



EUROPEAN CENTRAL BANK
EUROSYSTEM

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Mario DRAGHI
President

Mr Werner Langen
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 12 February 2019

L/MD/19/33

Re: Your letter (QZ-081)

Honourable Member of the European Parliament, dear Mr Langen,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 27 December 2018.

Let me first of all clarify that I am replying to you in my capacity as ECB President. The European Systemic Risk Board (ESRB), of which I am the Chair, has also looked at the European Market Infrastructure Regulation (EMIR) and the issue of exemptions. The views of the ESRB on the European Commission's proposal on the revision of EMIR are set out in an ESRB report.¹

As part of the efforts to increase the resilience and transparency of derivatives markets and enhance global financial stability, the G20 leaders made the commitment in 2009 that all standardised over-the-counter (OTC) derivatives should be centrally cleared in the future. In line with this commitment, EMIR introduced a central clearing obligation for certain derivatives contracts, which entails that these are subjected to certain risk management practices applied by central counterparties (CCPs).

One such risk practice is the exchange of variation margin. Variation margin typically takes the form of cash² and is exchanged on at least a daily basis. The exchange of variation margin ensures that cleared net

¹ See "Revision of the European Market Infrastructure Regulation", ESRB, April 2017, available at https://www.esrb.europa.eu/pub/pdf/other/20170421_esrb_emir.en.pdf.

² Throughout this letter, the term "cash" is used to refer to deposits held with a central bank or a credit institution.

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positions can be continuously valued at market prices throughout the duration of the transaction. If the market value of a net position falls, the clearing member needs to provide variation margin to the CCP. Conversely, if the market value of a net position increases, the CCP pays out to the clearing member. In other words, the CCP collects variation margin from clearing members facing a loss, and pays out gains to those whose positions have increased in value, thereby ensuring that cleared net positions always reflect current market prices.

EMIR recognises that requiring pension funds to clear OTC derivatives contracts through a CCP may lead pension funds to switch a significant portion of their portfolio from long-term non-cash assets to cash to be able to meet potential cash variation margin calls from CCPs, in particular under stressed market conditions. As cash commonly generates lower returns than other assets, higher cash holdings could thus reduce pension funds' overall returns on their investments. To avoid such a potential negative impact on the retirement income of (future) pensioners, EMIR allows for a time-limited exemption for pension funds from the central clearing obligation. This exemption – which can potentially be extended – is intended to apply until a suitable technical solution has been found for the provision of variation margin by pension funds to CCPs.

The ECB supports a broad application of the central clearing obligation. Exempting pension funds on a permanent basis would leave out an important category of active derivatives users from the scope of the central clearing obligation, potentially reducing the financial stability benefits of the reforms undertaken in the wake of the 2008 financial crisis. In fact, pension funds already use central clearing on a voluntary basis today, and mandatory central clearing would merely expand this use further. Increasing the use of central clearing could deepen market liquidity and hence reduce the costs of central clearing, thus reinforcing incentives to use central clearing for the market as a whole.

It is our understanding that there is not yet an appropriate technical solution available to resolve the challenges pension funds are facing in providing potentially large amounts of variation margin in cash to CCPs under stressed market conditions. The ECB is following the discussions under way among the various stakeholders to tackle these challenges, with a view to allowing derivatives contracts of pension funds to be included in the central clearing obligation.

Yours sincerely,

[signed]

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