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ESAs' second consultation on draft RTS on risk-mitigation techniques for derivatives not cleared by a CCP

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Contact person:	International Affairs and Reinsurance Department	E-mail:	international@insuranceeurope.eu
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Comments on the updated draft Regulatory Technical Standards (RTS)

Insurance Europe **welcomes** the changes made to some of the technical elements of the RTS, including:

- Equivalent treatment of **credit assessments from external providers** and internal models. This means that market participants, such as insurance companies, are not penalised for making use of external credit ratings.
- A **delay in the phase-in schedule** by ten months. This is, in general, welcome and needed for the operational implementation. **However**, Insurance Europe argued that the application date of rules for over-the-counter OTC derivatives should be well after the application date for central clearing requirements, allowing at least a 24 months experience in the central clearing environment to be used for the implementation of OTC requirements. This concern was not addressed in the current draft.
- Insurance Europe welcomes that a general **concentration limit for sovereign debt** has been removed in the updated daft RTS. The European Supervisory Authorities (ESAs) and the European Commission (EC) should not revert to stricter requirements regarding government bonds.

In a number of areas that are linked to the practical application of the OTC derivatives rules, Insurance Europe continues to have concerns:

- In the area of **intra-group transactions**, Insurance Europe is still of the view that a clarification on "current or foreseen restrictions" is needed. Such a clarification could read as follows: *"Restrictions shall be deemed current or foreseen if concrete restrictive actions or effects materialize or are imminent to materialize".* The element of materialisation is important to allow for an appropriate reflection of the intention of the European Market Infrastructure Regulation (EMIR), including recognition of the fact that collateralisation rules for intra-group transactions may limit the efficiency of the transactions from a risk-management perspective.
- Moreover, Insurance Europe continues to believe that the threshold of €500 000 on total collateral (ie the **minimum transfer amount** in Article 4 GEN, paragraph 1) is too low and will create an unnecessary operational burden. A more appropriate threshold would be €1m, which is a level commonly used in bilateral Credit Support Annex (CSA) agreements.

Insurance Europe aisbl
Rue Montoyer 51, B-1000 Brussels
Tel: +32 2 894 30 00 • Fax: +32 2 894 30 01
E-mail : international@insuranceeurope.eu
www.insuranceeurope.eu

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General comments on EMIR and its implementation

The strengthening of the derivatives framework in an OTC environment should **strike a balance between the need to mitigate counterparty risk and the potential economic risks and costs** that could derive from the proposed measures. Excessive requirements for derivatives may result in an excessive cost of hedging financial risks, and therefore discourage hedging operations. Furthermore, any additional costs arising out of the margin requirements will, directly or indirectly, be passed on to policyholders. Therefore, every effort should be made to ensure that costs associated with non-centrally cleared derivatives do not become prohibitively high and eventually harm policyholders.

Insurance Europe would therefore like to reiterate its concerns on the **practical implementation** of the EMIR. It appears that central clearing counterparties (CCPs) only accept **cash as collateral** and EMIR may, therefore, have a severe negative impact on insurers. As a consequence, insurers might be forced to either: keep higher cash amounts than optimal, perform forced sales or access cash trough repo markets. All of the possibilities may cause pro-cyclical behaviour on the side of the insurers in times of market stress. The practice under EMIR will, therefore, force insurers to look for liquidity and to deviate from their traditional role as long-term investors, which allowed them to stabilise the economy.

Another concern is the **treatment of insurance derivatives**. These represent instruments that are used as an alternative to traditional reinsurance for the purpose of mitigating insurance risk. Their payout is usually linked to triggers other than a policy holders' loss, for example wind speed data. Due to the link to insurance risk, insurance derivatives' impact on financial stability is minor and they should, therefore, not be in the scope of EMIR.

Other comments

Apart from the points mentioned above, there is currently no **interaction between EMIR and Solvency II** (ie Commission Delegated Regulation (EU) 2015/35) with respect to the capital charges for derivatives. EMIR and Solvency II appear to take different approaches regarding exposure to collateral and emerging counterparty default risk. There are two main areas where Insurance Europe believes Solvency II should reflect EMIR provisions:

1. Capital requirements in the current draft Solvency II rules do not **distinguish between centrally-cleared vs OTC derivatives**.

Solvency II defines capital requirements for the counterparty risk associated with derivative transactions. The current charges are, however, calibrated based on a pre-EMIR OTC environment (without taking into account eg compulsory margining and haircuts). Given the emerging rules of full collateralisation, haircuts and initial margin, the counterparty default risk charge for derivatives should be set at zero.

2. The collateral adjustment is very punitive and there is no interaction with the EMIR haircut approach.

Solvency II defines a risk-adjusted value of collateral in the calculation of capital charges for counterparty risk. The risk-adjustment for collateral is based on a stress calibrated at a safety level of 99.5% over one year. However, EMIR recognized that the haircut should be based on a ten day time horizon due to the possibility of replacing a derivative within that period. The provisions of Solvency II therefore overstate the risk and build in safety for multiple defaults in the same year.