Anlage

Comments

of the German Insurance Association (GDV)

ID-Number 6437280268-55

on the Public Consultation on Regulation (EU) No 648/2012 on OTC Derivatives, Central Counterparties and Trade Reposito-ries

(EMIR-Review)

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Key Aspects

The German Insurance Industry supports the European Commission in its initiative to review the European Markets Infrastructure Regulation (EMIR). The EMIR was one of the key elements in answering the financial crises. We agree with Commission President Juncker and Vice-President Timmermans that the time is now to assess financial services regulation on a broader basis.

With respect to EMIR, we believe a clear exclusion of products related to insurance (as more clearly described below under item I. 1 b.) from the scope of EMIR is indispensable for the following reasons:

- **a) Different nature:** Products related to insurance are neither used to package and synthesize risks nor to make them tradable, as opposed to derivatives.
- **b) Different risks:** Insurers and reinsurers are using products related to insurance to cover specific individual exposures. These products are not available to the wider public on regulated markets.
- **c) Different regulatory law:** The requirements under EMIR and Solvency II are not consistent as regards risk mitigation techniques. Solvency II as the relevant insurance supervisory legislation meets the objectives and requirements of the insurance sector.

In order to conform to the comprehensive principle of proportionality, **small insurance companies should be treated like non-financial counterparties** in the context of EMIR. Because of administrative, operational and financial burdens resulting from EMIR, small insurance companies would otherwise be forced to reduce important hedging strategies for their restricted assets.

In case of **exchange traded derivatives,** the mandatory **two-side reporting does not improve data quality** and can therefore be replaced with one-side reporting.

PART I – Questions specified in Art. 85 EMIR

The GDV has no comments as regards the questions raised in Part I of the Commission's consultation paper.

Part II – General Questions

Question 2.1: Definition and Scope

i. Are there any provisions or definitions contained within Article 1 and 2 of EMIR that have created unintended consequences in terms of the scope of contracts or entities that are covered by the requirements?

ii. If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?

I. Clarification for products related to insurance

We are of the opinion that EMIR does not make it sufficiently clear that products related to insurance do not fall under its scope. Therefore, we are requesting that the European Commission clarify that such products are not regulated by EMIR by including a recital in EMIR or an amendment thereto. We believe there are compelling reasons for our request, as further described below.

1. Exempt products related to insurance from the scope of EMIR

a) Besides assuming the risks related to traditional insurance products, reinsurers also assume global risks by entering into insurance arrangements with respect to which the proof of loss is demonstrated by the occurrence of triggers based on physical and other variables, generally referred to in these comments as "products related to insurance". Examples are physical-parametric variables (earthquake/ storm intensity), insurance industry market losses (e.g. PCS, Perils), modelled-losses as well as mortality and longevity indices.

   Despite relying on physical or other variables for payout, such arrangements are nevertheless based on a typical insurance event risk. These products related to insurance rely, however, on a distinctive payout mechanism, namely the occurrence of a specified event that is usually known to cause damages to an insurable interest, though a proof of actual damages is not required.

The definition of “Derivative” or “Derivate contract” in Article 2 EMIR is not clear as to whether products related to insurance fall under the scope of EMIR. The regulation of such products under EMIR would not, however, promote the regulation’s objective of increasing transparency of derivatives and reducing the risks they pose to financial stability. In addition, the EMIR requirements are not appropriate for such products (reasoning see below).

Therefore, products related to insurance should be excluded from the EMIR initiative, for example by adopting a new recital in EMIR. This would ensure legal certainty for European insurance and reinsurance undertakings.

b) The recital requested should read essentially as follows:

> “The EMIR regulation does not apply to products related to insurance. These are products that cover insurable risks or risks related to insurance or reinsurance operations, and have effects similar to insurance, reinsurance and retrocession agreements. The underlying contracts are entered into by an insurance undertaking or an undertaking carrying out reinsurance and retrocession activities referred to in Directive 2009/138/EC on the one hand, and an insurer, reinsurer or coverage buyer which is neither a credit institution nor an investment firm on the other hand.”

2. Assessment

a) Current EMIR/MiFID provisions would already exclude most products related to insurance

Based on the definition of “Derivatives” and “Derivative Contracts” in EMIR, a strong argument can be made that most products related to insurance are not covered by that regulation because they are not derivatives.

“Derivatives” and “derivative contracts” are defined in EMIR by reference to points (4) to (10) of Annex I Section C of the MiFID Directive, as implemented by Articles 38 and 39 of the MiFID Regulation. An product related to insurance could only fall into one of the categories described in points (4) to (10) of Annex 1 if it is either an option, future, swap, forward rate agreement or other derivative contract, derivative instrument or financial contract for differences. Products related to insurance do not, however, constitute derivative contracts or any of the other items described in the relevant regulations. Articles 38 and 39 of the MifFID Regulation also only purport to regulate “derivatives”. As such, products related to insurance are also not covered by those sections, even if they are triggered by certain physical variables. As a consequence, products related to insurance generally do not fall under the ambit of EMIR.

Since EMIR does not, however, precisely state that products related to insurance are excluded from its regulatory scope, and since certain of these products relate to climatic and other physical variables described in Annex I Section C of the MiFID Directive and Articles 38 and 39 of the MiFID Regulation, a clarification is necessary in order to provide legal certainty to the insurance industry.

b) Regulating products related to insurance is not one of the purposes of MiFID and EMIR

According to Article 2, 1 (a) of MiFID, the directive does not apply to insurance undertakings or undertakings carrying out reinsurance and retrocession activities. This is appropriate and necessary for the regulatory purposes and provisions of MiFID/MiFIR. But the definitions of Annex I Section C MiFID have a direct impact on the EMIR regulation, which could in turn have an impact on the regulation of products related to insurance. The writers of MiFID were not even aware that the definitions they wrote might be used this way and did not take such products into account in drafting MiFID. Thus, for the purposes of EMIR the definition under MiFID is not sufficiently precise.

The objectives of EMIR are increasing the transparency of derivatives and related markets as well as reducing their impact on financial stability. In order to fulfil these objectives, it is important that the categories of financial instruments regulated under EMIR are those which pose risk to financial market stability.

The derivative definition under MiFID is overarching and vague for EMIR-purposes. Innovative, alternative, business models, such as the products related to insurance described above, are vital for global economic development. An overly broad regulatory scope of EMIR bears the risk of making such products economically unviable (e.g. due to collateralisation). The result would be the loss of an important source of liquidity to parties with insurable interests.

c) **EMIR requirements are not appropriate to products related to insurance**

The EMIR requirements cannot be appropriately applied to insurance-related products used for the alternative transfer of insurance risks. This is due to the major differences between derivatives and the products related to insurance set out above. The risk-mitigation techniques under EMIR are far less suitable and effective for managing the risks of insurance products than the highly specialised risk management system of insurance and reinsurance undertakings as required by Solvency II.

In addition, basic requirements, like a daily mark-to-market valuation are not possible, given that products related to insurance do not have a market value. Payment obligations arising from such special insurance products are generally triggered by the occurrence of natural events, such as storms or earthquakes.

These products are tailor-made risk transfer arrangements for the individual risk exposures of policyholders. Therefore, the number of business transactions between the same parties is usually very limited, which makes the requirement of regular portfolio reconciliations inappropriate.

Furthermore, the collateralisation of such products is not feasible, given that it would make these economically important insurance arrangements too expensive.

3. Appropriateness of the result

Clearly excluding products related to insurance from the scope of EMIR is appropriate for the following reasons:

a) **Different nature:** Products related to insurance are neither used to package and synthesize risks nor to make them tradable, as opposed to derivatives. They provide coverage for the risk situation of individual policyholders as precisely as possible. They do not entail the risk of systemic knock-on effects or financial stability risks.

b) **Different risks:** Insurers and reinsurers are using products related to insurance to cover specific individual exposures. This is why such products are not available to the wider public on regulated markets. As a general rule, such products are bilateral contracts which neither include nor multiply any financial risks. Consequently, they do not pose any risk to the financial system.

c) **Different regulatory law:** The requirements under EMIR and Solvency II are contradictory, e.g. regarding the collateral requirements for the products they regulate: Article 11 (3) of EMIR explicitly requires the exchange of collateral. The legal situation in insurance supervisory law is the exact opposite: it follows from Art. 105 (6) of the Solvency II Directive that no collateral requirements apply to the products referred to in that paragraph. The paragraph only requires "collateral or other security held by or for the account of the insurance or reinsurance undertaking and the risks associated therewith" to be appropriately taken into account in the calculation of the solvency capital. Owing to the fact that both Art. 105 (6) Solvency II and Art. 11 (3) EMIR address the issue of counterparty default risk, these regulations are clearly inconsistent with one another. Both Directives have been adopted in order to ensure the "stability of the financial system", but only Solvency II is the relevant insurance supervisory legislation and therefore perfectly suitable to meet this objective in the insurance sector.

This assessment is expressly <u>confirmed by ESMA</u>'s final report on its technical advice to the Commission on MiFID II and MiFIR of 19 December 2014 (page 421, point 13):

> "*Respondents were skeptical in respect of this proposal, considering that they do not see much reason for expanding the scope to contracts with actuarial statistics as the underlying. <u>One respondent, in addition, cited concerns that introducing actuarial statistics may cause an overlap and inconsistencies with insurance regulation. Hence, ESMA decided not to pursue this proposal further</u>.*"

II. Definition of financial counterparty, Article 2 (8) EMIR

In order to conform to the comprehensive principle of proportionality, **small insurance companies should be treated like non-financial counterparties**.

According to the German Act on the Supervision of Insurance Undertakings, insurance companies are only permitted to carry out non-insurance business as it is directly related with insurance business. Such a relationship is deemed to exist in the case of dealings in futures, options and other financial instruments if these are to serve

a) as **hedge** against price and interest rate risks in connection with existing assets

b) or **future purchases** of securities

c) or if **any additional return** is to be generated on existing securities, without performance of delivery obligations causing a shortfall of the restricted assets.

The trading and dealing of financial derivatives without a connection described above is therefore not permissible. Insurance companies predominately use financial derivatives to carefully **hedge parts of their restricted assets** "Gebundenes Vermoegen", which cover the insurance companies' liabilities against their insurance clients. These hedging strategies - and the corresponding acquisition of financial derivatives on the buy-side - are important instruments of the insurers' asset liability management.

Since the stepwise introduction of EMIR, small insurance companies are forced to reduce the use of such important hedging tools, because they cannot stem the administrative, operational and financial burdens of EMIR anymore. **Small insurance companies sustain competitive disadvantage** if they cannot hedge their portfolios at reasonable costs against future risks.

Question 2.3: Trade reporting

i. Are there any significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations in accordance with Article 9 of EMIR?

ii. If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?

III. Two-side reporting, Article 9 EMIR

For **exchange traded derivatives** two-side reporting seems unnecessary. The parties acquire and sell derivative products under the respective market places conditions, so that **all details are agreed and no dispute can arise**. In case of exchange traded derivatives the mandatory **two-side reporting does not improve data quality** and can therefore be changed into one-side reporting.

Berlin, August 7, 2015