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Executive Vice-President,
An Economy that Works for People,
European Commission,
Rue de la Loi 200,
Brussels 1049

Steven Maijoor,
Chair,
ESMA,
201-203 rue de Bercy
Paris 75012

7 September 2020

Dear Executive Vice-President Dombrovskis,

Dear Chairman Maijoor,

Post-Brexit exemption for pension scheme arrangements under EMIR

The International Swaps and Derivatives Association (**ISDA**) is grateful for the work of the Commission and the European Supervisory Authorities (**ESAs**) to date in taking action to mitigate the impacts for EU and UK market participants of the UK's departure from the EU without reaching an agreement on the long-term relationship between the UK and EU.

ISDA and its members respectfully request that the Commission and ESMA consider taking action to mitigate the risks posed to EU banks, investment firms and pension funds, as well as UK pension funds, by the fact that UK pension funds will cease to benefit from the exemption under the EMIR clearing obligation for pension scheme arrangements following the end of the Brexit transition period on 31 December 2020.

1. BACKGROUND

UK and EU pension funds are currently exempt from the clearing obligation under EMIR as a result of the transitional provisions in Article 89 EMIR, which provide that the clearing obligation does not apply to OTC derivative contracts that are objectively measurable as reducing investment risks directly relating to the financial solvency of pension scheme arrangements as defined in Article 2(10) EMIR.

Current application to UK pension funds

A number of different types of UK pension funds and their EU counterparties currently rely on this exemption, including:

- UK IORPs which fall within Article 2(10)(a) EMIR;

- UK and EU funds and other UK and EU legal entities set up for the purpose of investment of UK IORPs, acting solely and exclusively in their interest, within Article 2(10)(a) EMIR;
- UK pension scheme arrangements that are not IORPs but which fall within Articles 2(10)(c) and (d) EMIR.

The definition of "pension scheme arrangements" only expressly applies to EU pension funds, and ESMA has stated in its EMIR Q&A OTC 13 (c) on EMIR that a pension scheme established in a third country would not benefit from the exemption¹.

Approach taken in UK onshored EMIR

When onshoring EMIR into UK law, the UK recognised the potential difficulties for UK counterparties of applying this exemption only to UK pension schemes, and took action to protect UK counterparties by extending the exemption under UK EMIR so that it is available in relation to OTC derivatives entered into with EU pension schemes, as well as UK pension schemes, for the duration of the exemption.

We consider that similar potential difficulties arise for EU credit institutions, investment firms, pension funds and citizens if the exemption under EMIR applies only to EU pension schemes. We discuss these potential difficulties in more detail below.

2. POTENTIAL IMPACTS OF THIS EXEMPTION FALLING AWAY

If, after the end of the Brexit transition period, EMIR no longer recognises UK pension schemes as EMIR Article 2(10) pension scheme arrangements, this change in regulatory treatment will have cost and other implications for the affected pension scheme arrangements, for their counterparties and for the citizens whose retirement income depends on these investments. This change in treatment will also have other connected impacts in regulation. For example, transactions with pension scheme arrangements referred to in Article 2(10) EMIR and subject to the Article 89 transitional provisions are currently also exempt from the own funds requirement for CVA risk. The MIFIR Article 28 Derivatives Trading Obligation (DTO) would also apply to contracts between EU counterparties and UK pension scheme arrangements in classes subject to the DTO.

ISDA believes that the wide-ranging impacts of this exemption falling away at the end of the transition period are such that mitigating action is warranted. While removing this clearing exemption for new OTC derivatives entered into with UK pension scheme arrangements clearly has an impact for those UK pension schemes, there are also many negative effects for

¹ See OTC Question 13(c) https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emir_implementation.pdf

EU entities that are counterparties to those OTC derivatives or that otherwise rely on the exemption, including:

- **Uneven playing field and operational challenges for EU banks and investment firms:** EU firms that currently deal with UK pension scheme clients may start to lose this business as they will be at a significant disadvantage compared to UK firms which can continue to enter into OTC derivatives with UK and EU pension fund clients without those transactions becoming subject to the clearing obligation or own funds requirement for CVA risk. Furthermore, these EU counterparties will face a difficult task in identifying fund vehicles solely invested in by UK pensions schemes which may have been benefiting from the exemption.
- **Impact for EU pension funds and for EU legal entities that have been set up for the purposes of investment by IORPs:** Many UK pension funds invest using fund vehicles established in the EU. These fund vehicles currently benefit from the exemption from the clearing obligation where they fall within Article 2(10)(a) EMIR, but will lose the benefit of that exemption from the end of the Brexit transition period. Similarly, this would negatively impact not only UK pensions funds invested within these funds vehicles, but also any EU pension funds that are invested in those same EU funds vehicles. These EU pension funds, as investors in these EU fund vehicles, will incur increased costs and risk as a result.
- **Impact for EU funds regime:** UK pension funds are likely to restructure and onshore their investments back to the UK, to maintain the pension fund clearing exemption, making the EU fund regime less attractive to UK and EU pension funds and investors.
- **Impact on UK and EU consumers:** The UK pension market is one of the largest pension markets in Europe. EU savers benefit from UK pension funds – for example EU nationals employed by UK firms or by EU firms with a UK presence, are members of UK pensions schemes. The loss of the clearing exemption at the end of the Brexit transition period will entail increased costs and risks which will adversely impact the returns/pension entitlements of these EU citizens.

In order to address these issues, we would respectfully request that the Commission take action to ensure that the temporary exemption from the clearing obligation (and other connected exemptions) continues to be available to EU counterparties which enter into new OTC derivatives with UK pension scheme arrangements, as well as to EU entities which currently rely on the exemption as legal entities set up for the purpose of investment of UK IORPs.

3. PROPOSED SOLUTION

There are a number of methods through which ESMA and the European Commission could effect this outcome.

For example:

- ESMA could re-examine its existing EMIR Q&A (OTC Q.13(c)), in light of current circumstances to clarify that the EMIR clearing derogation is also available to UK pension scheme arrangements that qualified under Article 2(10) prior to 31 December 2020.
- Alternatively, the European Commission could propose an amendment to the Level 1 text of EMIR (to Article 2(10)), to confirm that the transitional exemption will continue to be available to UK pension scheme arrangements that would have qualified under Article 2(10) prior to 31 December 2020. While it is unlikely that an amendment to EMIR could be achieved before the end of 2020, it may be possible for the Commission to start the process of amending the text and for ESMA to publish guidance to EU supervisory authorities recommending that they do not take action against EU counterparties who will be able to rely on the exemption when facing UK pension scheme arrangements that were qualified under Article 2(10) prior to 31 December 2020. This would be a similar approach to that taken in relation to the extension of the end date for this transitional exemption.

As the current exemption is transitional, rather than permanent, we do not consider that amending it to preserve its application to transactions with UK pension schemes should be viewed as discriminatory or creating an unlevel playing field with respect to other non-EU pension schemes, as the Commission would be simply preserving the status quo for a transitional period.

We would welcome the opportunity to discuss this issue with you and are also very happy to answer any questions you may have in the meantime.

Yours sincerely,



Scott O'Malia,

Chief Executive Officer

International Swaps and Derivatives
Association, Inc.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 925 member institutions from 75 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on [Twitter](#), [LinkedIn](#), [Facebook](#) and [YouTube](#).