European Association of CCP Clearing Houses

EACH Note – Access to SFT clearing for insurance undertakings in Solvency II

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1. Background

For many years, European financial institutions have voluntarily cleared securities financing transactions (SFT), including repurchase (repo) transactions, due to the benefits of centrally cleared SFT markets and their reliability even in times of market stress. More recently, prudential regulators have also recognized the need to promote central SFT clearing in response to disruptions of uncleared SFT markets[1], as reflected in the U.S Treasury clearing mandate[2], similar initiatives by the Bank of England[3], and the latest FSB report on leverage in non-bank financial intermediation[4].

The insurance industry, as one of the largest institutional investor groups in the EU, is a key participant in EU SFT markets. CCPs have developed direct and sponsored access models specifically designed to address the needs of non-bank financial institutions (NBFIs), including insurance companies, with a view to facilitate access to central clearing by a broader range of market participants and support the diversification, stability and liquidity of the EU's SFT markets. However, under the current capital treatment rules of the Solvency II Delegated Regulation (Commission Delegated Regulation (EU) 2015/35[5]), insurance companies are disincentivized from using such CCP access models and building direct CCP exposure.

The forthcoming relief from the currently unfavourable capital treatment of (re-)insurers directly accessing CCP-cleared derivatives as recommended by EIOPA[6] and recently proposed by the European Commission[7] for the revision of the Solvency II Delegated Regulation marks a welcome step toward encouraging greater central clearing adoption among insurance companies.

This note describes the rational for NBFIs use of central clearing services by CCPs and suggests next steps to ensure they can fully benefit from the advantages of central clearing through adequate an adequate capital treatment.

The note concludes that EACH would appreciate guidance from the European Commission as to whether the preferential treatment of direct CCP SFT exposure shall be granted and if EACH can support the European Commission and EIOPA with their further assessment of changes to the capital requirements methodology in this respect. EACH would also welcome feedback on the timeline foreseen by the European Commission.

[1] https://www.congress.gov/crs-product/IF12012
[2] https://www.sec.gov/files/rules/final/2023/34-99149.pdf
[3] https://www.bankofengland.co.uk/news/2025/september/boe-launches-discussion-paper-seeking-views-on-measures-to-enhance-gilt-repo-market-resilience
[4] https://www.fsb.org/uploads/P090725-1.pdf
[5] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0035
[6] https://www.eiopa.europa.eu/publications/technical-advice-standard-formula-capital-requirements-direct-exposures-qualifying-central_en
[7] https://finance.ec.europa.eu/document/download/083d4c4a-e66e-492c-a8f4-14ed122df302_en?filename=solvency2-delegated-regulation-

2. Central clearing of SFTs – Rationale

NBFIs' SFT market has increased dramatically over the last decade and there is an over-reliance on banks' intermediation, as NBFIs cannot face other NBFIs directly either due to regulatory requirements or due to internal risk management constraints (e.g. counterparty type, maturity transformation).

Repo has a large footprint on the banks' balance sheet and in a context where banks are constrainted in term of financial resources allocation to NBFIs (being Leverage Ratio or RWA). Central clearing maximises netting opportunities for Leverage Ratio calculation and allows banks to offer wider liquidity access. This is especially true during period of stress where clearing acts as a release valve. To address the financial stability as well as liquidity risks stemming from uncleared SFT markets, the ESRB has recommended[8] to remove impediments to central clearing for NBFI entities (including insurance companies). The current unfavourable capital treatment of SFTs under Solvency II is one of such impediments which should be addressed.

Insurance companies are mainly net cash lender and fuel the repo market for liquidity. If the insurance sector does not have an incentive to centrally clear SFTs, the cash redistribution to the system will be limited and may lead to a dislocation of the liquidity transmission channel potentially resulting into stressed de-leveraging for net cash borrower NBFIs. This could pose a systemic risk for the financial market and centrally cleared repo transaction could act as a protection layer by providing liquidity in periods of stress or volatility.

Whilst insurance companies are not the biggest users of SFTs, their capabilities to access liquidity to be able to meet their requirement for policy holder is critical.

CCPs have developed direct access models allowing NBFIs, including re-insurance undertakings, to access central clearing in addition to the traditional client clearing relationship. Several (re-)insurance undertakings are using the different models to access CCPs and centrally clear their OTC derivatives and, to a smaller extent, SFTs. Notably, there are already several EEA (re-) insurance undertakings that use or are assessing the use of those access models of, for example, Eurex Clearing AG and LCH for clearing their derivatives and SFTs. CCPs also support (re-)insurance companies to become full clearing members (up-to-date member lists are available on their websites).

[8] 'A system-wide approach to macroprudential policy' ESRB (2024), Page 84 first paragraph, available for download here: https://www.esrb.europa.eu/pub/pdf/reports/esrb.response_ecconsultation202412~4a44bca53f.en.pdf?a3336ab4366e38395ca744f2d85cc079

In this context, it should be noted that the clearing access models under which NBFIs such as insurance undertakings access CCPs differ depending on asset classes. For derivatives, insurance companies tend to use an indirect clearing access, while for SFTs they would typically use direct access through sponsored models that CCPs have developed, whereby insurance companies directly face the CCP. Key drivers for (re-)insurance undertakings to opt for a direct CCP membership are their benefit from increased clearing capacity, improved operational resilience and mitigation of counterparty credit risk in comparison to traditional client clearing models. It is important to note that the choice of access to a CCP for insurance companies relies mostly on the impact it has on the clearing member (the broker/dealer), whether they are acting as an intermediary for derivatives or as a sponsor for repo transactions.

With insurance undertakings being key institutional investors that increasingly hedge their risk by using centrally cleared markets, it is essential to ensure both broad access to central clearing and efficiency.

3. Central clearing of SFTs – Use cases

The use of SFTs can encompass a vast variety of activities. Focusing on insurance companies, SFTs would be used for three main purposes:

1. **Collateralized lending** that would allow insurance companies to maximize their return whilst protecting their policy holder money;
2. **Interest Rate Hedge** given the high exposure of insurance companies to interest rate risk;
3. **Funding Management:** Whilst insurance companies are traditionally "cash rich entities", their increased footprint on centrally cleared transactions (mainly OTC derivatives and FX transactions) increase their need for short term funding to be able to cover the variation margin the CCPs would call as part of the life cycle of the trade.

Repo transaction would be a natural fit for funding management, and this can be operated into both a bilateral basis and in centrally cleared framework.

On a bilateral basis and given the impact of repo transaction on the banks' balance sheet, any shock onto the market would render liquidity access very difficult for insurance companies. Indeed, they usually are not the most active on the repo market and if a bank had to discern its financial resources allocation to counterparty, insurance companies would certainly be affected as they would not be able to access liquidity through their usual channels forcing them to deleverage.

In that case, centrally cleared repo transactions appear as a viable solution as banks would be able to net the repo and the reverse repo (match book) neutralising any impact on its balance sheet through the netting criteria for the Leverage Ratio Exposure.

4. Central clearing of SFTs – Regulatory challenges: current situation

But unlike for OTC derivatives that have a small footprint on Balance Sheet, repo transactions can only be netted if the insurance companies is a direct member of the CCP; hence the development of the Sponsored Model.

Indeed, through an indirect model, the insurance company and the Broker would benefit from the relief on the Balance Sheet impact that would now be bear by the Clearing Member porting the trade into the CCP. In reality, the balance sheet impact is then not muted but just transferred from the Broker to the Clearing Member who would have no benefits from porting the transaction onto a CCP.

Whilst there is specific treatment into the Basel Framework for centrally cleared OTC derivatives transactions that allow to get some reliefs for indirect clearing, SFTs only have relieves when centrally cleared for direct clearing.

In the current state of regulations (CRR and Solvency II), intermediaries are reluctant to offer indirect clearing for SFTs, and insurance companies are not getting any beneficial treatment for centrally cleared repo compared to bilateral.

In BAU environment, intermediaries are able to absorb liquidity demand and insurance companies have no interest in centrally cleared SFTs. But given the increasing demand for liquidity access and given pressure on intermediary on both Balance Sheet and RWA, a process that allow liquidity transmission is required.

Until Solvency II recognizes and treats direct centrally cleared SFT transactions, insurance companies would not have access to a secured and stable access to liquidity exposing them to any shock on the market, including VM spike called by CCPs. This is even more palpable given the over reliance of insurance companies to credit institutions for liquidity access.

Several reports from regulatory bodies have pointed out the systemic risk posed by NBFIs through stressed deleveraging and insurance companies would not be immune from this risk although less exposed than other type of NBFIs.

Promoting centrally cleared SFTs through recognition of direct clearing and the subsequent capital treatment would encourage insurance companies to clear more transaction and then mitigate their liquidity risk.

Whilst this model access would not necessarily be the go-to route for BAU refinancing, it would guarantee liquidity access when most needed and then protect insurance companies and the wider financial market.

5. Central clearing of SFTs – Regulatory challenges: Classification of SFTs as Type 1 exposures under Solvency II

EACH understands that the European Commission proposes the re-classification of SFTs as type 1 exposures for (re-)insurers' calculation of capital requirements[9]. We also understand that the European Commission believes that the classification as type 2 exposures would have resulted in too conservative capital requirements for (re-)insurers' and prevented an extension of the preferential capital treatment of direct CCP-derivatives exposures to SFTs. Hence, EACH welcomes the European Commission's reclassification proposal.

However, it is not fully clear yet if the preferential approach taken for direct CCP derivatives exposures shall be explicitly extended to SFTs on the back of the reclassification. Nevertheless, EACH understands as well that the European Commission, together with EIOPA, aims to assess further changes to the capital requirements regime with a view to reflecting the risk-mitigating effect of CCP clearing. EACH would welcome if a practical solution to address the remaining disincentive to central clearing of SFTs would be found.

Classification of asset under type 1 or type 2 is mainly driven by two factors:

1. Counterparty credit risk
2. Counterparty type and or rating

- **Credit Risk**

  The counterparty credit risk factors in the complexity of modelling this risk. More complex products are classified as Type 1 whereas instrument for which risk measurement is deemed to be simpler are classified into Type 2.

  When looking at the counterparty credit risk, for a repo transaction, it could be convenient to consider the risk as the difference between the cash lent and the value of the collateral.

  Indeed, repo transactions are collateralised transactions that offer a protection to the seller (cash lender) in case of default of its counterparty (cash borrower).

  In case of default of the counterparty, the collateral would be transferred to the remaining counterparty and selling such collateral back on the market would cover a large portion of the non-recovered cash.

[9] https://finance.ec.europa.eu/document/download/083d4c4a-e66e-492c-a8f4-14ed122df302_en?filename=solvency2-delegated-regulation-2025_en.pdf#:~:text=The%20review%20of%20Commission%20Delegated%20Regulation%20(EU),as%20underlined%20in%20the%20Commission%27s%20Competitiveness%20Compass2.

To that extent, repo transaction could be looked at as risk mitigated transaction, but it is important to stress some of the specific repo market features:

- On bilateral basis, most transactions are conducted with zero haircut due to commercial pressure ignoring the counterparty credit risk and the quality/volatility of the underlying used as collateral.
- Whilst the mitigation effect of the collateral transfer in a repo agreement transaction is broadly recognised; it is also important to factor in 2 variables that can affect the value of the collateral/

- **Concentration risk**

  The concentration into a single collateral issuer that could shift the market value of this collateral when selling large notional on the market.

  Whilst no one dispute the liquidity of the collateral used (Sovereign bonds or HQLA), in period of stress (e.g. LDI crisis) market price of HQLA can de-peg from their theoretical price, generating a replacement cost loss when selling these asset to recover the cash lent to the defaulting counterparty.

  In the current bilateral market, concentration risk and its implication on the liquidation value of the collateral is not factored in which contradicts requirements of article 214 (1) (b) i "*sufficiently stable in value*";

- **Wrong way risk**

  Moreover, securities put as collateral are frequently from the same region to not say from the say same issuing country as the counterparty providing collateral and there is in this case inevitably a correlation between the state of the economy of the issuing country and the potential impact of the government state on the counterparty viability. This relationship should be captured through Wrong Way Risk correlation.

  This relationship ignored in Type 2 contradicts the principle enacted in article 214 (2) b (ii) and 214 (2) c "*there is no material positive correlation between the credit quality of the counterparty and the value of the collateral;*

  The concentration module is defined in Article 182 and repo agreement made on a single country issuer would naturally fall under this requirement if classified as Type 1.

- **Counterparty type** (The rating of the counterparty)

  Type 2 counterparty would be mainly appropriate for unrated counterparty in the similar approach as the Basel Framework under the IRB approach.

  As explained in preamble insurance companies rely on banks for intermediation of rpeo

intermediation and given regulatory constraints on credit institutions (banks), none of them acting on the repo market are unrated.

- **Risk measurement**

  Finally, when recognising the collateral as risk mitigant, it is accepted that the "exposure at default" for a SFT transaction is:

$$E^* = \max\left\{0\,, \left(E \times (1 + H_e) - C \times \left(1 - H_c - H_{fx}\right)\right)\right\}$$

  Where:

  E* is the adjusted exposure value after risk mitigation;
  E is the current marked-to-market value of the exposure;
  H_e is the haircut appropriate to the exposure (see rule 4.5.18);
  C is the current marked-to-market value of the collateral;
  H_c is the haircut appropriate to the collateral (see rule 4.5.18).
  H_{fx} is the haircut appropriate for the currency mismatch between the collateral and the exposure.

  This approach is very similar to Article 192 of Solvency II Delegated Regulation (Loss-given-default) where the value of the collateral is adjusted by a factor F where *"F denotes a factor to take into account the economic effect of the collateral arrangement in relation to the reinsurance arrangement or securitisation in case of any credit event related to the counterparty."*

  When comparing to OTC derivatives, it is important to note that for bilateral OTC derivatives, an Uncleared Margin Requirement (UMR) is required. This framework will impose the calculation and the payment of both initial margin and variation margin.

  Initial margin would then act as a buffer for the potential future exposure and variation margin will adjust the mark to market valuation adjustment. Whilst calculation differ, the same principle applies when such transactions are cleared.

  For repo transactions, there is no UMR and the market practice is to only impose Variation Margin that factored in the level of rates and the price of the collateral.

  It is important to note that under normal market conditions, price movement of government bonds (used as collateral is relatively stable).

  The absence of initial margin collection and haircut could lead to a wider loss may the counterparty default compared to an OTC derivative despite the repo transaction being a collateralised one.

For all the reasons, it seems inappropriate to classify Security Financing Transaction as Type 2 as this would ignore some underlying risk that would materialise when liquidating the collateral to recover the cash and undermine market dynamics in period of stress. This lag of risk management can then hide potential future loss for insurance companies forcing them to absorb loss that were not appropriately capitalised.

We also would like to seize this opportunity to suggest the following amendment to point (g) of Art. 189(2) to include reverse repo agreements in the proposal to re-include all SFTs in the Type 1 exposures:

(a) in paragraph 2, the following point (g) is added:
Article 189 is amended as follows:
'(g) repurchase transactions ***or reverse repurchase transactions****, and securities lending or borrowing transactions;*

6. Conclusion – Good progress and guidance from the European Commission

EACH calls for insurance undertakings not to be penalised from a capital perspective when accessing CCPs directly through new access models to centrally clear SFTs. We however understand that the highly welcomed changes to the capital treatment of centrally cleared OTC derivatives may not easily be extended to SFTs under the current rules:

- On 30th January 2025, EIOPA provided a technical advice to the European Commission suggesting not to extend the scope of its advice to SFTs and hence, not provide a more favourable capital treatment for direct CCP-SFT exposure.
- On 4th December 2024, EIOPA consulted amongst other on the classification of SFTs as a type 2 exposure to align the current classification in the EIOPA guidelines with the Level 1 text and differentiate the capitalization methodologies of derivatives and SFTs. However, in case SFTs are treated as type 2 exposure, the approach taken for OTC derivatives, which are type 1 exposures, cannot be transposed to SFTs.
- On 18th July 2025, the Commission proposed amendments to the Solvency II Delegated Act which includes the favourable capital treatment of direct CCP exposure for derivatives. It seems like the Type 2 exposure classification proposed by EIOPA may have been adopted prior to the publication of the Commission's revision of the Solvency II Delegated Act, because the Commission's proposal re-classifies SFTs as type 1 exposures for the calculation of capital requirements. Despite the reclassification it seems like the preferential capital treatment of direct CCP derivatives exposure may however not explicitly be extended to SFTs yet but, that further work shall be assessed by the Commission and EIOPA.

Given the current legal ambiguity, EACH would appreciate guidance from the European Commission as to whether the preferential treatment of direct CCP SFT exposure shall be granted and if EACH can support the European Commission and EIOPA with their

further assessment of changes to the capital requirements methodology in this respect. EACH would also welcome feedback on the timeline foreseen by the European Commission. EACH understands that the revision of the Solvency II Delegated Act shall be finalized until the end of the year. It is not fully clear yet, if the announced assessment of further changes to the capital requirement would be part of the revised Delegated Act or if it would follow afterwards.