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EUROPEAN COMMISSION
DG Financial Stability, Financial Services and Capital Markets Union
Unit B2 – Economic analysis and evaluation
SPA2 06/070
1049 Brussels
Belgium

29 January 2016

Dear Sir or Madame,

This letter accompanies the response of the London Stock Exchange Group ("LSEG") to the Call for evidence on EU regulatory framework for financial services published on 30th September 2015. It should be read in conjunction with the responses we provided in the European Commission's online questionnaire and with the confidential Annex which contains LSE group company data.

For the European Commission's information, this letter summarises the key issues raised in our response to the Call for Evidence, listed by order of priority.

I. Financial Markets

a. Easing prospectus requirements

We support the revision of the **Prospectus Directive** rules and further encourage the European Commission to **remove the prospectus requirement for secondary issuance** and further **raise the proposed threshold** triggering prospectuses. We believe these measures would help **raise the number of investors and issuance amounts**. We believe that cross-border notification requirements should be abolished, among other barriers to the free movement of capital, and that **passporting requirements should be modernised** to better reflect a Single Market. We further seek to remove the proposal for third country issuers to appoint an EU legal representative, which would not be operable and make the EU less competitive with other capital markets.

b. Addressing the fiscal bias against equity

We welcome the European Commission's effort to address the **fiscal bias against equity** (i.e via the public consultation on re-launch of the CCCTB) and believe the Allowance for Corporate Equity (ACE) to be the best option; however, we support it with caution as its effectiveness will depend on the detailed implementing measures. We do not support the proposal of a **Financial Transaction Tax (FTT)** as this undermines the European Capital Markets Union objectives of increasing non-bank financing options for companies of any size, **encouraging an equity culture** or further integrating EU capital markets.

c. Proportionate treatment of market makers in less liquid securities

We consider that CSDR rules will lead to a reduction in **market making in less liquid securities**, the majority of which are those of small and medium sized entities (SMEs). Market makers who provide liquidity in less liquid securities will have to account for the risk that such securities may not be available within the CSDR settlement periods and may opt to stop making markets. Market making in less liquid securities is also expected to reduce due to **MiFID II transparency requirements**. Taken together, these initiatives are likely to reduce liquidity in SMEs and undermine the Commission's objective of supporting SME Growth Markets.

d. Removing MiFID II complex product classification from unit trusts

We believe that the potential **MiFID II designation of investment companies as "complex" products** is **not necessary** in order to achieve the appropriate level of investor protection. This designation would discourage retail investment in these listed, transparent companies, which would go against the European Commission's objective of extending choice for EU retail investors.

II. Post-Trade

a. Access to central bank liquidity and overnight repo rules for CCPs

We support the adoption of measures to facilitate **access of EMIR-authorised CCPs to central bank liquidity facilities** in order to help such CCPs **manage the large cash balances** resulting from margin requirements and default fund contributions in accordance with the EMIR liquidity management rules.

We also believe that CCPs need to have the ability to **place on-demand, unsecured cash deposits** in a manner which does not increase the credit exposure of the CCP to the heightened risk of a stressed membership rules to perform its function to ensure that markets are being stabilised. Since a central bank is the only mechanism which can provide the capacity for **demand deposits without further increasing the risk profile of a CCP** during a market stress, we suggest that measures are taken to facilitate CCP access to central bank liquidity.

b. Portfolio margining

We are convinced that it is important to **recognise the absence of correlations as a risk diversification tool**. We therefore suggest that (i) correlations be allowed within the portfolio margining framework if they can be modelled with a **Type II error below 5%** and (ii) the cap of 80% for the offset should only be considered in the cases where such Type II error test is not successful. These changes will still recognise that such margin benefits will only be available to the extent that they are **reliably present in times of stress**. This modification would lead to a crucial improvement in margin calculation and significantly support the **competitiveness of European CCPs**.

c. Functioning of the EMIR colleges

We believe that both the process to approve new products and services required under **Article 15 of EMIR** and that to approve changes to CCPs' risk methodologies under **Article 49 of EMIR should be streamlined**. This is especially important when European CCPs compete with CCPs from jurisdictions that authorise self-certification processes as the **time-to-market** for these entities will be significantly shorter, posing a **competitive problem**.

With regards to **Article 49 of EMIR**, we strongly believe that depending on the nature, type and materiality of the change, **approval from the CCPs' competent authorit**y, followed, if necessary, by a notification to the EMIR College, would provide sufficient rigor and oversight to the process. We do not think that the escalation of all changes sets the right incentive for effective risk management by CCPs, and seems therefore against the policy objective of EMIR. CCPs should be able to take **timely action to respond to changing circumstances** under their own governance frameworks to best minimise risk.

As for **Article 15 of EMIR**, **National regulators and ESMA should have a common understanding** of what is deemed to be a new product, service, or activity that would trigger the college process under Article 15 EMIR. We would not expect regulators to trigger such process for changes to a **product belonging to an asset class already cleared** by the CCP.

d. Capital requirements

We are concerned that the proposed **CSD capital requirements** act as a barrier to entry and stifles competition both for issuer and investment CSDs. We suggest that CSD capital requirements be recalibrated so that they are more proportionate to the risks associated with this particular type of market infrastructure (operational concerns rather than trading or investment activity risks) and do not act as an additional barrier to entry for smaller CSDs.

We consider that the calibration of **CCPs' wind-down capital and skin-in-the game under EMIR is appropriate** and orientated towards the relevant risks the CCP faces (covered by the regulatory capital).
We are convinced that CCPs' capital requirements should not be formulated in a manner which causes the requirements to **rise unreasonably** with increased levels of clearing following the imposition of EMIR clearing mandates or to **create moral hazard** by indirectly subsidising the risk taken by clearing members.

e. CRD capital rules for clearing members

We encourage regulatory efforts **to revisit the proposed rules on the leverage ratio**, in order to recognise **segregated margin as being risk-reducing**. In particular, we would encourage the European Commission to revise the leverage ratio rules to enable clearing members to calculate the derivatives exposure in the leverage ratio using the **Standardised Approach to Counterparty Credit Risk (SA-CCR)** instead of the Current Exposure Method (CEM). The SA-CCR recognises the reduced risk in a cleared environment and therefore would maintain members' incentives to offer client clearing for OTC derivatives.

f. Pro-cyclicality buffers

We believe that the current standards in place under EMIR (a. 25% buffer on margin, b. minimum 25% weight to stress observations, and c. floor of margin on 10 year look-back) allow CCPs, as risk management experts, to **address pro-cyclicality as it applies to the risks inherent to certain products**. We would **not seek to make the standards any more restrictive** in nature so as to allow for CCPs to have the necessary flexibility to efficiently address the pro-cyclical nature of all the products they clear and markets they serve. However, we would encourage the European Commission and ESMA to **consider requiring similar pro-cyclicality measures when assessing the recognition of 3rd country CCPs** under Article 25 EMIR and Article 2 of the EMIR RTS on requirements for CCPs.

g. Transaction reporting

We encourage the European Commission and ESMA to establish clear Level 3 guidance or changes to existing Regulatory Technical Standards (RTS) to clarify how the **requirements for position reporting** should be undertaken by firms and Trade Repositories when reporting **ETD transactions**. We believe that the European Commission should seek to **remedy implementation errors** rather than transition to abandon the **high standard of dual-sided reporting.** Further, we believe that moving to a single-sided reporting regime would **increase compliance complexity and costs** after firms and infrastructure providers have built systems and processes to comply with dual-sided reporting, **creating further market disruption** while firms have invested in long-term planning to prepare for the start of MiFID II reporting. LSEG endorses ESMA's approach to product identification**, mandating the use of ISIN** – a standardised, unique and unambiguous identifier which is already adopted worldwide.

III. Regulatory issues common to all FMIs

a. Appropriate calibration of financial services rules to FMIs

Financial market infrastructures are essential market participants that are delivering post-crisis risk management, transparency and capital raising facilities. Some CCPs, CSDs and all market operators regulated as investment firms are subject to Bank Recovery and Resolution Directive (BRRD), the Capital Requirements Regulation (CRR) and other requirements designed for risk taking entities. We urge the European Commission to ensure that **such rules applicable to FMIs are appropriately calibrated to the unique nature of FMI businesses.**

b. Global competitiveness and third country provisions

As noted, we encourage the European Commission to ensure that the third country provisions in the Prospectus Regulation and other rules do not create artificial barriers for third country issuers to list in the EU. We note that the free movement of capital in the EU applies under Article 63-64 under the Treaty of the Functioning of European Union (Lisbon Treaty) and **support all measures to reduce barriers to the free movement of capital from third countries.**

c. Technological progress and rule-making

We also advise the European Commission to **draft any new rules in manner that is technologically neutral**, and we suggest that technology specific provisions are omitted from Level 1 texts. We welcome the development of technologies such as blockchain and stand ready to assist the European Commission with any rule making required to regulate this or other new technology.

We hope that the LSEG's response to this Call for evidence will assist the European Commission in addressing the unintended consequences of financial reforms. Should you have any questions on our response, please do not hesitate to contact Bdorudi@lseg.com; Corentine.poilvet-clediere@lchclearnet.com; bsivak@lseg.com and Natalie.caldwell@lchclearnet.com.

Yours sincerely,

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