LSEG Response to the European Commission Proposal on the ESA Review

Introduction

- **About London Stock Exchange Group.** London Stock Exchange Group ("LSEG" or "the Group") is a financial market infrastructure provider with significant operations in Europe, North America and Asia. Its diversified global business focuses on four key areas:

  1) Capital formation – operation of a range of regulated markets and MTFs across asset classes including London Stock Exchange and Borsa Italiana, AIM / AIM Italia the SME Growth Markets as well as Turquoise (pan European equity trading venue) and MTS (pan-European Sovereign bond venue). Through its platforms, LSEG offers market participants, including retail investors, institutions and SMEs unrivalled access to Europe's capital markets. The Group also plays a vital economic and social role, enabling companies to access funds for growth and development.

  2) Intellectual property – Through FTSE Russell, the Group is a global leader in financial indexing, benchmarking and analytic services with approximately $15 trillion benchmarked to its indexes. The Group also provides customers with an extensive range of data services, research and analytics through Mergent, SEDOL, UnaVista, XTF and RNS.

  3) Post-trade services – majority ownership of the multi-asset global CCP operator, LCH Group ("LCH") and the Italian clearing house CC&G and Italian CSD Monte Titoli. LCH has subsidiaries in the UK (LCH Ltd), France (LCH S.A.), and the US (LCH LLC). LCH serves both venue and OTC trading across many asset classes notably interest rate swaps and repos inter alia.

  4) Technology services – trading, market surveillance and post trade systems for over 40 global organisations. Additional services include network connectivity, hosting and quality assurance testing with the capacity to analyse Fintech both from a provider and a user perspective.

- **LSEG is delighted to respond to the European Commission (the 'Commission') consultation on the review of the European Supervisor Authorities (ESAs).** We support the objectives of the Commission to ensure a level playing field across the Single Market. We agree with the principle of supervisory convergence in order to reduce any real or perceived regulatory arbitrage between jurisdictions. At the same time we agree with the Council that some recalibrations of the proposal are needed to ensure an effective balance of powers and governance oversight for ESMA, with a more incremental approach towards building a single capital markets supervisor. We believe that any increase in ESA powers should be complemented by appropriately enhanced accountability and a correctly calibrated framework of decision making drivers including objectives that support international competitiveness and growth as well as financial stability. In particular we propose five key enhancements which a transformed 'new ESMA' must possess in order to support its important mission and set out three policy tests to determine which direct supervisory powers should be granted to ESMA. We also suggest a new model of direct extraterritorial licensing for ESMA to supervise third country financial institutions with direct application of the *acquis,* underpinned by regulatory co-operation but without duplicative equivalence assessments.

- **In this paper** we explain the key principles underpinning our recommendations and provide suggestions for how the proposal could better meet its objectives. Our key principles apply across all ESAs. However in this paper we focus on ESMA as this is the European Supervisory Authority ('ESA') (i) for which the Commission has proposed the greatest enhancements of power, (ii) that has to play a

role in delivering a successful Capital Markets Union and (iii) with which LSEG businesses are principally engaged. There are four sections: 1. ESMA's powers over financial institutions; 2. ESMA's powers in relation to third countries (Article 33); 3. ESMA's powers in relation to national competent authorities (NCAs) and 4. ESMA's governance.

We call on the Commission to raise the profile of the ESA review with market participants and encourage them to engage with the process. Industry players are focused on MiFID II/R implementation and need to understand the significance of the ESA review and its interconnectedness with multiple other critical regulatory proposals (e.g. EMIR 2.2).

Suggested key Principles for the ESA Review

- **The co-legislators should assess the impact of the ESA review against the full context of relevant dossiers** (e.g. EMIR 2.2; ECB Article 22; CCP R&R). An appropriate balance of powers between all relevant regulatory organisations should be established with the complete picture in mind. In addition a clear vision for ESMA's role must be defined, particularly in respect of its direct supervision of CCPs and the interplay between the ESMA Executive Board and the CCP Executive Session. In our view the balance between different aspects of ESMA comprises: 1) Standard Setting; 2) ESMA's practices as a supervisory body for EU institutions; and 3) as licensor of third country financial institutions.
- **Transformational enhancement** is needed for ESMA if it is to deliver its objectives effectively with a significantly increased mandate and powers. 'New ESMA' must be a fundamentally enhanced organisation if it is to be able to effectively play a greater role in supervision. Significant investment in technology and experienced staff would need to be made, which would take considerable time. In addition, an enhanced ESMA would demonstrate enhanced transparency, with appropriately calibrated decision-making oversight to complement an increase in powers.

FIVE KEY ENHANCEMENTS WHICH 'NEW ESMA' MUST POSSESS TO COMPLEMENT ITS INCREASE IN POWERS AND SUPPORT ITS IMPORTANT MISSION

We support an enhanced role for ESMA and to make it work effectively the following features are needed:

1. **Accessibility.** ESMA should be provided with the necessary resources to enable it to maintain close and continuous contact with their supervised entities, supported by trusted and named relationships at all levels and efficient processing times.

2. **Empowerment.** ESMA cannot have its ability to act unduly hampered by other regulatory players (e.g. Central Banks of Issue) otherwise it cannot deliver its objectives appropriately and in a timely fashion.

3. **Accountability.** ESMA deserves an enhanced oversight structure in order to ensure even greater transparency with market participants (e.g.in designing the Executive Board; supporting ESMA with the necessary powers to consult on Q&As and provide rationale for product assessments etc.).

4. **Proportionality.** Building on ESMA's targeted approach, future supervisory tools should continue to be deployed with the principle of proportionality in order to avoid undue burdens which can lead to increased costs faced by end users (e.g. a reasonable qualification of powers to request information; delegation powers etc.).

5. **International Competitiveness.** ESMA should be empowered with an objective to support the international competitiveness of Capital Markets Union in order to ensure that Europe is well positioned to take full advantage of global growth opportunities. The founding text should also be consistent with global frameworks (FSB, IOSCO).

THREE TESTS FOR DIRECT ESMA SUPERVISION IN THE CURRENT PROPOSAL

i. **Systemic impact.** Where there are links with European and global financial stability in the event of stressed market conditions, there is a stronger role for centralised supervision to play (e.g. CCPs and Critical Benchmark Administrators). The FSB defines systemically important financial institutions (SIFIs) as those whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity.

ii. **Significant cross-border activity.** If financial activity can be demonstrated to have a significant cross-border footprint then there may be a more coherent case for pan-EU oversight (e.g. Central clearing).

iii. **Clearly defined and manageable set of market participants.** If the set of financial institutions is sufficiently homogeneous and limited in number, with a clear and commonly applied regulatory framework, then ESMA direct supervision is more feasible and appropriate. However, this test is not met in others cases (e.g. prospectus approvals) where there is a vastly heterogeneous group of institutions involved in related activities governed by a multiplicity of regulatory frameworks.

1 ESMA's powers over financial institutions

CCPs

- **The ESA Review, EMIR 2.2 and Article 22 of the ECB statute.** LSEG considers that the supervisory arrangements set out in EMIR 2.2, the ESA review and Article 22 of the ECB statute are linked, specifically in relation to the future direct recognition and supervision of some third country financial institutions. This is acknowledged by the Commission's drafting in the new Article 47 of the ESMA Regulation which states that the ESMA work programme prepared by the Executive Board will "includ[e] a part on CCP matters". Therefore, it is important that the considerations and feedback provided in respect of the EMIR 2.2 proposals are read together with the ESA Review. the proposed changes to Executive Board and potential interaction with the CCP Executive Session should be considered together.

  Executive Board

  The revised Article 45 of the ESMA Regulation indicates that the Head of the CCP Executive Session shall participate as an observer to all meetings of the Executive Board. Where there are powers or actions that the Executive Board could take which would impact the supervision of CCPs by ESMA or application of rules by the College, we believe that the Head of the CCP Executive Session should be

able to participate in such decisions, or that the decisions could only be taken by the Executive Board where the CCP Executive Session does not object (similar to those proposals for decisions that are relevant to the central bank of issue under EMIR 2.2.)

Central banks of issue

The proposal does not adequately address the division of responsibility and powers between the CCP Executive Session, the Executive Board and Central Banks of Issue. LSEG believes that the rationale for including Central Banks of Issue in the decision-making process and oversight of CCPs is to allow them to perform their role in relation to the application of monetary policy and not create a duplicative supervisory role. As currently drafted in EMIR 2.2, Central Banks of Issue will have an effective veto over decisions related to prudential matters for CCPs as well as an ability to impose additional conditions for recognition of third country Tier 2 CCPs, regardless of their potential impact on monetary policy. This is likely to lead to imbalances compared to the role of the CCP Executive Session itself or ESMA's Executive Board and will complicate decision-making.

While it is proposed that Central Banks of Issue will have an effective veto over prudential matters of CCPs, they will also be members of the CCP Executive Session (as non-voting members). This has the potential to undermine further the actual powers of the CCP Executive Session and duplicates the role of supervisors over CCPs. The need to obtain approvals from four different supervisory bodies (NCA, CCP Executive Session, Executive Board and Central Banks of Issue) following four separate decision-making processes in respect to prudential aspects of CCPs and/or issues linked to monetary policy is likely to lead to increased divergence and inability to make required changes to margin or risk methodologies in a responsive and prudent manner to market and risk developments. Instead of providing a veto through the EMIR 2.2 "Consent" procedure (as per Article 21b of EMIR 2.2), Central Banks of Issue could instead have restricted voting rights within the CCP Executive Session for some prudential matters and have these responsibilities separated from their role in respect of implementing and safeguarding monetary policy.

Co-decision process

The proposals under EMIR 2.2 (including the change to Article 22 of the ECB Statute) are currently in the process of co-decision and the issues surrounding CCP supervision and the relationship of the CCP Executive Session are best dealt with under the EMIR 2.2 dossier as opposed to the ESA Review itself. However, LSEG understands that the negotiations in respect of the organisation and function of the ESAs (ESMA in particular) require their own legislative workstream to address the ESA regulations themselves. We support the fact that the arrangements for the CCP Executive Session and direct supervision over EU and third country CCPs are being dealt with in the EMIR 2.2 legislative workstream and agree that it is the right set up. In particular the composition of the CCP Executive Session should be discussed in detail and ensure that the relevant NCAs are represented when decisions are adopted on a specific CCP. This would imply a selection procedure for the NCAs to be part of this CCP Executive Session in a manner equivalent to that of Article 18 of EMIR. It is only once the key concepts are finalised within the EMIR 2.2 legislative workstream that they should be reflected in the drafting changes necessary under the ESA Review.

- **Direct supervision and application of EMIR**. LSEG recalls that international cooperation on regulatory requirement for and supervision of CCPs has intensified considerably in recent years, recognising the global nature of many of these institutions and the global markets in which they operate.

LSEG supports in principle the EMIR 2.2 proposal that Tier 2 third country CCPs would have to register with and be subject to direct supervision by ESMA and be compliant with the relevant prudential requirements under EMIR. Through proportionate direct registration and supervision (similar to the DCO regime used by the CFTC in the USA and in close coordination with the Home Authority) CCPs would have greater assurance and transparency that their operations in the EU are compliant with regulatory requirements and can continue to operate under the full expectations of the EU market supervisor. This close relationship with local supervisors could help further protect financial stability in general, clearing members and participants. LSEG has maintained this position in other marketplaces and throughout the development of its clearing services LCH Ltd has chosen to operate a proportionate direct registration model to serve its clients in the jurisdictions where this option was available. LSEG is and remains a strong supporter of the robust EMIR framework, which appropriately protects CCPs, their members, clients and the broader financial system against financial distress and has proven efficient in doing so through the most recent financial shocks.

- **The example of other jurisdictions' supervision model and equivalence.** We understand that the rationale for the system of direct supervision of non-EU CCPs is partly based on the model of supervision used by other jurisdictions including that in the US. However, there are key differences in this model of supervision versus that discussed in the ESA Review and EMIR 2.2.

  In the experience of LSEG, the majority of jurisdictions around the globe adopt a more proportionate approach to the one proposed by the Commission as only the services provided in that jurisdiction are effectively covered by a licence from local authorities. In practice, local supervisors may focus their attention even more particularly on specific participants in one service. Further, where the nature of a service being provided is of minimal size or impact in that jurisdiction, authorities may allow the CCP to operate under an exemption or other more limited arrangement. For example, the CFTC supervision of CCPs is directed at specific US-focussed provisions of CCP services and does not seek to supervise services and products outside of its jurisdiction.

  Therefore, the EC proposal should allow for a more proportionate approach to be in line with the practices of other jurisdictions. The level of extra-territorial jurisdiction envisaged for ESMA in the two proposals should be consistent with the practices of other jurisdictions and underpinned by close regulatory and supervisory cooperation mechanisms. Several powers attributed to ESMA seem to imply that it is the sole supervisor and does not have to coordinate with CCPs' home authorities to conduct its activities. ESMA's third country supervisory framework should include full cooperation with the home authorities of the third country entity supervised. Indeed, in order to be proportionate and manageable in practice, ESMA direct supervision should ensure mechanisms for cooperation and coordination of supervisory activities with local authorities (e.g. for audits and inspections) in line with the established Principles for Financial Markets Infrastructures.

  Finally, in line with the practice of other regulators around the globe, it should not necessarily be required that market infrastructure, such as CCPs, have to wait for an equivalence determination for their jurisdiction in order to seek direct registration and supervision by ESMA. This assessment of the third country regime by the EC seems an unnecessary pre-condition for Tier 2 CCPs since they will be directly subject to EMIR requirements and ESMA direct supervision. In addition, it duplicates the ESMA comparable compliance process that allows ESMA to conduct such assessment. We suggest a separation between the equivalence regime (that should be applicable for Tier 1 CCPs only) and Tier 2 direct registration processes in order to ensure a more proportionate and streamlined third country regime, and avoid unnecessarily duplicative processes.

Benchmarks (Article 8)

- **Third Country Administrators.** We support the proposal to abolish the current 'member state of reference' procedure and establish ESMA as the supervisor for third country benchmark administrators. We believe that the proposed amendments to the Benchmarks Regulation should be made more proportionate and remove the requirement for a legal representative in the Union (unless no regulatory co-operation exists) and the pre-condition for an Equivalence decision to have been made before ESMA can recognise an administrator (although regulatory co-operation agreements would be required). This could be modelled on an amended version of the EMIR 2.2 proposal for the recognition of Tier 2 third country CCPs by ESMA, whereby ESMA could require on at least an annual basis confirmation that the administrator continues to fulfil the key requirements of the regulation (i.e. an extraterritorial license). This would also be consistent with the principle that ESMA should be the central supervisory contact in the EU where a financial activity could have a systemic impact and would be manageable from a market practice point of view because supervisory relationships for benchmark administration are a new phenomenon (outside of the UK).

- **Critical Benchmarks.** We agree with the proposal in Article 8 that a reformed ESMA should become the competent authority for administrators and supervised contributors of critical benchmarks, with the power to designate a benchmark as critical based on the criteria in BR Article 20 (new) (page 214). This is a sensible streamlining measure (by abolishing the existing regulatory colleges), consistent with the principle that where a financial activity may have a systemic link or significant cross-border impact it could be supervised by ESMA. As drafted, it is not clear whether it is technically possible for a third country administrator to provide a critical benchmark and this needs to be clarified.

- **Regulation of supervised contributors.** As drafted, the proposal suggests that ESMA should be the regulator for supervised contributors to critical and third country benchmarks**.** Given that most contributors are banks which are regulated by banking regulators this does not seem to be suitable and the intention should be clarified here.

- **MiFID II / R, Regulated Data and Equivalence.** We recommend that policymakers clarify the treatment of regulated data for the purposes of classifying regulated data benchmarks (which cannot be considered critical benchmarks), bearing in mind that regulated data is defined with reference to trading on trading venues. It is not clear whether a specific equivalence agreement is needed to designate third country trading venues as equivalent (further to those that exist for say the trading obligation) for the purposes of designating regulated data benchmarks which draw on input data from third countries.

Prospectuses (Article 9)

- **Local market expertise is needed for the benefit of issuers and investors.** In general, we believe that prospectuses are best reviewed and approved by NCAs who have the expertise of the local market and understanding local risks and developments e.g. through other supervision activities/local policy changes. Individual competent authorities have an understanding of local market practice and their participants built up over a number of years. We support harmonisation of standards and a common framework. However, we also support local markets and operators being able to function within that common framework as opposed to increasing direct supervisory powers of ESMA. Insufficient or no

evidence has been presented as to why certain issuers should have their prospectuses approved by ESMA.

- **Very large and diverse market ecosystem.** There is a substantial atomisation of market participants involved in bringing prospectuses to regulators (underwriters, lawyers, comms firms, brokers etc.) with whom NCAs maintain close and trusted relationships. This allows them to keep abreast of domestic financing trends, market practices and knowledge of marketing requirements which is essential to their work approving prospectuses. The ecosystem includes thousands of participants, of which a local NCA is best placed to develop a detailed knowledge and a close relationship.

- **Independent Reviews** (Article 30). A more effective and proportionate way to achieve the above objectives are proposed reviews of NCAs (Article 30 - as recommended by the 2013 report of the European Parliament), which replace peer reviews with a more impartial and rigorous process supported by a review committee and underpinned by a clear methodological process. We agree that these reviews should not only focus on the convergence of supervisory practices, but also on the capacity of competent authorities to achieve high quality outcomes, as well as on the independence of those competent authorities, with the results of those reviews published to encourage compliance and increase transparency. ESMA's follow up work on peer reviews of best execution shows that this tool is already starting to be used even more effectively and can be developed further as a key lever to deliver convergence.

- **Risks and uncertainties.** We believe that the current proposal for ESMA to be the prospectus approval authority for certain categories of issuer presents unwelcome risks and uncertainties, especially given that the Prospectus Regulation has only just been reviewed and is yet to be implemented (and there was no mention of prospectus approval power being transferred to ESMA in the 2017 ESA review consultation). For example, the scope of the proposals on the types of prospectuses which would move to being approved by ESMA is very extensive. This would introduce uncertainty as to how the types of companies mentioned should be interpreted (e.g. property companies - would this affect funds/ designers / developers / builders/ electronic platforms etc.). This could have a direct impact on investor confidence and companies' ability to raise capital Lastly, ESMA approvals could increase costs due to the non-domestic nature of the procedure (language issues, difficulty to have physical meetings, communications expenses)

Data Service Reporting Providers (DRSP) (Article 6, Recital 42)

- **In principle, we are not opposed to a future transfer of supervision to a central authority** (this may have advantages in consolidating 32 data repositories into one); however, we believe that the current regime which has only just been introduced under MiFID II (which also provides for a central financial instrument database run by ESMA which is now live) should be given a chance to bed in. As it stands however, DRSPs are currently best regulated by NCAs as they have a close relationship for the benefit of the local market and are respected by participants for their transparency, accountability, accessibility and necessary technical expertise.

- **Singling out DRSPs to be centrally supervised by ESMA from other segments of the data market (which are not) may not achieve its objective to improve data quality.** There is a vastly heterogeneous group of data originators, numbering into the tens of thousands, and an array of different regulatory frameworks under which they operate The original data source is a more important measure of data quality i.e. the universe of MiFID II / R investment firms and execution venues which are already regulated. In addition, some segments of the data market are not regulated at all (e.g. data vendors and software providers) yet they are just as much an important part of the data segment and this should be considered further.

- **Enhancing the current regime.** We recommend that the Commission's objectives to address the quality, formatting, reliability and cost of trading data could be served in the shorter term by exploring how to make the current system implemented by MIFID II/R function better. The role that ESMA currently provides the central financial instrument database, which has just gone live. In addition, in the case of ARMs, for NCAs to be able to effectively provide whole market information they need access to other markets and data sharing arrangements are needed to deliver this. We also support the role of the proposed new Independent Reviews (Article 30) as a more effective and proportionate way to ensure more consistent supervision of DRSPs across the EU.

- **Third country DRSPs.** It would make sense to allow for a form of registration with ESMA to enable EU firms to access third country DRSPs because at present it is not clear that there is any kind of third country DRSP envisaged under the framework at all.

No action letters (new)

- **Forbearance.** We believe that proposals put forward by various bodies (e.g. FIA) calling for a version of formal regulatory forbearance to be extended to ESMA, based on the 'no-action letter' model in the United States deserve some consideration.

ESMA international competitiveness objective (new))

- **Global growth opportunities.** We recommend that ESMA is given an objective to support the international competitiveness of Capital Markets Union. This would ensure that the Single Market is well positioned to enable the financial sector to support Europe's economy and take full advantage of global growth opportunities.

Environmental, Social and Governance (ESG) Factors (Article 8)

- **We welcome that ESMA will carry out monitoring of how financial institutions identify, report and address ESG risks to financial stability**. In order to enhance the concrete framework for how this will be carried out, we recommend that ESMA has regard to relevant global and leading market framework and these should be reflected in the text where appropriate. For example, we support the work of the FSB project aiming to harmonize the existing 400+ ESG disclosure regimes, building on the work done by the UN Sustainable Stock Exchange (SSE) to enable true global harmonisation of disclosure standards. LSEG is delighted to participate in the Commission's Expert Group on Sustainable Finance and we look forward to taking forward its conclusions to support ESMA to achieve its ESG objectives.

Fintech (Article 8)

- **Supporting competition.** We note that ESMA will have tools to ensure integrity of data use, lower operational costs & barriers to entry. In principle we support that ESMA should take account of the evolution of Fintech in order effectively to deliver its objectives. However, the co-legislators should be mindful not to introduce undue intervention powers that would inhibit effective competition in the market to the detriment of end users. We believe close, consultative and active collaboration between regulators, FinTech startups and existing service providers is crucial to make sure that innovations bring concrete value to the market in terms of efficiency, broader choice, transparency and customer protection while maintaining market resilience.

Retail risk reviews (Article 9)

- **Thematic Reviews**. We support that ESMA will have an explicit mandate to use tools such as thematic reviews of business conduct and develop retail risk indicators to protect consumers. This is an appropriate way to manage emerging risks to retail consumers, preferable to overly restrictive regulation.

Guidelines and recommendations (Article16)

- **Guidelines.** LSEG believes that guidelines and recommendations are an essential part of the ESAs' work and necessary for both market participants and NCAs to apply legislation in an appropriate and realistic manner. We support the proposal that the ESAs should always conduct cost-benefit analyses; consult on guidelines and recommendations; and that the Commission can withdraw ESMA guidelines if it deems that ESMA has gone beyond its mandate.

- **Q&As.** While Q&As are not guidance and lack any legally binding authority, they are still an important part of the interpretation and implementation of legislation and, in many cases, are more relied upon by market participants than official guidelines or recommendations. Therefore, these should be recognised as a tool of the ESAs and their legal status clarified. However, LSEG believes that the use of Q&As is important and must remain responsive to industry practices and routinely updated. Therefore, we believe these do not need the full scope of consultation and cost-benefit analyses that guidelines or recommendations do (a process similar to that for Implementing Technical Standards may be more appropriate, which does not require an impact assessment). However, they should still be subject to review by the relevant stakeholder groups and capable of being overridden or withdrawn by a decision of the Commission where they exceed the ESA's competence, are inaccurate, or not relevant to actual market practices involved.

Breaches of EU law investigations (Article 17)

- **Power to request information.** LSEG does not object to ESMA being competent to investigate breaches of EU law. However, we do not believe that the ability to request information directly from market participants that are not themselves supervised by ESMA is appropriate. Instead, such requests

should be made to the competent authority in question, who is responsible for the supervision of the market participant. It would not be appropriate, particularly in respect of investigations where there are alleged breaches of law, that market participants could have competing or potentially incompatible requests for information from different authorities. The requests should always come from the applicable supervisory, police and/or judicial authorities that are responsible for ensuring compliance with EU law of the market participant in question.

Outsourcing and delegation (Article 31a)

- **Benefits of outsourcing.** Outsourcing and delegation arrangements are an important mechanism for the provision of financial services to clients, including offering cost-effective services while allowing greater access to international finance and investment strategies/opportunities. We believe the new proposals are too extensive and burdensome (e.g. reporting to ESAs on regular outsourcing by NCAs and could impact these benefits. There is no evidence that the current arrangements do not work well today.

- **Support UCITS and AIFMD as successful brands.** Existing legislation, such as UCITS and AIFMD, explicitly provides for the possibility of delegation of certain functions, including to persons outside of the EU. When delegates outside of the EU are appointed, such as fund managers, they are subject to strict requirements for initial and ongoing due diligence and monitoring. The framework proposed for the ESAs to monitor outsourcing should not go beyond the existing requirements for appointment and ongoing monitoring. LSEG agrees with the position of EFAMA that the current model of delegation is reliable, well-functioning and tested. There is no justification to put this in jeopardy (for example, risking an expansion of what is considered outsourcing) when the current arrangement (which is notably seen in the delegation of fund management to UK, Swiss, US based practitioners) is central to investor choice, allowing EU investors to access world leading investment expertise and outcomes and is supportive of UCITS as a global regulatory brand. We believe that competition, choice and proportionality are key to ensuring the international openness that will deliver best outcomes for end investors.

- **Guidelines and peer review.** LSEG believes that, instead of reviewing and opining on individual outsourcing arrangements, it would be better (where related to entities still supervised by NCAs and not ESMA) to produce guidelines for NCAs (and ESMA itself as a supervisor) in respect of types of outsourcing activities. This would ensure consistent application of outsourcing rules, but would not entail an additional process for outsourcing not envisaged in existing legislation. It would also not undermine the role of the NCAs as the relevant supervisor for most financial market participants. There is also a role for the enhanced peer review process to deliver greater convergence on the treatment of outsourcing.

Stress testing (Article 32b)

- **ESRB**. LSEG does not object to ESMA conducting annual EU-wide stress tests as these are an important aspect of ensuring market confidence and allowing institutions to evaluate their ability to meet stresses deemed most relevant to supervisory authorities. Any stress tests should be coordinated with, and subject to, the input of the European Systemic Risk Board. This will ensure that risks identified for

stress tests are relevant in addressing potential threats to systemic issues throughout the EU and not just for a smaller identified marketplace or specific market participants.

- **Confidentiality**. The current proposals suggest that the identities and results of financial institutions subject to stress tests should be arbitrarily published. LSEG does not agree that this is appropriate. While stress tests can create market confidence when undertaken by an industry; where results are known for specific entities and their specific results individually published, this can have a detrimental effect and actually reduce market confidence or provoke a withdrawal of confidence in an institution that could precipitate a stressed scenario. Instead, results could be published anonymously and/or on an aggregated basis.

Supervisory Arrangements (Article 35)

- **The proposed powers are very broad**. LSEG understands the change of approach in Article 35 to account for more direct supervision of institutions by ESMA. While the powers are modelled off extensive powers for NCAs under their national legislation, it should be clear where and how the ESAs can exercise such extensive powers (including for the imposition of fines, penalty payments, withdrawal of authorisation, etc.). While we do not suggest exactly what the range of powers and triggers will be (particularly as these will differ for different types of supervised entities and products), should be well defined and clear, so it is not possible for ESMA to exceed their authority. This is important as NCAs can normally be afforded wider discretion under domestic law than EU institutions as there is normally a clear process for redress by the institution subject to such a decision and corrective action can be taken domestically in the courts. Such a process is not readily available for the supervisory arrangements of the ESAs, so decisions such as these must be exercised only when clear and precise conditions are met.

Accountability

In this section we wish to reemphasise that we support a stronger role for ESMA. However in order to complement this, it should be enhanced and supported with clearer lines of accountability for its actions. This would further increase confidence and trust in the important work of the agency. This can be delivered through more transparent and stronger governance, an appropriate balance of power with NCAs and even better levels of dialogue with industry.

- **Duplication.** There should not be a duplication of information requests emerging from both ESMA and NCAs as this would have an adverse impact on efficiency and represent a cost burden to industry. The need to manage the identical distribution of information to both ESMA and NCAs would represent an undue compliance burden and risk undermining supervisory relationships if any differences emerged in information supplied even if this was for administrative reasons.

- **Access to ESMA's information.** In general, we believe that access to information should work both ways – ESMA should also be much more open and accessible to financial institutions with a substantially higher degree of transparency in their decision making (please see our comments on ESMA's governance in section 4).

Annual financial contributions (Article 49a)

- **Service Standards.** In general, we understand the principle of financial contributions to increase ESMA's capacity, so long as the overall cost of supervision does not increase. However we expect that this should be accompanied by a significant enhancement of ESMA's accountability, transparency, supervisory and direct communication standards. This would help ESMA achieve its objectives whilst at the same time supporting industry's ability to innovate and achieve product authorisation in a timely manner to serve customers. ESMA should have its capacity enhanced but this need to be accompanied by appropriate accountability to fee payers. In practice this means appropriate levels of relevant policy support, specialist resources and corporate services which take account of the need to support international competitiveness as well as financial stability. For example, providing substantive reasons behind product assessment decisions; credible mechanisms for industry to input into ESA policy conclusions contained in official Opinions; and timely responses from named officials to industry queries.

- **NCA to collect payments.** We support that indirectly supervised financial institutions should pay contributions via NCAs However, LSEG does not believe that each NCA should be at liberty to collect revenues as it sees fit when passing these on to ESMA. Instead, the funding model should be transparent and set guidelines available on how NCAs should apply the collection of the levy in their jurisdictions.

- **Level 1 clarity.** LSEG agrees that an industry-funded levy is normally appropriate and many NCAs currently operate on such a model. However, there are normally strict rules on how the NCA must determine its estimated workload and costs for the upcoming year and how that relates to the specific amount required by institutions. We note that there is to be a Commission Delegated Act to establish how the total amount is shared by different categories of market practitioners. We believe that the maximum amount of clarity should be provided in the Level 1 text (how is the categorisation established; how are the fees split between ESMA and NCAs when responsibility is split). The design of fee structures should reflect international peer comparisons. Fees should be sustainable and proportionate to the relationship and service provided by the regulator. There are different models available (e.g. fees for application, change to permissions, annual fees, income-based fees etc.). In the UK for example, there are 23 different categories for the annual fee payment, as well as other types of fees on top. In the US, the NFA has 16 categories; the SEC bases fees on aggregate amount of securities sales; and FINRA fees are based on entity size.

2 ESMA's powers in relation to third country entities (Article 33)

Equivalence

- **ESMA should have a proportionate greater role.** We note that the proposal only reflects current procedures. However we believe that ESMA should have an enhanced role to make equivalence recommendations and not merely assist the Commission (although the final decision should rest with the Commission). We note that the original report of the Jacques de Larosiere group stated that ESMA should "prepare (and in some cases could adopt) equivalence decisions…[and] would represent the EU interests in bilateral and multilateral discussions with third countries relating to supervision." For

example, we welcome that the European Commission has designated certain venues in the USA and Switzerland as equivalent for the purposes of the trading obligation under MiFID II/R. However, we believe that a timely and efficient technical advice process led by ESMA would have allowed market participants to feed in relevant expertise in a more effective manner. Equivalence should be primarily a technical not political process; time limitations on equivalence do not appear to be consistent with such a principle. An enhanced role for ESMA in recommending equivalence could also support a more efficient process for particular cases such as allowing third country investment firms to be members of EU trading venues, avoiding the current burdensome arrangements.

Annual report on third country practices

- **Third Country NCAs should have the right to review ESMA assessments.** It makes sense for ESMA to have a role in ongoing monitoring of regulatory and supervisory practices of third countries where appropriate. However we do not support the proposed annual confidential report to the Commission as currently envisaged. We recommend that ESMA should disclose this report to the third country NCA and they should be given due opportunity to comment on the report before this is passed to the Commission. Such practices should fit within a global framework with for example a role for global bodies to assess how these powers are used.

Third country co-operation

- **Scope.** We caution against too broad a scope for ESMA to claim that a third country NCA has refused to co-operate and the impact this may have on an equivalence decision. Such a test should be strictly administrative and technical. ESMA's powers and actions should be transparent, coherent with the global regulatory framework and support international openness and competitiveness.

3 ESMA's powers over NCAs

Settlement of disagreements (Article 19)

- **We do not support the proposal** to allow the process to be triggered on ESMA's own initiative in cross-border situations. We prefer the binding mediation mechanism today which relies on NCAs to initiate. There is not sufficient enhancement envisaged to the oversight and governance of ESMA to ensure that the proposed change would lead to an appropriate balance of power between ESMA and the NCAs.

ESMA to set EU-wide priorities for supervision in a 'Strategic Supervisory Plan' against which NCAs are assessed (Article 29a)

- **Convergence.** In principle, we support the proposal to ensure greater transparency on where NCAs are departing from the agreed strategic regulatory priorities of the single market regulation. However, not every member state will have matching priorities and a common agenda. Forcing them to adopt a supervisory plan which does not address local market concerns or specificities risks undermining market integrity. A wider range of supervisor convergence measures such as peer reviews may be more appropriate, alongside the power to make recommendations.

Independent Reviews (Article 30.)

- **We welcome the proposal** for a more impartial and rigorous peer review process (as recommended by the 2013 report of the European Parliament) supported by a review committee and underpinned by a clear methodological process. We agree that these reviews should not only focus on the convergence of supervisory practices, but also on the capacity of competent authorities to achieve high quality outcomes, as well as on the independence of those competent authorities, with the results of those reviews published to encourage compliance and increase transparency.

ESMA able to recommend NCAs to initiate market abuse investigations (Article 31b)

- **Security.** We note that ESMA will be able to recommend NCAs to initiate market abuse investigations where it suspects activity with cross-border effects threatening markets and stability. The proposal is for ESMA to maintain a data storage facility to collect information from and disseminate between NCAs therefore we believe it is key that assurances are provided on the security of such a database given the cyber threat.

4 ESMA's corporate governance

Executive Board (Article 45. Composition; Article 45a Decision Making; Article 47 Tasks)

- **Checks and balances.** We believe that the Executive Board (EB) will need more checks and balances in order to balance the extensive increase of its powers and its cross representation on other bodies (full time members will have a non-voting position on the Board of Supervisors, and the EB may establish its own internal committees under Article 45b). The EB will act based on decisions made by simple majority to: draw up a draft budget and implement it; possess ultimate decision-making powers regarding NCAs and dispute settlements, breaches of Union law, independent reviews and supervisory priorities; will monitor delegation, outsourcing and risk transfer arrangements to third countries; have ultimate decision-making EU-wide on stress testing and approaches to communication of their

outcomes; be in charge of decisions on requests for information; and will prepare the ESMA work programme (for adoption by the Board of Supervisors - BoS). As currently drafted, the BoS can only reject a proposal for a decision by the Executive Board by a majority of thirds [as drafted by the Commission, we assume two-thirds is meant] (in situations where ESMA will exercise powers related to direct supervision).

We recognise the benefits of more efficient decision making likely to follow from the creation of the EB. However we recommend that the EB agenda and working practices should be public and transparent. It should clearly be a technical and not a political body. For example, when preparing Q&As this should be responsive to and based around formal dialogue with industry, with a set timeline for feedback and full disclosure of reasons for making certain decisions. This is necessary to ensure trust and confidence in the process. The members of the Executive Board should also be more in number and more senior than envisaged by the staff grading in the Commission's accompanying analysis, in order to properly enhance the capacity of ESMA.

Chairperson (Article 48)

- **Accountability**. The ESMA Chairperson will be a very powerful figure as this person will chair both the BoS and the EB (in which they possess a casting vote). *We therefore believe that the BoS should retain its current power to have disciplinary authority over the Chairperson.*

We hope that the European Commission finds this submission useful and we look forward to engaging further as policies are developed. Should you have any questions on the response or wish to discuss it in detail, please do not hesitate to contact us at Corentine Poilvet-Clediere: cpoilvetclediere@lseg.com; Martin Koder: mkoder@lseg.com; Paola Fico: paola.fico@borsaitaliana.it.