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COVER NOTE

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Subject:	COMMISSION DELEGATED REGULATION (EU) …/... of 9.6.2022 extending the transitional period referred to in Article 89(1), first subparagraph, of Regulation (EU) No 648/2012 of the European Parliament and of the Council

Delegations will find attached document C(2022) 3584 final.

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EUROPEAN
COMMISSION

Brussels, 9.6.2022
C(2022) 3584 final

COMMISSION DELEGATED REGULATION (EU) …/...

of 9.6.2022

extending the transitional period referred to in Article 89(1), first subparagraph, of Regulation (EU) No 648/2012 of the European Parliament and of the Council

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) provides for a temporary exemption from the clearing obligation for Pension Scheme Arrangements (PSAs) meeting certain criteria. This transitional period is set out in Article 89(1) of EMIR and provides further time for central counterparties (CCPs), PSAs and clearing members to develop viable technical solutions which would allow PSAs to meet the cash variation margin calls of CCPs, mitigating potential adverse effects of centrally clearing derivative contracts on the retirement benefits of future pensioners.

The temporary exemption has been extended over the years, since no viable technical solution has emerged.

- The review of EMIR (Regulation (EU) No. 834/2019, "EMIR Refit") prolongued the exemption until 18 June 2021;
- In accordance with Article 85(2) of EMIR, it is possible to extend it twice, each time by one year, by adopting a Commission delegated act while the ultimate aim of the Regulation remains central clearing by PSAs.
- On 8 June 2021 and 10 June 2021, respectively, the European Parliament and the Council did not object to a proposal adopted on 6 May 2021 by the Commission for an extension of the exemption for a further year, so the exemption currently runs until 18 June 2022.[1]

The Commission is proposing with this Delegated Act to prolong the existing exemption by an additional year. This is the final extension possible under the current EMIR framework.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

"EMIR Refit" provides for a comprehensive framework to assess the progress made in finding viable solutions towards obstacles preventing pension scheme arrangements from clearing centrally. According to Article 85(2), the Commission has to prepare annual reports assessing whether viable technical solutions have been developed to allow PSAs to cover variation margin in cash or transfer non-cash collateral as variation margins, and the need for additional measures to facilitate those viable technical solutions.

The European Securities and Markets Authority (ESMA), in cooperation with the European Insurance and Occupational Pensions Authority (EIOPA), European Banking Authority (EBA) and the European Systemic Risk Board (ESRB), has to submit yearly reports to the Commission on the topic to contribute to the Commission's assessment. Moreover, the Commission is required to set up an expert group composed of representatives of CCPs, clearing members, PSAs and other relevant parties to monitor their efforts and assess the progress made in the development of viable technical solutions that facilitate the clearing of

[1] Commission Delegated Regulation (EU) 2021/962 of 6 May 2021 extending the transitional period referred to in Article 89(1), first subparagraph, of Regulation (EU) No 648/2012 of the European Parliament and of the Council (OJ L 213, 16.6.2021, p. 1)..

OTC derivative contracts by PSAs (hereinafter: 'PSA expert group'). CCPs, clearing members and pension scheme arrangements shall make their best efforts to contribute to the development of viable technical solutions.

The Commission published its reports to the co-legislators in September 2020 (COM(2020) 574 final of 23.9.2020) and May 2021 (COM(2021) 224 final of 06.05.2021). In the reports, the Commission recognised that over the years liquidity conditions for PSAs have continued to improve while progress has been made by the relevant stakeholders towards finding viable solutions. In particular, CCPs have developed, or are in the course of developing, facilitated access models to the cleared repo markets, where PSAs could transform non-cash collateral into cash[2]. Some PSAs are already clearing voluntarily a portion of their derivatives, as clients of clearing members. The reports highlighted that a persistent issue for PSAs remains the need to post variation margin in cash in stressed market conditions, when cash margin requests from CCPs can become significant and PSAs' capacity to resort to the repo market may not always be ensured.

The Commission received the latest report from ESMA on 25 January 2022.[3] The report confirmed that broadly the description, analysis and findings detailed in the ESMA Report of December 2020[4] still stand, while this time focussing on the PSAs operational readiness to clear. ESMA's conclusion is that PSAs are largely operationally ready to clear and a growing number is clearing voluntarily at least a part of their derivative portfolios, but that PSAs and the relevant market participants need time to finalise their clearing and collateral management arrangements. Furthermore, ESMA believes the start of the clearing obligation for PSAs should be seen in the context of building clearing capacity in the EU. On that basis, it concludes by recommending another extension by one year.

This conclusion is corroborated by discussions within the PSA expert group, which has met six times since its inception in 2019, most recently in March 2022. During the last meeting, participants indicated that PSAs are largely ready to clear, have clearing arrangements in place and already clear some trades voluntarily. Nonetheless, PSA representatives in the exeprt group have underlined that the specific issue of PSAs having access to sufficient liquidity in stress periods to provide cash for variation margin calls still remains, hence the continuing reluctance amongst some to clear a larger proportion of their derivatives portfolios.

In light of the ESMA report as well as discussions in the PSA expert group, the Commission prepared a report[5] concluding that, since 2019, there has been substantial progress towards central clearing for PSAs, including some PSAs partially moving to central clearing on a voluntary basis. Nevertheless, further incentives are needed to facilitate the clearing of PSAs.

[2] A repurchase agreement ("repo") is an agreement to sell securities at a given price combined with an agreement to repurchase those securities at an agreed price at a later date. The repo market brings together firms which provide collateral in exchange for cash and firms which provide cash in exchange for collateral.

[3] Clearing obligation for pension scheme arrangements, European Securities and Markets Authority, ESMA70-451-110, 25 January 2022.

[4] Report on the central clearing solutions for pension scheme arrangements (No.2), European Securities and Markets Authority, ESMA70-151-3248, 17 December 2020

[5] COM (2022) 254, 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

In particular, EU CCPs should use the allotted time to continue to evolve their facilitated access and collateral transformation models, to increase their attractiveness to PSAs.

In addition, the Commission services have consulted the Expert Group of the European Securities Committee on the proposal for a delegated act to extend the PSA central clearing exemption by one year, until June 2023. This consultation showed a broad consensus on the proposal to extend the exemption and the recognition that central clearing for PSAs will become mandatory in June 2023. Some Member States stressed the need for clear communication to ensure that CCPs build up their clearing capacity and PSAs develop their liquidity management processes to allow PSAs to be able to seamlessly access central clearing when the temporary exemption from the clearing obligation lapses in June 2023.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The right to adopt a delegated act is provided for under Article 85(2) of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

COMMISSION DELEGATED REGULATION (EU) …/...

of 9.6.2022

extending the transitional period referred to in Article 89(1), first subparagraph, of Regulation (EU) No 648/2012 of the European Parliament and of the Council

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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[6], and in particular Article 85(2), third subparagraph thereof,

Whereas:

(1) Article 89(1) of Regulation (EU) No 648/2012 provides that until 18 June 2021, the clearing obligation set out in Article 4 of that Regulation is not to apply to OTC derivative contracts that are objectively measurable as reducing investment risks directly relating to the financial solvency of pension scheme arrangements and to entities established for the purpose of providing compensation to members of pension scheme arrangements in case of default. That transitional period was introduced to allow for the development of viable technical solutions for the transfer by pension scheme arrangements of cash and non-cash collateral as variation margin, and thus to avoid any adverse effects on the retirement benefits of future pensioners that would be caused by an immediate application of the clearing obligation to such OTC derivative contracts.

(2) Article 85(2), third subparagraph, of Regulation (EU) No 648/2012 empowers the Commission to extend the transitional period laid down in Article 89(1) of that Regulation twice, each time by one year, were the Commission to conclude that no viable technical solutions for the transfer by pension scheme arrangements of cash and non-cash collateral as variation margins have been developed and that the adverse effects on the retirement benefits of future pensioners due to centrally clearing derivative contracts have remained unchanged. For that purpose, Article 85(2), first subparagraph, of Regulation (EU) No 648/2012 requires the Commission to prepare yearly reports, until the final extension of the transitional period, to assess whether such viable technical solutions have been developed and whether any measures to facilitate those viable technical solutions need to be adopted.

6 OJ L 201, 27.7.2012, p. 1.

(3) The Commission has adopted two annual reports on 23 September 2020[7] and 6 May 2021[8] respectively. In those reports, the Commission observed that market participants have made efforts over the years to develop appropriate technical solutions which include collateral transformation either by clearing members or through cleared repo markets. The Commission also noted that some pension scheme arrangements have started to centrally clear a portion of their derivatives portfolios voluntarily. The report concluded that the key remaining challenge for pension scheme arrangements was access, in stressed market conditions, to liquidity to be able to post variation margin, because that requirement would rapidly and significantly increase the risk of exhausting the cash allocations of pension scheme arrangements.

(4) Article 85(2), second subparagraph, point (a), of Regulation (EU) No 648/2012 requires the European Securities and Markets Authority (ESMA), in cooperation with the European Insurance and Occupational Pensions Authority, the European Banking Authority and the European Systemic Risk Board, to submit to the Commission yearly reports assessing whether CCPs, clearing members and pension scheme arrangements have undertaken an appropriate effort and have developed viable technical solutions facilitating the participation of such arrangements in central clearing by posting cash and non-cash collateral as variation margins, including the implications of those solutions on market liquidity and procyclicality and their potential legal or other implications.

(5) In Commission Delegated Regulation (EU) 2021/962[9], the Commission has extended the transitional period laid down in Article 89(1) of Regulation (EU) No 648/2012 once, until 18 June 2022.

(6) On 25 January 2022, ESMA submitted its latest report on whether CCPs, clearing members and pension scheme arrangements have undertaken an appropriate effort and have developed viable technical solutions facilitating the participation of such arrangements in central clearing by posting cash and non-cash collateral as variation margins. While largely confirming its earlier findings detailed in previous reports to the Commission, ESMA in that report focussed on the operational readiness of pension scheme arrangements to clear OTC derivative contracts. Although a steadily growing number of pension scheme arrangements voluntarily clears OTC derivative contracts and liquidity conditions continue to evolve favourably, ESMA's report also concluded that pension scheme arrangements and relevant market participants need sufficient time to finalise their clearing and collateral management arrangements. ESMA therefore expressed the view that an additional extension with one year of the transitional period laid down in Article 89(1) of Regulation (EU) No 648/2012 is needed.

(7) In its latest assessment of the state of readiness of pension scheme arrangements to centrally clear their derivatives portfolios[10], the Commission came to a conclusion that is similar to ESMA's. According to the Commission's analysis, liquidity conditions for pension scheme arrangements remained robust, even during recent periods of

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7 COM (2020) 574 final

8 COM (2021) 224 final

9 Commission Delegated Regulation (EU) 2021/962 of 6 May 2021 extending the transitional period referred to in Article 89(1), first subparagraph, of Regulation (EU) No 648/2012 of the European Parliament and of the Council (OJ L 213, 16.6.2021, p. 1).

10 COM (2022) 254

market stress, and is expected to continue to evolve favourably as the funds take up alternative access models to the repo market. A positive outlook for liquidity access has led to a situation where a growing number of pension scheme arrangements started to clear voluntarily at least a part of their derivative portfolios. The alternative models to access liquidity through the repo market must be given time to mature, however, while pension scheme arrangements must improve their internal liquidity and collateral management practices.

(8) The Commission, taking into account the report of ESMA, therefore concluded that it is indeed necessary to extend the transitional period laid down in Article 89(1) of Regulation (EU) No 648/2012 by one more year.

(9) The transitional period laid down in Article 89(1) of Regulation (EU) No 648/2012 should therefore be extended.

(10) This Regulation should enter into force as a matter of urgency to ensure that the transitional period is extended before it expires,

HAS ADOPTED THIS REGULATION:

Article 1

The transitional period laid down in Article 89(1), first subparagraph, of Regulation (EU) No 648/2012 is extended until 18 June 2023.

Article 2

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union.*

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 9.6.2022

For the Commission
The President
Ursula VON DER LEYEN