate amounts of cash: if this is not the case, and a clearing member cannot post the required variation margin in due time, it is declared in default by the CCP, which then triggers its default procedures in order to re-match the book. Moreover, variation margin needs to be posted to CCPs in a short timeframe, raising further operational difficulties<sup>11</sup>.

Cash has a high opportunity cost, as it is not as profitable as other assets and is not adequate to balance the maturities of PSAs' liabilities, thus exposing them to asset-liability mismatches. Holding large amounts of cash instead of other higher-yielding assets would contribute to decreasing the returns for pensioners and impact PSAs' asset allocation, and indeed pension funds typically do not hold a lot of cash, as it is shown also in the annual global pension statistics published by the OECD.

The issue of cash variation margin can prove challenging especially in times of stressed market conditions, in conjunction with increasing interest rate levels, when variation margin requests by CCPs could increase significantly for PSAs.

Indeed, large variation margin calls can occur also in the context of non-centrally cleared trades, in which PSAs currently participate. However, in that context PSAs can post variation margin also in other forms than cash, for instance using high-quality government bonds (an asset pension funds are typically rich of) - even if the extent to which PSAs are requested to post variation margin in cash also in their bilateral trades may have increased recently.

It is to be noted that the rationale of the EMIR regulatory framework is such as to promote central clearing also by making bilateral trades less convenient, in line with the

---

<sup>10</sup> Also, cash variation margin allows CCPs to remain certain of their ability to value their transactions correctly and is the market convention for cleared swaps adopted by all market participants of the cleared swaps market.

<sup>11</sup> For intraday margin calls some CCPs allow participants to use securities instead of cash; however, end-of-day margin calls have to be met with cash.

associated risks: this and other regulatory developments, together with market forces, are expected to lead to increasing volumes of centrally-cleared derivatives, with potentially better pricing in the cleared segment relative to the non-centrally cleared one. Indeed, as mentioned, some pension funds have already started clearing centrally on a voluntary and select basis.

It is to be noted that generally PSAs are more likely to clear indirectly as clients of clearing members than to become direct clearing members of a CCP, as further discussed in the following sections.

The above provides the background for the characteristics that a potential solution to the central clearing issue should have: it should be such as to strike the right balance between the objective of financial stability and the need to be viable for PSAs in terms of cost, so as not to excessively impact the benefits of retirees and it should be robust enough also under stressed market conditions.

### **3.3 Potential solutions explored so far**

The debate over PSAs central clearing has led to explore different avenues over the years. An outline of some potential solutions was included in the report the Commission delivered under EMIR in 2015 on this issue, which concluded that no viable technical solution had been developed.

The options explored so far have focussed on how PSAs could post variation margins to CCPs in a safe and cost-effective way. In a first stage, as described in the 2015 Commission report, it was considered whether CCPs could accept variation margin in other forms than cash, such as high-quality government bonds: however, it has been generally recognised that such an avenue would be difficult to pursue, because it would require CCPs to manage a portfolio of bonds to be converted into cash with the related risks, which could lead to a distortion of their role as pass-through running a flat book.

A second range of options is thus being explored, under which PSAs could exchange their bonds with cash in order to meet CCPs' margin calls (collateral transformation). Potential solutions explored and developed over the last years by industry stakeholders have focussed indeed on ways to allow efficient collateral transformation by PSAs.

#### Collateral transformation by clearing members

Clearing members such as banks can typically provide to their clients, including pension funds, collateral transformation services<sup>12</sup>, by means of repos. Indeed, most of the PSAs which engage in central clearing do so as clients of clearing members today, and may continue doing so even under mandatory clearing. A repo transaction is one in which a party sells an asset to another party and commits to repurchase the asset at an agreed price at a future date. The asset is typically a bond and serves as collateral to insure the cash lender against counterparty credit risk. Repos can thus be used as a

---

<sup>12</sup> Such a service could also be provided to pension funds by other banks, different from their clearing member.

means for transforming bonds into cash and post variation margins, with the additional advantage that the provider of the bonds retains ownership of the bonds themselves and continues getting the returns in the longer term.

Large banking groups are typically active in the repo market. However, some factors have been raised as disincentivising clearing members from engaging in such transactions. As raised by many market participants, the construction of the leverage ratio under the Basel III framework made it less convenient to engage in repos, because such transactions have low margins and expand banks' balance sheets, thus contributing to increasing the denominator of the ratio. As such, banks need to have a larger amount of Tier 1 capital to respect the requirement. Similar considerations are developed by the Committee on the Global Financial System's 2017 analysis of repo markets<sup>13</sup>, which pointed to the possible trade-off between regulatory reforms focussing on the size of banks' balance sheets (aimed at limiting excessive leverage) and the consequences, including for end users, in terms of repo availability<sup>14</sup>. In this regard, repo market volumes in the EU have nonetheless been increasing in recent years<sup>15</sup> and according to the ECB's analysis unintended consequences of regulatory reforms on the provision of repo services by euro area banks have not been material<sup>16</sup>.

In addition, the way the leverage ratio was originally conceived made it less convenient for banks to provide client clearing services, because margins posted by clients could not be used to offset the amount of the exposure (which would feed into the denominator of the ratio). In 2019 the Basel Committee<sup>17</sup> proposed to introduce changes in the calculation of the leverage ratio, so that client clearing would not be unduly penalised. These changes were reflected in the revised Capital Requirements Regulation (CRR2), which entered into force in June last year.

An amendment to the leverage ratio was also introduced concerning the treatment of reverse repos. These changes may contribute to encouraging banks to engage in client clearing and possibly in repo intermediation, thus also supporting repo market liquidity. The impact of such changes will have to be assessed.

In addition, concerns have been raised as to the capacity of the repo markets to meet the cash demand of all PSAs together, especially in times of stress, as discussed in greater detail below.

### Collateral transformation through cleared repo markets

---

<sup>13</sup> CGFS, "Repo market functioning", 2017.

<sup>14</sup> "A contraction in intermediation capacity may also reduce the degree to which repo markets can respond to demand during future periods of stress. A reduction in repo market functioning might create frictions in cash and derivatives markets, and reduce the ability of financial institutions to monetise assets. The scale of the resulting costs to financial stability and the real economy in times of stress might be significant altogether, although such situations have not materialised on a substantial scale in the most recent past. Repo market adaptations might mitigate the costs to some end users, but could also introduce new risks".

<sup>15</sup> ICMA, December 2019 European Repo Market Survey.

<sup>16</sup> ECB, Financial Stability Review, 2017.

<sup>17</sup> Basel Committee on Banking Supervision, "Leverage ratio treatment of client cleared derivatives", 2019.

In recent years, some CCPs have developed new models to support PSAs central clearing based on facilitating access by PSAs to CCPs and to the cleared repo markets; this may also involve access to the cleared OTC market. These models have been developed in the European Union by at least one CCP and to the Commission knowledge similar models are likely to be adopted also by other CCPs<sup>18</sup>. In this framework, PSAs have a direct contractual relationship with the CCP and are “assisted” (or otherwise “sponsored”) by a clearing member (typically, a bank) which acts as a clearing agent and facilitates PSAs’ central clearing, for instance by contributing to the CCP’s default fund and engaging in default management and other services (collateral management etc.).

These models do not eliminate per se the need to post variation margin in cash for cleared OTC derivatives, however they do provide PSAs with additional access to repo markets. Such “facilitated membership” models would also aim at alleviating some of the limitations of client clearing, such as the concentration of client clearing in the EU at just a few clearing members or the issue of portability of clients’ positions in the case of default of a clearing member. From the point of view of banks, such models should prove less demanding in terms of capital requirements than traditional client clearing activities.

To the Commission best knowledge, such a model has been developing overtime with somewhat increasing appetite from the market, however only a few PSAs – typically large ones - have started using such a service so far. One obvious reason may be the fact that having a direct relationship with a CCP may require additional operational and legal preparedness and investment by market participants, both PSAs and clearing members. Moreover, the pension funds participating in the Commission stakeholder group reported that such models are generally available only to large PSAs, only a small number of banks currently support them, and still imply reliance by PSAs on clearing member’s willingness to provide the related services.

According to a joint paper by the International Swaps and Derivatives Association (ISDA) and Pensions Europe of 2018<sup>19</sup>, direct membership or “facilitated” membership models are looked at with interest by the market, also because they may be more interesting for banks than the traditional client clearing relationships. Full direct membership appears to be challenging for a number of reasons (including the need to meet CCPs’ participation requirements and default fund contributions, as well as to have operational capability); facilitated access models may be a way to get closer to that. According to the pension funds participating in the Commission stakeholder group, some further improvements would still be required.

#### Discussion on the repo market

---

<sup>18</sup> Outside the EU, based on the information available to the Commission, LCH Ltd (UK), Canadian Derivatives Clearing Corporation (Canada) and the DTCC FICC (US) have established buy-side repo clearing offerings.

<sup>19</sup> Pensions Europe and ISDA joint paper “Potential demand for clearing by EU Pension Funds”, 2018.

The repo market is generally seen by PSAs as a useful tool for their liquidity needs, and in the discussions of the expert group set up by the European Commission it has generally been described as a potential piece of the overall solution to the variation margin issue.

However, industry concerns remain as to the capacity of repo markets to meet the overall demand for cash stemming from all PSAs having to clear under stressed market conditions, when repo markets are likely to be under pressure to absorb large liquidity demand – not only from PSAs. Moreover, banks may not always be willing to provide repos to PSAs, or to the same extent, in times of stress. As ESMA points out, a number of these and other aspects also have to do with the overall commercial relationship between banks and their PSA clients. If PSAs are not in a position to use the repo market under stress conditions, they may be unable to meet the margin calls of CCPs and even be at the source of broader financial stability issues. In this regard, the possibility to establish a diversified set of liquidity arrangements between banks and PSAs could prove helpful.

Cleared repo markets should have the advantage of being more liquid than the bilateral markets, as banks are in principle more willing to trade cleared repos rather than bilateral repos – not least because they can net their positions with the CCP. According to the CGFS (2017), in the Euro Area “the share of repo market trading via CCPs increased over the past years, accounting for 50-60% of the euro area repo market volumes, owing to their attractiveness for the balance sheet management”. Efforts developed by some CCPs to allow for direct participation of end users to their cleared repo platforms have to be put also in this perspective. PSAs reported that the cleared repo market can offer additional repo capacity relative to bilateral repos, but also have the limitations mentioned above.

An overview of the functioning of the European repo markets is provided by the International Capital Markets Association (ICMA), which in its 2019 Repo Market Survey estimates the overall size of the market at 8,310 billion euros<sup>20</sup>. The 2018 and 2019 European Repo Market Surveys by ICMA confirm that the European repo market is seen as generally functioning well, thus potentially being a channel for collateral transformation; however, repo markets are less liquid at quarter-end and year-end, due to banks tending to close down their repo positions when approaching reporting deadlines. The range of such regular shrinks has been decreasing in recent years and is expected to decrease further in the future, also thanks to implementation in the EU of BCBS recent recommendations aimed at reducing quarter-end and year-end volatility.

ICMA also provides analysis<sup>21</sup> of the most recent developments occurred in the market during the Covid-19 crisis. According to this survey, the European repo market for the most part held up well during the Covid-19 pandemic starting from end-February/early-March 2020. Repo market activity increased over the first two weeks of March, due to

---

<sup>20</sup> Based on the value of the repo and reverse repo contracts outstanding on the books of the 58 financial institutions participating in the Survey.

<sup>21</sup> ICMA, “The European repo market and the Covid-19 crisis”, April 2020.

increased collateral transformation requests to meet margin calls and to flows out of riskier assets towards short-term assets. However, clients reported that banks hardly coped with the increasing demand for repos and some started serving only top-tier clients. According to the survey, “While the demand to access the repo market increased during the height of the crisis, banks’ capacity to intermediate that access did not. Buy-side participants report an increased reliance on the repo market as fund outflows drove the need to generate cash against holdings, as well as to meet margin calls against derivatives positions as volatility increased. However, it would seem that banks struggled to keep pace with client demand. Many report limiting business to top tier clients, with no capacity for new business. Banks further report that in light of the heightened volatility, it was more a case of RWA (risk weighted assets) limits becoming the binding constraint on business, rather than the Leverage Ratio, particularly for one-directional business flows (such as net borrowers of cash).”

Reportedly, central bank interventions eased such tensions, by freeing up banks’ credit lines and reversing the sell-off of risk assets.

Market developments during the Covid-19 crisis have been discussed also in the context of the Commission stakeholder group. CCPs reported continued smooth performance of cleared repo markets during the crisis, with high volumes of activity. In their recollection, access was not constrained for buy-side firms participating in the cleared repo market. Overall resilience of market infrastructure was also highlighted, including when it comes to the margin models, thus contributing to the predictability of margin requests to participants. Pension scheme arrangements reported suffering from the considerable market volatility, with large margin calls from bilateral counterparts and from clearing members to clients. They reported being just able to cope with such a situation, but if markets had performed worse, they would have faced very serious difficulties. They also confirmed that banks were reluctant to engage in repo intermediation and that they struggled to get access to clearing member banks’ balance sheet to access repo markets. As a consequence, PSAs feel that the repo market cannot be relied upon in all market conditions; PSAs often heavily depend on banks for accessing it, and banks have limited repo lines for their clients in times of stress.

In light of the difficulties with repo markets in times of stress, market participants have often raised the issue of the need for a central bank liquidity backstop in times of stress. According to market participants, this backstop role of central banks could be designed as central banks providing liquidity to a regulated entity which would then provide it to the PSAs: such an entity could be banks or CCPs. After receiving the liquidity from banks or CCPs, the PSAs would be able to meet the cash variation margin calls.

It is to be noted that, given that central banks are exclusively competent for the establishment of central bank facilities and for the interpretation of their intended usage, any option based on a central bank liquidity backstop would need to be endorsed and supported by the central banks.

The ECB provided its perspective on the issue. As regards banks, of course they are monetary policy counterparties and are authorised to provide collateral transformation services subject to the relevant banking regulation. Therefore, they are in a position to intermediate in the repo market, including on the basis of their use of central bank facilities.

According to the ECB, however, the central bank backstop role does not appear to be straightforward, or may even not be feasible for CCPs, even when the latter have a banking license: taking up collateral transformation services by CCPs seems to be outside of their core business, hence it may raise concerns in relation to risk consequences. Further, according to the ECB, should CCPs take up collateral transformation on the basis of their additional banking license (if allowed), current exemptions granted to them from certain prudential banking requirements on the ground that CCPs do not engage in typical banking activities and have a different business model do not seem to be reasonable anymore. Therefore, further analysis would be needed to ascertain the legal nature, CCP risk management impact and regulatory compliance of any such arrangements. First reactions by some CCPs have also shown some scepticism.

As regards the need for a potential “dedicated” central bank backstop for PSAs (with PSAs becoming counterparties to central banks and receiving liquidity from them directly), the ECB contributed to the debate of the Commission stakeholder group from the perspective of the Eurosystem, i.e. focussing on the euro-denominated funding needs of entities domiciled in the euro area. The Eurosystem’s quantitative assessment estimated the liquidity needs of euro area PSAs to meet variation margin under a stress scenario based on a 1% shift in rates (see also above). Within the euro area, according to data available to the Eurosystem, the Dutch PSAs are the most involved in derivatives, with 89% of all pension fund interest rate swaps entered into by them. The Eurosystem’s analysis found that the actual liquidity needs of euro area PSAs in such a circumstance would be manageable (i.e. below 2%) as compared to the overall size of the European repo market (proxied by the outstanding amount of reverse repos), suggesting that repo market per se could offer solutions to euro area PSAs’ needs. On the basis of the findings it was concluded that the Eurosystem’s monetary policy framework, including its counterparty framework, is adequate for monetary policy implementation purposes and does not warrant changes to establish a dedicated Eurosystem liquidity backstop for PSAs<sup>22</sup>.

#### **4. CONCLUSION**

The issue of PSA central clearing has been longstanding, and during the last EMIR negotiations it became apparent that co-legislators sought to encourage as much as possible a solution which could make such actors access the central clearing system

---

<sup>22</sup> Such a Eurosystem liquidity backstop facility would be distinct from Emergency Liquidity Assistance (ELA), which falls within the remit of national central bank mandates.

designed by the G20 reforms in 2009, while taking into account the need to have adequate solutions in place to accommodate concerns in a stressed market situation.

Long discussions have taken place in the Commission stakeholder group, where it emerged that PSAs have already started clearing some derivatives voluntarily, and it can be concluded that the key issue which remains to be solved is the issue of cash variation margin in times of stressed market conditions.

The Commission has been constantly monitoring market developments and has facilitated exchanges and discussions among the relevant stakeholders to find possible ways forward. Over the years efforts have been made by industry stakeholders. In particular, once the option of posting variation margin in bonds directly with CCPs was eventually dismissed due to compatibility issues with the nature and business model of CCPs, other avenues have been explored in order to better allow PSAs to transform collateral.

As outlined in this report, facilitated access models have been developed during recent years in order to explore a potentially viable avenue for PSAs' central clearing. To the Commission's best knowledge, such an option is already being used by a few PSAs. The Commission intends to explore further with relevant stakeholders this option, including its cost for PSAs. The fact that more than one CCP is adopting such a model seems to be a positive development, also in terms of promoting more choice.

Finding a suitable solution will most likely require effort on a number of different fronts. On the one hand, some aspects of banking regulation should be further assessed, including whether the recent changes in the leverage ratio calculations have helped. On the other hand, it should be considered which ways of securing liquidity facilities to PSAs in times of stress can be explored.

The results of the public consultation launched by ESMA should provide further insight into recent market developments and possibly further quantitative data which will be examined carefully. The Commission is also committed to exploring any appropriate and feasible initiative in order to move further towards a viable and robust central clearing solution.

These analyses over the next months will inform the Commission's decision with regard to the central clearing exemption.