I offer pension scheme, asset management and corporate clients services in the following areas:

- *Building the case for strategic change*
- *Information gathering and decision-making support*
- *Assistance in execution/implementation of decisions*
- *Getting the most out of your current advisers*
- *Building of reporting and governance platforms*
- *Trustee training*
- *Independent Trustee / Non-Executive Directorships*

Please contact me on 07799 370585, enquiries@veaseyassociates.co.uk or visit my website www.veaseyassociates.co.uk for my full range of research and commentary on UK pensions.

Central Clearing of Derivatives - EMIR Update

26th January 2012

There has been some relief in the pensions area, and in investment management in general, that we have been granted a three-year exemption from the European Markets Infrastructure

Regulation requirement that over the counter derivatives should be centrally cleared through exchanges.

Pension schemes which have established swap-based liability hedging programs would be particularly badly hit, though the legislation would extend to the use of derivatives in other areas: such as bond fund management, where they are routinely used to manage duration and credit risk.

The two keys areas of concern are as follows:

- We are well used to the practice of posting "variation margin" - pledging collateral where we owe our counterparty money and receiving vice-versa. Pension schemes have been used to being able to pledge gilts, but the exchanges are pushing for cash to be used exclusively.

  As returns on collateral flow back to the asset owner and cash yields are far below gilt yields (even today), this would force schemes to either cash out gilt holdings used for this purpose or to use repos to borrow cash against them

- The practice of "initial margin" is new for the over the counter market - the pledging of a large block of permanent collateral to the exchange to cover the risk of changes in market value following a possible default.

  This pledge is expected to be able to be made as gilts or cash but, as an additional commitment, will unnecessarily use up scarce scheme collateral capacity. This, in turn, may mean that schemes are not able to hedge liabilities to the same extent as previously planned.

  The real issue here is that the level of initial margin is not risk adjusted, so pension schemes are subsidising higher risk participants such as investment banks and hedge funds

Pension schemes should consult with investment advisers and managers to determine what action is being taken to protect their interests in this. It is worth noting that legislators and regulators particularly welcome feedback from investors and direct users and the more sophisticated schemes could consider this form of direct engagement.

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