

<p>Title: The Pension Fund Clearing Obligation Exemption and Intragroup Transaction Transitional Clearing and Risk-Management Obligation Exemptions (Extension and Amendment) Regulations 2023</p> <p>SI (Statutory Instrument) No: 2023/472</p> <p>Other departments or agencies: Bank of England, Financial Conduct Authority</p> <p>Contact for enquiries: Owen Davies owen.davies@hmtreasury.gov.uk</p>	<p>De minimis assessment</p> <p>Date: 17/04/2023</p> <p>Type of regulation: Domestic</p> <p>Date measure comes into force: 12/06/2023</p>
<p>Cost of Preferred (or more likely) Option: £750,000 (maximum)</p>	<p>Equivalent Annual Net Direct Cost to Business per year (EANDCB in 2022 prices) £750,000 (maximum)</p>

1. What is the problem under consideration? Why is government intervention necessary?

This instrument extends an exemption for pension funds from the obligation to clear their derivatives through central counterparties by two years, and exemptions for intragroup transactions by three years.

Background

Central Counterparties (CCPs) are used by firms to reduce certain risks that arise when trading on financial markets, such as derivatives and equities markets. They sit between the buyers and sellers of financial instruments, providing assurance that contractual obligations will be fulfilled. The process of transacting through a CCP is known as 'clearing'. CCPs have played a vital role in making markets safer following the 2008 financial crisis, and they help substantially in managing potential systemic risk arising from global financial transactions.

In 2009, G20 countries agreed that standardised Over-the-Counter (OTC) derivatives contracts should be cleared through CCPs. In the EU this was implemented through legislation commonly known as the European Market Infrastructure Regulation (EMIR). Article 4 of EMIR contains what is known as the 'clearing obligation' which states that certain OTC derivative contracts should be cleared through a CCP. The UK incorporated the clearing obligation into UK law when the UK left the EU and EMIR was incorporated into domestic law.

EMIR also contains risk mitigation requirements for trades that are not cleared through a CCP (often known as 'bilateral' trades). These include a requirement for counterparties to have appropriate procedures for exchanging collateral (or 'margin') on bilateral derivatives contracts they enter into.

Pension fund exemption

Since the introduction of EMIR in 2012, pension funds have been exempt from the clearing obligation. The exemption was introduced because of the specific challenges that pension funds face when clearing trades – pension funds do not usually hold large cash reserves as the low return on cash, compared to other asset classes, could impede their ability to meet their future obligations to pensioners. As noted, CCPs exist to help mitigate risk in financial markets and within this role will call on the firms that use them to provide collateral. This collateral must be provided in cash in certain instances. For pension funds to raise this cash collateral to give to the CCP, they may have to sell assets such as gilts, which can have a negative impact on

financial markets. Alternatively, the pension funds could hold larger cash reserves, but this could impact pensioners' returns.

Since the exemption was created, authorities in the UK and the EU have explored different solutions that might allow pension funds to clear without compromising the ability of pension funds to meet their obligations to pensioners. HM Treasury considers that no appropriate solution has yet been found.

For this reason, in this instrument HM Treasury exercises the power in Article 89 of EMIR (as incorporated into domestic law) to extend the exemption by a period of two years. This exemption is currently set to expire on 18 June 2023, and this instrument this will extend it until 18 June 2025. Failure to extend would result in some pension funds needing to make significant changes to the structure of their business at short notice, potentially creating risks to UK financial stability.

Temporary intragroup exemption regime (TIGER)

Intragroup transactions are used by global firms to manage risk across their businesses in different jurisdictions. There are provisions in EU law that can exempt such transactions from the clearing obligation and margin requirements, making them less costly and burdensome to administer. To benefit from these exemptions, firms must notify the Financial Conduct Authority (FCA) and demonstrate that they have satisfied certain criteria, such as having appropriately robust risk management procedures.

When it incorporated EU law into domestic law, the Treasury created a Temporary Intragroup Exemption Regime ('TIGER') to replicate the effect of existing EU exemptions. These exemptions are valuable for firms and help maintain the UK's position as a hub for financial services.

The TIGER is set to expire on 31 December 2023, and the Treasury has the power to extend it further. Failure to extend would not only be disruptive to firms' operations in the short term but may affect their view of the UK as a location for doing business in the longer term.

2. What are the policy objectives and the intended effects?

The instrument extends the pension fund exemption by two years, to 18 June 2025, and extends the TIGER by three years, to 31 December 2026. The objective of these extensions is a) to avoid the negative impacts mentioned in the section above of these exemptions expiring and b) to provide time for development and implementation of longer-term policy approaches.

3. What policy options have been considered, including any alternatives to regulation?

Please justify preferred option

Do nothing – allow the regimes to expire. This is not considered an appropriate option – as described, failure to extend the pension fund exemption could potentially cause significant disruption to pension funds and the markets they trade in, which could create financial stability risks. Failure to extend the TIGER would cause disruption to firms and affect the UK's status as a financial services hub.

Preferred option – use our legislative powers to extend the regimes, as described. This will mitigate these risks, provide continuity for firms and provide adequate time for policy development and implementation of longer-term approaches.

These extensions cannot be made without using the legislative powers.

4. Please justify why the net impacts (i.e., net costs or benefits) to business will be less than £5 million a year.

- What will businesses have to do differently?

Business will not have to do anything differently as a result of these extensions – they maintain the status quo and hence provide continuity for firms. We have therefore estimated that there are no policy costs or policy benefits, as we are maintaining the baseline position.

- How many businesses will this impact per year?

According to FCA data fewer than 100 UK firms use the intragroup exemptions in TIGER. No data is currently available on the number of pension funds that utilise the clearing exemption. According to data from The Pensions Regulator there were 33,800 UK pension schemes on 31 December 2022¹, but the number of schemes that use the exemption is likely to be significantly lower than this figure as only funds with derivative contracts large enough to meet certain thresholds are subject to the clearing obligation. These thresholds vary by the type of contract, but the smallest is an average aggregate position of EUR 1 billion for equity and credit derivatives². In addition, pension funds' derivative contracts are usually administered by asset management firms, which can manage portfolios for a large number of funds. Therefore, only a few firms are likely to be directly involved in reading the SI and interpreting its effect.

For the purposes of this impact assessment, in order to illustrate a maximum cost scenario, we have included all UK pension schemes in the familiarisation cost calculation below, but the actual number of firms affected (and therefore the total costs to firms) is likely to be much smaller.

- What is the direct cost/benefit per business per year?

Minimal. As explained above, the policy position remains unchanged as measured against the status quo baseline.

Therefore the only costs are likely to be familiarisation costs. It is assumed the affected firms could incur costs (time and labour) in familiarising themselves with the relevant instrument, though this in turn would be minimal given that the instrument maintains the status quo and does not contain any new requirements. HM Treasury calculates familiarisation costs as an approximation of the time spent reading the instrument on the basis of the word length of the instrument, the difficulty of the text based on the Flesch Reading Score and the hourly rate of an external legal expert that a business may procure to read the instrument. We do not expect these costs to be material to businesses.

Number of words in SI (rounded up)	Words read per minute	Hourly rate (£)	Number of businesses affected	Familiarisation costs per firm (£)	Total familiarisation costs (£) (rounded
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¹ <https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2022-2023>

² <https://www.fca.org.uk/markets/uk-emir/clearing-obligation>

to nearest 100)				(rounded to 2 significant figures)	to 2 significant figures)
400	100	330	33,900	£22	£750,000

As noted, the real-world impact is likely to be much lower than the figure above, but this standard EANBCD assessment resulting in a figure of £750,000 can give confidence that the impact will be significantly below the £5 million threshold.

5. Please confirm whether your measure could be subject to call-in by BRE (Better Regulation Executive) under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:

a) Significant distributional impacts (such as significant transfers between different businesses or sectors)

No

b) Disproportionate burdens on micro, small, and medium businesses (below 500 employees).

No

c) Significant gross effects despite small net impacts

No

d) Significant wider social, environmental, financial or economic impacts

No

e) Significant novel or contentious elements

No

Sign-off for de minimis assessment: SCS

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

SCS of Securities and Markets Team

Signed: ***Tom Duggan***

Date: 17/04/2023

SCS of Better Regulation Unit

Signed: ***Linda Timson***

Date: 17/04/2023

Sign-off for de minimis assessment: Minister

I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

Signed: ***Andrew Griffith***

Date: 25/04/2023