London Stock Exchange Group (LSEG)
Response to the European Commission Call for evidence on
EU regulatory framework for financial services

Part A: Introduction

Financial markets infrastructure ("FMI") regulation has changed dramatically in the past six years, due to the swift response of policymakers to the financial crisis and continuous technological innovation. In this paper London Stock Exchange Group ("LSEG") evaluates the impact, across the range of LSEG businesses, including our markets, information services and post-trade divisions, of a number of regulatory initiatives intended to reduce systemic risk and increase transparency. LSEG shares the European Commission's aims for a post-crisis regulatory framework, with **orderly, efficient and transparent markets,** where investors benefit from high levels **of protection,** where **competition** between market participants thrives**,** where companies of all sizes **can more easily access financing** and in which European markets remain globally **competitive**.

LSEG is one of the world's leading financial market infrastructure providers, with significant operations across the EU. Our markets are home to 2000 European companies from 24 EU Member States ("MS") with an aggregate market capitalisation of €3.4 trillion (40% of the entire market capitalisation of all EU listed companies). We enable investors and institutions to access some of the world's leading equity, fixed income and derivatives markets, offering full range post-trade services including clearing, settlement and custody. Further, we provide information services in form of data, financial benchmark and indices, and provide FMI technology around the world.

This paper discusses the impacts of certain post-crisis rules in effect but also extends certain arguments to rules which are not yet in effect where we are able today to identify that inefficiencies and unintended consequences are likely to occur. We contribute evidence in form of data and quantitative analysis on the impact of the changes where possible. LSEG would be happy to discuss with the European Commission any explanations or examples in further detail.

Following the structure of the questionnaire, our response is ordered:

- Part A: Introduction
- Part B: Rules affecting the ability of the economy to finance itself and grow
- Part C: Unnecessary regulatory burdens
- Part D: Interactions of individual rules, inconsistencies and gaps
- Part E: Rules giving rise to possible other unintended consequences.

Our response is accompanied by a cover letter which organises our proposals by theme and in order of priority and a second confidential letter containing data and statistics.

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Part B: Rules affecting the ability of the economy to finance itself and grow

1. Unnecessary regulatory constraints on financing: the Commission launched a consultation in July on the impact of the Capital Requirements Regulation on bank financing of the economy. In addition to the feedback provided to that consultation, please identify undue obstacles to the ability of the wider financial sector to finance the economy, with a particular focus on SME financing, long-term innovation and infrastructure projects and climate finance. Where possible, please provide quantitative estimates to support your assessment.

EXAMPLE 1: PROSPECTUS REQUIREMENTS

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example)

- Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading (including its delegated regulations) (Prospectus Directive)

- Proposal COM/2015/0583 final - 2015/0268 (COD) for a Regulation on the prospectus to be published when securities are offered to the public or admitted to trading (Prospectus Regulation proposal)

(b) Please provide us with an executive/succinct summary of your example:

LSEG welcomes the review of the prospectus rules. We believe that the Prospectus Regulation proposal could: increase access to non-bank financing and the fostering of a European entrepreneurial and equity culture, lead to more competition between funding sources and create more jobs in European economies.

We believe that the new Prospectus Regulation will be an important stepping stone in further developing capital markets based financing. When developing such models, it is crucial that the European Commission remains aware of the need for European market players to compete globally, and does not disadvantage EU markets in relation to other jurisdictions.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

According to estimates, there are currently 23 million SMEs across the EU. However, only 11 thousand companies access the capital markets. While we recognize that not every small and medium sized company (SME) is a suitable candidate for raising capital via listing, LSEG believes that the EU capital markets are not meeting SME funding needs, and this has a direct consequence in terms of reduced job creation. According to statistics[1], more than 90% of jobs in a company are created after it has gone public.

The Prospectus Regulation proposal should allow EU markets to compete and be attractive globally, and not put them at a disadvantage when an issuer is considering the jurisdiction in which to establish and raise capital; for instance, in 2015, only 28 Non-EEA issuers listed on our markets and raised $3.5bn at IPO, compared with twice as many EEA issuers (65) who raised $16.8bn. Similarly, in terms of additional capital raising through further issues, only 113 Non-EEA issuers returned to our markets raising an additional $11.3bn, whilst three time as many EEA companies (336) did so, raising $43.8bn (LSEG data).

[1] European Union IPO Task Force Report (March 2015) http://www.europeanissuers.eu/_mdb/spotlight/44en_Final_report_IPO_Task_Force_20150323.pdf.

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The EU should be seen globally as an attractive place for raising capital, including for the emerging markets, where there is huge demand. For instance, in India, currently the fastest growing economy in the G20, there is a need for future growth capital financing, with an estimated $1.7 trillion needed by 2020[2] to finance its infrastructure needs. Therefore, we believe in granting an exemption for third country central banks and international bodies as not to discourage and disadvantage these issuers from raising money in Europe. The Inter-American Development Bank (IDB)[3] raised £7bn debt on LSEG markets in 2015 to fund clean water projects in Latin America (LSEG data).

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

LSEG specifically recommends the following:

1. **Removing prospectus requirements for secondary issuance**. To ensure the rules bring benefits to the end-users of capital markets, namely the companies and investors, LSEG recommends removing the prospectus requirement for secondary issuance. Existing obligations and disclosure requirements on issuers under the EU Transparency and Market Abuse result in comparable information which is freely available to investors.

2. **Raising the thresholds for triggers**. We support the European Commission's proposal to raise prospectus issuance thresholds and encourage legislators it to raise it further, while retaining the discretion for Member States (MS) to impose prospectus thresholds for considerations as low as €500,000 to make the rules work in markets where smaller issuance is more common.

3. **Abolition of the retail/wholesale threshold for bonds**. We welcome the abolition of the € 100.000 denomination threshold between retail and wholesale bonds. This expands the range of products available to retail investors and unifies the market, boosting liquidity and potentially lowering the cost of capital. Currently, 70% of all EU listed bonds are in "wholesale" denominations only, denying investor access to more well established companies and paradoxically reducing investor choice. Despite our endorsement of this change, legislators should be mindful to deliver on the European Commission's intentions and avoid "levelling up" requirements for all bond issuance to match the previous retail regime. We believe that overly burdensome disclosure requirements would drive many bond issuers toward private placement.

4. **Passporting.** The passporting process should be amended and streamlined to further facilitate the development of the Single Market. We support the proposal of the UK FCA that once a prospectus is approved by a home Competent Authority, it should be a pan-EU document and no passporting should be required. There should be no need for cross-regulatory notifications, which add administrative burdens and costs to issuers and create barriers to cross-border investment.

5. **Third-country regimes.** The Third-country regimes must be calibrated to ensure there is no adverse impact on the international competitiveness of the EU. As drafted, the provisions are contrary to Art. 63 of the Treaty on Functioning of the European Union (TFEU) whereby "all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited".

[2] Goldman Sachs, Global Economics Research, 16 September 2009.

[3] IDB is the main source of multilateral financing in Latin America, providing solutions to development challenges and support in the key areas of the region, http://www.iadb.org/en/inter-american-development-bank,2837.html.

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Requirements for an EU legal representative to "ensure compliance" should be removed. The third country equivalence regime must be enhanced to support international competitiveness of EU markets. Further, exemptions should be allowed for third country central banks and international bodies e.g. IFC, OECD (see above the statistics for The Inter-American Development Bank).

For further details, please take note of our response to the European Commission's consultation on the revision of the Prospectus Directive.[4]

EXAMPLE 2: EQUITY-DEBT BIAS

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- COM/2011/121Commission proposal for a Common Consolidated Corporate Tax Base (CCCTB) & the Consultation on Relaunch of CCCTB (October 2015)[5]

(b) Please provide us with an executive/succinct summary of your example:

LSEG believes that the European capital markets and issuers of all sizes would benefit from the revision of the current fiscal bias against equity. Equity finance is a key source of risk capital for innovative, high growth businesses which benefit the economy as a whole. Some corporate tax systems favour debt-financing over equity-financing by treating interest payments as a tax deductible expense, with no equivalent deduction for the return paid on equity. Currently, equity is taxed as many as four times in some Member States (dividend tax, corporation tax, capital gains tax, financial transaction tax); in contrast, debt is tax-deductible.

For our response to this question, please refer in addition to the confidential letter that we submitted, containing relevant examples, data and/or statistics, as appropriate.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

In Italy, the fiscal bias against equity was addressed by introducing the Allowance for Corporate Equity (ACE), first introduced in 1997 and reformed to its current form in 2011. In Italy this is a deduction that corresponds to the net increase in the equity created by the entity, multiplied by a rate determined each year by the Italian Ministry of Finance.

In the UK, equity finance is underutilised, with only around 3% of businesses using equity finance. The Mirrlees Review Committee[6] recommended ACE for adoption in the UK in 2010, based on the positive results in Belgium and Italy (amongst others). Findings of the Institute for Fiscal Studies[7] suggest that in the longer term, any additional UK investment that results from the lower cost of capital implied by the presence of the ACE

[4] LSEG response to the European Commission consultation on the review of the Prospectus Directive (May 2015) https://ec.europa.eu/eusurvey/publication/prospectus-directive-2015, Summary: http://www.lseg.com/sites/default/files/content/documents/LSEG%20FULL%20response%20to%20the%20Prospectus%20Directive%20review_0.pdf.
[5] Consultation on the Re-launch of the Common Consolidated Corporate Tax Base (CCCTB), http://ec.europa.eu/taxation_customs/common/consultations/tax/relaunch_ccctb_en.htm
6 Institute for Fiscal Studies, Mirrlees Review http://www.ifs.org.uk/publications/mirrleesreview/.
7 Institute for Fiscal Studies, Tax by design : http://www.ifs.org.uk/docs/taxbydesign.pdf

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allowance would generate additional taxable profits and thereby offset part of this revenue cost. According to independent reports[8], the existing debt/equity bias in the UK also promotes short-termism and undermines the long-term financing of the economy.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

While we welcome the European Commission's effort to address the fiscal bias against equity (public consultation on Re-launch of the CCCTB – original proposal COM/2011/121) and believe the Allowance for Corporate Equity (ACE) to be the best option, we support it with caution as the result would heavily depend on the detailed design of the measure. However, we believe there is a risk that the ACE approach may result in a reduction in Member State tax revenues, and that policymakers may then seek to limit the deduction of interest expense on debt. This would negatively impact companies and the economy as a whole.

LSEG specifically recommends the following:

1. **Impact assessment with a cross-border focus**. While there have been published studies on ACE on national level, we encourage the European Commission to conduct an extensive impact assessment addressing the cross-border element.

2. **Dedicated consultation.** This topic was addressed only as a minor point within CCCTB framework, but it has significant political implications. We believe it was not given sufficient attention and that the European Commission should consider addressing the debt-equity bias as a standalone issue, in a separate consultation.

EXAMPLE 3: FINANCIAL TRANSACTION TAX

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- COM (2013) 71 on a proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (FTT).

(b) Please provide us with an executive/succinct summary of your example:

We believe that the Financial Transaction Tax (FTT) as currently proposed (not being a global or a pan-European mechanism), would likely have the effect of further fragmenting European capital markets. It will also pose a risk for SMEs, as it will likely lead to reduced liquidity and the impact of reduced liquidity has the greatest impact on SMEs, because they are most sensitive to the increased cost arising from the liquidity premium. This does not seem consistent with the policy objectives of the Capital Markets Union, in particular widening the investor base for SMEs and further integrating European markets.

Further, introducing an FTT in the countries of the enhanced cooperation could actively undermine the EU's attractiveness as a place to invest for third country investors[9], thus decreasing capital available for SME financing.

8 The Cox Review: Overcoming Short-termism: http://www.yourbritain.org.uk/uploads/editor/files/Overcoming_Short-termism.pdf

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Introducing an FTT could expose SMEs to unnecessary costs as the costs of hedging their risk by using derivative products is likely to increase substantially.[10]

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

An Italian FTT applies to both equities and derivatives trades from 1 March 2013. Since the Italian FTT (IFTT) was introduced, average daily turnover (ADT) in Italian stocks has fallen by 29.7% from the average from January to February 2013. Over the same time period, ADT in other European stocks increased by 4.5%; therefore, Italy has experienced a 34.2% relative decline in ADT since the introduction of the tax[11].

On the other hand, since the abolition of the UKs own FTT, Stamp Duty, in 2014 for companies quoted on the UK's leading market for SMEs (AIM), there has been the largest AIM issuance since the financial crisis (Worldpay raised €8 billion in 2015). Taken together with the inclusion of AIM companies in tax-advantaged 'ISA' accounts, there has been a significant inflow of retail investment into SMEs (€6 billion in 2014), providing valuable liquidity and helping to give individual citizens a stake in the future growth of some of Europe's most promising and exciting growing companies.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

An FTT would be an effective measure only if it is implemented on an international level, with no possibility for arbitrage between jurisdictions to disadvantage European companies and other European market participants. But there is no international initiative in support of an international FTT at this time, and we believe that political capital is being spent unnecessarily by the EU on the current proposal.

Accordingly, due to the legal uncertainty of the proposal, especially in light of Estonia withdrawing, the European Commission should consider withdrawing the proposal or, at the very least, ensure that appropriate exemptions are provided for SME issuers (case in Italy), investors and those that support their ability to raise non-bank capital (e.g. market makers).

EXAMPLE 4: INVESTMENT VEHICLES

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 202/92/EC and Directive 2011/61/EU ("MiFID II").

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9 Riksbanken, the Swedish national bank published a paper summarizing the Swedish experience with FTT, overall, 90% of trades in bonds, equities and derivatives moved from Sweden to other jurisdictions, particularly the UK. Sveriges Riksbank: www.riksbank.se/Documents/.../rap_pov_artikel_4_120210_eng.pdf.

10 Economics consultancy Oxera published in 2014 an in-depth review of the anticipated impact of the FTT, estimating that the cost of the FTT applied to derivatives transactions for non-financial corporations (among others SMEs) would be €4.8 billion per annum. Oxera: What could be the economic impact of the proposed financial transaction tax? http://www.oxera.com/getmedia/820b2d8d-c8b3-45ba-bb53-7d2bcac7708d/Oxera-Financial-Transaction-Tax-report.pdf.aspx?ext=.pdf.

11 FTSE Global Markets, referencing The Swiss bank's Trading Strategy report (2014) http://www.ftseglobalmarkets.com/news/ftt-drags-down-italian-stock-trading-volumes.html#sthash.PfIaw6yw.dpuf

- Article 25(4) (*Assessment of suitability and appropriateness and reporting to clients*)

- Final report ESMA/2014/1569 Technical Advice to the Commission on MiFID II and MiFIR

(b) Please provide us with an executive/succinct summary of your example:

In the UK, investment companies (non-UCITs) are widely used by retail investors. Investment companies (or investment trusts) are closed-ended investment funds, they have a transparent portfolio and their shares are publicly priced and traded on EU regulated markets. As the investment company is required to invest according to its published investment policy and spread risk, these investments help investors to diversify their portfolios and thereby decrease their risk exposure. Investment trusts are often vehicles for raising money in fields such as renewable energy, peer-to-peer lending, infrastructure and others. In this way, they contribute to the financing of the real economy, and have done so reliably for many decades.

Under the new MiFID II, Level 2 rules, investment trusts may be deemed complex instruments. This would mean that the investment trusts captured by these MiFID II rules would only become accessible via an advised sale or through a sale following an appropriateness test. We believe that investment in a single operating company, such as investment trusts, should not require additional investor protections and should not be deemed to be "complex".

As currently designed, the rules will:

- add additional complexity (appropriateness test)
- substantially increase the costs for all participants
- disadvantage the listed, transparent and stable investment trust companies.

We further note that rules which result in reducing retail participation are against the aim of the Capital Markets Union of providing more broad participation in capital markets (which supports financial stability) and investment opportunities for retail investors (increasing opportunities for higher returns and competition between retail financial services providers).

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

LSEG lists approximately 400 investment trusts, covering a wide range of strategies. But all of them provide an investment opportunity through diversified and transparent portfolios. The table below gives example of some recently admitted trusts, their market capitalisation and money raised. We believe that this table demonstrates the crucial role these vehicles play when it comes to funding well-established, but also innovative, capital markets initiatives.

For our response to this question, please refer in addition to the confidential letter that we submitted, containing relevant examples, data and/or statistics, as appropriate.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Investment trusts are regulated under the extensive existing MiFID and AIFMD rules and fulfil all the requirements that apply to firms that are listed on regulated markets. We do not believe that this additional layer of complexity is necessary or justified.

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We understand that Level 1 text will not change, but we urge the European Commission and ESMA to recognize the fact, that these investment vehicles have functioned for many years without a market failure in relation to these investments. We encourage the European Commission to appropriately calibrate the Level 2 rule to recognize the low risk profile of these products.

2. Market liquidity: please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on market liquidity. Please elaborate on the relative significance of such impact in comparison with the impact caused by macroeconomic or other underlying factors.

EXAMPLE 1: MARKET MAKING

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on Central Securities Depositories and amending Directives 98/26/EC and 204/65/EU and Regulation (EU) No 236/2012 ("CSDR").
  - Article 7 (*Measures to address settlement fails*)
- Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 202/92/EC and Directive 2011/61/EU ("MiFID II").
  - Article 17 (*Algorithmic trading*)
  - RTS 15: Regulatory technical standards on market making, market making agreements and marking making schemes

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(b) Please provide us with an executive/succinct summary of your example:

Market makers provide a key function in the provision of liquidity to markets. On a continuous basis, market makers provide two-way pricing in financial instruments in specified sizes during market hours. Market maker liquidity is particularly relevant to smaller SME securities where there may not always be a natural market of buyers and sellers.

The widening of the definition of liquid securities in MiFID II is relevant to the Central Securities Depositaries Regulation (CSDR), as a greater number of securities will be considered liquid, and therefore subject to a tighter buying in regime. In the context of CSDR, market makers now face a more stringent buying in regime, which (in the case of less liquid securities particularly) may bring negatives impact to the market. Specifically:

1. Reduce liquidity in markets.

Currently, there are many trades executed by market makers under their markets' requirements that do not or cannot settle on the intended settlement day (ISD) for a legitimate reason. Implementing the CSDR settlement discipline regime as currently intended, by enforcing the buy-in period and potentially requiring cash compensation payment, will lead to potential penalisation of participants who are willing to provide two-way liquidity to the market.

If a security with a smaller or tightly held free-float experiences an increase in demand, market makers may not always be able to source the stock to deliver on intended settlement date. Therefore where there is significant penalty to provide a firm offer price, a participant may decide that it may not be economically viable to do so and subsequently withdraw liquidity from the market.

2. Price volatility

In illiquid securities with limited availability of stock, the proposed cash compensation mechanism may lead to price volatility and 'short squeezes'. Cash compensation could lead to situation where a participant seeks to drive the up price of a security through repeated buying in the knowledge that delivery of the security will not be possible within the buy in timetable, in order to avail of the cash compensation.

3. Reduce capital raising for SMEs

The shares of SMEs are typically less liquid in their market trading. If the regime is implemented as currently intended, certain SME securities may become less attractive for investors, restricting the ability of these companies to raise capital, and thereby growing, creating jobs and contributing to the real economy.

4. Increase costs for investors

As proposed, market makers will be liable for the risk that securities may not be available within the prescribed settlement periods in spite of their best efforts to obtain them, through widening of spreads, impacting investors. In the event that an investor receives cash compensation yet wants the security, investor expectations were not fulfilled.

5. Irregular distinction between Regulated Markets and SME Growth Markets

SME Growth Market securities are given an extended buying in timetable in the Regulation, however less liquid securities which may have in certain instances a similar liquidity profile to that of SME Growth Market securities, are on more stringent buying in terms. For example, a cleared trade in less liquid securities will be subject to the same buying in terms as that of a liquid security (ISD+4 extension and 4 day execution period). As a result, certain issuers may decide to remain on AIM rather than moving up to the Regulated Market, and similarly, certain issuers may choose to move from the Regulated Market to AIM.

6. Misalignment in buying in timetables in less liquid securities

The distinction made between cleared and uncleared trades (ISD+4 and 4 days / ISD+7 and 7 days) can:

- Bring disconnect between off book and on book trading. For example a participant who buys off book and sells on book will be subject to 2 buying in timetables. In the event that the delivery for the off book trade is late, the participant may be bought in on the on book leg 3 days before the buy in process begins for the off book leg.
- Create market preferences to trade away from on book cleared environments, and
- Prompt consideration of removal of CCP clearing on order book segments for less liquid securities.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

For our response to this question, please refer to the confidential letter that we submitted, containing relevant examples, data and/or statistics, as appropriate.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

We suggest that the competent authorities are allowed to exercise discretion when applying the CSDR penalty regime for failed delivery and that these authorities recognise that less liquid securities are traded both on SME growth markets and regulated markets.

For further details see London Stock Exchange Group response to the ESMA consultation on CSDR[12].

EXAMPLE 2: OVERNIGHT REPO LIQUIDITY

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (“EMIR”)
  - Article 47 (*Investment Policy*)

[12] LSEG Response to ESMA Discussion Paper: Draft technical standard for the Regulation on improving securities settlement in the European Union and on central securities depositories (May 2014) http://www.esma.europa.eu/is/system/files/lseg_response_esma_dp_on_csdr__22052014.pdf

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- Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties ("EMIR RTS on requirements for CCPs" and for the purposes of this example together with EMIR, the "EMIR Rules")

    - Article 43 (*Highly liquid financial instruments*)
    - Article 45 (*Highly secured arrangements maintaining cash*)
    - Annex II (*Conditions applicable to highly liquid financial instruments*)

- Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("CRD IV")

    - Article 87 (*Risk of excessive leverage*)

- Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 ("CRR")

    - Article 429 (*Calculation of the leverage ratio*)
    - Article 429a (*Exposure value of derivatives*)
    - Article 429b (*Counterparty credit risk add-on for repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions*)
    - Article 451 (*Leverage*)

- Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the leverage ratio

(b) Please provide us with an executive/succinct summary of your example:

Overnight repo liquidity

In the normal course of business, a CCP collects margin from its members, a proportion of which is delivered in cash. It must then decide how and where to invest that cash so as to generate a liquidity profile to cover its needs for normal payments in variation margin across multiple currencies, together with any potential needs generated by a member default. Article 45 of the EMIR RTS on requirements for CCPs requires that 95% of cash deposited overnight must be "through arrangements that ensure the collateralization of the cash with highly liquid financial instruments". The consequence of this condition is that it forces the CCP to rely largely on the overnight repo market to comply with these rules while simultaneously maintaining the liquidity required for business as usual purposes.

This situation can be exacerbated when a CCP authorised under EMIR has US client margins to manage. CFTC Rule 17 CFR 1.25(d)(6) requires a CCP's repurchase agreements to be no more than one business day (or reversible on demand). This effectively limits CCPs operating across both the EU and US to only manage liquidity through overnight repo transactions or through the purchase of highly liquid government securities.

The EMIR Rules (combined with CFTC Rule 17 CFR 1.25(d)(6)) mean that large CCPs operating across both the EU and the US must therefore invest significant amounts of cash margin in the repo market each day,

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which: (i) is becoming increasingly challenging for such CCPs in current market conditions (as described in (c) below); and (ii) further reduces this available liquidity source to other market participants.

Capital and Liquidity Requirements

At the same time that CCPs increasingly need to rely on overnight repo markets, Basel III standards (implemented in Europe through CRD IV and CRR) are a strong disincentive for financial institution counterparties to participate in the repo market. Under the phase-in of the leverage ratio, banks already publish their leverage ratios and must fully comply with the leverage ratio requirements by 2018. The higher financial resource costs force the financial institutions to materially reduce their repo market capacity.

Additionally, new rules such as the Liquidity Coverage Ratio and the Net Stable Funding Ratio further constrain the balance sheets of financial institutions and lead to further reduced participation in the repo market.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

For our response to this question, please refer to the confidential letter that we submitted, containing relevant examples, data and/or statistics, as appropriate.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

The CPMI IOSCO quantitative disclosures (the “disclosures”) issued by various CCPs confirm our observations that there are a number of differences in the investment and liquidity profiles of CCPs. For example, US CCPs may invest their cash margins in money market funds or through unsecured cash deposits at commercial banks. In particular, the disclosure of one US CCP indicated that it invests a very significant amount (€11.5 billion) of cash in unsecured commercial bank deposits. On the other hand, EMIR-authorised CCPs are prohibited from investing in MMFs and cannot invest more that 5% of their cash margins in unsecured deposits overnight. In addition, while the disclosures indicate that some CCPs have access to central bank accounts and are able to deposit the cash margins they received from their clearing members in such accounts overnight, others (like LCH.Clearnet Limited) must invest their cash margins in the overnight repo markets to preserve capital and manage liquidity. The differences highlighted in the disclosures therefore demonstrate that there is an unlevel playing field caused by the differences in the investment and liquidity rules for different CCPs. Further, the different rules on CCP investments in money market funds in the US and EU places EU CCPs at a competitive disadvantage.

We make a number of suggestions below to remedy the issues outlined in our above examples.

Investment in money market funds (MMFs)

We suggest that the European Commission considers revisions to EMIR to allow CCPs to invest margins in secured money market funds provided certain conditions are met to ensure that they are safe, liquid and reliable. As discussed above, the current EMIR restrictions on a CCP’s investment policy is particularly problematic for CCPs that offer clearing services both in the EU and in the US (where such investment is allowed). To help create a level playing field, we would like to encourage the European Commission to revise the current restrictions in EMIR on depositing cash with MMFs or to provide guidance as to whether there is a possibility of creating a set of criteria against which to assess if a secured MMF could be considered EMIR-compliant.

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Highly creditworthy buy-side firms as investment counterparties of CCPs

We encourage the European Commission to amend EMIR to allow CCPs to treat regulated and highly creditworthy buy-side firms (e.g. pension funds and insurance undertakings) as potential investment counterparties for the purposes of entering into repo transactions for cash balances against high quality liquid assets. Such amendment would allow CCPs to diversify their investment counterparty risk profile, while simultaneously providing additional liquidity in the repo market for buy-side institutions.

Use of derivatives for hedging interest rate risk

Paragraph 2 of Annex II to the EMIR RTS on requirements for CCPs limits a CCP's use of derivatives to hedging: (i) the risks arising from default management; and (ii) the currency risks arising from liquidity management. Therefore, EMIR-authorised CCPs have no options available to hedge their interest rate risk, which arises naturally from their business model, leaving them exposed to profit and loss implications which can either be passed to clearing members through assessments or covered by a CCP's capital (neither of which is desirable). Instead, CCPs should be permitted to hedge such risk with counterparties who are well placed to price and manage this risk. For example, the current rules could be amended to ensure that CCPs can invest in specific derivatives, such as overnight index swaps (OISs) where the average time to maturity of the CCP's portfolio is below two years. Such amendment would enable CCPs to use certain derivatives to micro-hedge interest rate exposure, thereby protecting the CCP's and its members' financial resources.

Access to central bank liquidity facilities

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. Please refer to our response to Part E, question 14 for further information.

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3. Investor and consumer protection: please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on investor and consumer protection and confidence

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No comment

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4. Proportionality / preserving diversity in the EU financial sector: are EU rules adequately suited to the diversity of financial institutions in the EU? Are these rules adapted to the emergence of new business models and the participation of non-financial actors in the market place? Is further adaptation needed and justified from a risk perspective? If so, which, and how?

<u>EXAMPLE 1: OVERLAPS WITH BANKING LEGISLATION</u>

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- EMIR

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- Article 22 (*Competent authority*)

- CRD IV

- CRR

- Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council ("BRRD")

- Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions ("SSM Regulation")

(b) Please provide us with an executive/succinct summary of your example:

A key feature of recent regulatory reforms has been to address the role of entities such as CCPs, CSDs, and MTFs in the financial markets, including through the introductions of regimes governing how they are authorised and how they should operate (for example, EMIR for CCPs, CSDR for CSDs and MiFID II for MTFs). Before such regimes were established, these types of entities were regulated in some member states (such as France) by extensions to the regulations applicable to credit institutions, for example, by widening the definition of "credit institution" to cover such entities. However, this has led to situations where rules and supervisory practices that were originally designed for banks are applied to non-bank entities (CCPs, CSDs and MTFs) that either: (i) do not hold a banking licence; or (ii) hold a banking licence but do not engage in deposit taking or trading activities in the same way that a credit institution or an investment firm does.

In order to address this, National Competent Authorities ("NCAs") are often put in the position where they have to exercise their discretion not to apply certain rules or to grant waivers to accommodate these specific situations.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

BRRD

While it is recognised that the resolution processes in BRRD are not entirely appropriate for CCPs and we are awaiting legislation on CCP Recovery and Resolution, it remains the case that, the current rules do not adequately cater for the risks, operational and capital structures of CCPs that hold a banking licence. A key example of this is the minimum requirements for own funds and eligible liabilities ("MREL") under the BRRD. CCPs do not hold "eligible liabilities"; they tend only to hold Core Equity Tier 1 ("CET1") capital at a level that is compliant with both the CRR and EMIR. As EMIR only recognises liquid own funds as regulatory capital and excludes any other instruments such as subordinated debt, any additional liabilities held by a CCP would therefore only cover banking capital requirements and not those imposed on it in its function as a CCP. If a CCP were obliged to comply with the proposed criteria for determining MREL, it would need to increase its CET1 capital even though the risk profile of the CCP would not change.

CRD IV and CRR

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Under CRD IV, 'institutions' must comply with a range of operational and organisational requirements which are not necessarily linked to the risk or capital treatment of the activities that they undertake. A prime example of this is the CRD IV rules on remuneration, which are intended to protect against a culture of excessive risk taking by institutions that intentionally take balance sheet risk as part of their core operations. It follows that these rules should not apply to entities such as MTFs or CCPs that do not engage in those types of activities. MTFs operate as neutral, open access trading platforms, for equities and bonds respectively. They do not take positions, or risk principal or otherwise engage in risk taking activities that are intended to be the primary focus of CRD IV. Similarly, while certain CCPs are also designated as credit institutions under local laws (e.g. French laws) for a number of domestic reasons, including but not limited to, access to the central bank liquidity, they do not conduct any conventional banking activities. We therefore believe that the application of the remuneration requirements should focus on the types of activities legislators and policy makers intended to regulate as opposed to specific types of entity.

SSM

The ECB has taken the view that any Eurozone entity holding a banking licence is within the scope of the SSM and is therefore subject to ECB supervision. LCH.Clearnet SA is currently supervised by L'Autorité de contrôle prudentiel et de résolution (ACPR) L'Autorité de des marches financiers (AMF) and Banque de France, but due to its status as a regulated credit institution in France, is also subject to supervision by the ECB under the SSM.

There is therefore an overlap between the ECB supervisory powers over CCPs under the SSM and the supervision of CCPs by NCAs and CCP colleges under EMIR.

We do not believe, however, that it is the intention of the European Commission or the ECB, that the ECB (through the SSM mechanism) should supervise CCPs in a similar manner to the NCAs under EMIR. This view is supported by ESMA's opinion on the role of the ECB in EMIR colleges, which does not mention the ECB playing a part in the supervision of the CCP. For example, ESMA's opinion on the composition of CCP colleges under EMIR[13] contains a discussion of the process whereby the ECB can take a position and vote as the supervisor of particular clearing members, but not on the application of college rules to situations involving supervision of the actual CCP itself.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

We would encourage the European Commission to consider our examples above and to work with CCPs, MTFs and other market participants in the development of new (and, where applicable, the amendment of existing) regulations to ensure that such regulations are appropriate and proportionate to the entities that they cover. This will help to avoid the application of strict regulatory rules to unintended entities, and to reduce the adverse effects on the market that this may cause (such as increased costs to market participants, reductions in market liquidity and reductions in service provision and innovation).

BRRD

The European Commission should ensure that the upcoming legislation on Recovery and Resolution of CCPs removes authorised CCPs from the scope of BRRD where they are also credit institutions.

[13] ESMA/2015/838, 7 May 2015.

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CRD IV

The tiering system that was put in place by the UK Financial Conduct Authority (and similar arrangements in other member states) to deal with the types of investment firms that are subject to CRD IV takes into account the risk profile of MTFs (which are designed to be risk neutral) by putting them at the lowest level of application of the remuneration rules. We believe that the same principle should be applied to other entities which do not seek to take market or credit risks, and that CRD IV should be amended to explicitly reflect this.

SSM

We suggest that the SSM Regulation be revised to ensure that there is an explicit recognition that, as envisaged by EMIR, the competent authority of EMIR-authorised CCPs should be the NCA as designated under Article 22 of EMIR, regardless of whether the CCP in question is required to hold a banking licence.

EXAMPLE 2: CSDR INVESTMENT POLICY AND CAPITAL REQUIREMENTS

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CSDR
  - Articles 46(3)-(4) (*Investment policy*)
  - Article 47(1) (*Capital requirements*)

(b) provide us with an executive/succinct summary of your example:

We understand that there is a desire for a consistent approach to be taken to legislation applicable to bank and non-bank CSDs respectively (for example, CRD / CRR and CSD-R), as well as to legislation applicable to other FMIs (for example, EMIR for CCPs). However, a "one-size fits all" approach that does not reflect an institution's risk profile could disproportionately impact non-bank CSD businesses.

We believe that the CSDR investment policy and capital requirements are very burdensome for small and medium non-bank CSDs. While such requirements may be appropriate for CSDs that are banks, they do not sufficiently reflect the comparatively lower risk profile of non-bank CSDs.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

Article 46(3) (*Investment policy*) requires CSDs to invest only in cash or in highly liquid financial instruments with minimal market and credit risk. Further, such investments must be capable of being liquidated rapidly with minimal adverse price effect. This requirement mirrors the EMIR requirements on the investment policy of CCPs. Article 46(4) (*Investment policy*) further provides that the amount of capital not invested in accordance with Article 46(3) cannot count towards a CSD's required capital amount under Article 47(1) (*Capital requirements*). Whilst this strict prudential approach may be appropriate in respect of a CCP's risk profile (which requires prompt availability of financial resources to cover the CCP's credit and liquidity exposures), it is overly burdensome for non-bank CSDs that are not exposed to the same types of risk. A non-bank CSD's risk profile is

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characterised by operational risk rather than by financial and credit risks, and even their exposures to operational risk will be reduced with the migration to the T2S platform.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Articles 46(3)-(4) (*Investment policy*) and Article 47(1) (*Capital requirements*) of the CDSR should be recalibrated to take into account the specificities of a non-bank CSD's risk profile. This would enable non-bank CSDs to allocate their financial resources more effectively and avoid putting them at a competitive disadvantage compared to CSDs that also engage in bank-type activities and which have different business and risk profiles.

EXAMPLE 3: CSDR GOVERNANCE REQUIREMENTS

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CSDR
- Chapter II (*Requirements for CSDs*), Section 1 (*Organisational requirements*)
- Article 26 (*General provisions*)

- ESMA draft technical standards under CSDR, Annex II to the Final Report on the draft technical standards under the CSDR, ESMA/2015/1457/Annex II, 28 September 2015 ("ESMA draft RTS on CSD Requirements")

- Draft Article 49(9)

(b) Please provide us with an executive/succinct summary of your example:

CSDR creates a series of governance and organisational requirements for CSDs which do not take into account the fact that the main area of risk for non-bank CSDs and their participants is operational risk, rather than credit or investment risk.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

The requirement on CSDs to employ separate personnel responsible for risk and compliance under Article 49(9) of the ESMA draft RTS on CSD Requirements is a disproportionate requirement for small, non-bank CSDs both in terms of cost and operational uplift. We believe that for smaller non-bank CSDs combining these roles would not pose additional risk to the CSD, nor is such requirement necessary under the level 1 mandate.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

We suggest that governance and organisational requirements in CSDR be recalibrated to allow for smaller CSDs to enter the market without being required to create separate risk and compliance structures, provided they can satisfy their NCA that their systems and controls are proportionate to the services they provide.

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Part C: Unnecessary regulatory burdens

5. Excessive compliance costs and complexity: in response to some of the practices seen in the run-up to the crisis, EU rules have necessarily become more prescriptive. This will help to ensure that firms are held to account, but it can also increase costs and complexity, and weaken a sense of individual responsibility. Please identify and justify such burdens that, in your view, do not meet the objectives set out above efficiently and effectively. Please provide quantitative estimates to support your assessment and distinguish between direct and indirect impacts, and between one-off and recurring costs. Please identify areas where they could be simplified, to achieve more efficiently the intended regulatory objective.

EXAMPLE 1: FUNCTIONING OF EMIR COLLEGES

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- EMIR

  (i) Article 15 (*Extension of activities and services*)
  (ii) Article 49 (*Review of models, stress testing and back testing*)

(b) Please provide us with an executive/succinct summary of your example:

Functioning of EMIR Colleges

The implementation of the G20 commitment in Europe is bringing more products into clearing and CCPs continue to develop new products to address systemic risks associated with specific asset classes. It is, therefore, important that regulators and ESMA maintain an efficient college approval process for new products and services (Article 15 EMIR). Likewise, a smooth and reasonably fast process for the approval of risk methodologies would promote effective risk management by CCPs (Article 49 EMIR). We believe that both the process to approve new products and services required under Article 15 EMIR and that to approve changes to CCPs' risk methodologies under Article 49 EMIR could be streamlined.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

Article 15 (*Extension of activities and services*)

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 appreciate, for example, that the clearing of new classes of financial instruments is likely to introduce additional and novel risk within a CCP and would therefore require an appropriate level of consideration by National Competent Authorities (NCAs) and ESMA. However, we would not expect regulators to trigger such process for changes to a product belonging to an asset class already cleared by the CCP (for example an extension to new currencies or indices for a particular asset class or changes to the range of tenors under the existing risk framework) that would have less significant impacts on the financial market as a whole. Where the risk associated with a change in a product or service is outside of a CCP's risk framework and the CCP's risk methodology also needs to be reviewed, the process required under Article 49 may be more appropriate.

Article 49 (*Review of models, stress testing and back testing*)

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Article 49 EMIR requires the opinion of the college in respect to significant changes to risk models and parameters.

An example where the approach of regulators has not been in line with our expectations on the application of Article 49 EMIR includes the requirement to receive the approval of the college where changes to our risk methodologies are subject to the approval of the CCPs' Risk Committee. We believe that depending on the nature, type and materiality of the change, approval from the CCPs' competent authority, followed, if necessary, by a notification to the EMIR college, would provide sufficient rigor and oversight to the process. We do not believe 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. We would not expect our regulators to require the need for college approval every time our list of over one hundred stress scenarios is reviewed by our risk department. The need to take into account new scenarios or discontinue others swiftly is critical to our risk management. It would not be appropriate for such review to be implemented over a number of months.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Article 15 (*Extension of activities and services*)

LCH.Clearnet Limited recently received college approval for clearing of inflation swaps, which was a new product not covered by the original authorisation. We believe that the process has been applied in line with our expectations and we consider this example to be helpful when considering the appropriate use of Article 15.

We therefore recommend that ESMA issues guidance to the effect that the Article 15 process should not be triggered for changes to a product belonging to an asset class already cleared by the CCP (for example an extension to new currencies or indices for a particular asset class or changes to the range of tenors under the existing risk framework) that would have less significant impacts on the financial market as a whole.

Article 49 (*Review of models, stress testing and back testing*)

We believe that the issues noted in our response to (b) above will not require a change in the legislative text nor prescriptive rules. Instead, the development of publicly-disclosed guidelines by ESMA and National Competent Authorities (NCAs) would be useful. While in some circumstances national regulators may find it appropriate or necessary to go beyond the guidelines, these should form the basis for a common understanding among regulators and CCPs of the scope of the Articles 15 and 49 EMIR and therefore, the circumstance where they would apply. In the case of Article 49 EMIR such guidelines could be based, for example, on a self assessment by CCPs on the estimated impact of proposed changes to risk models and parameters. On this basis, competent authorities could assess whether the process under Article 49 EMIR is necessary or not. The CCP should be able to provide any relevant supplementary information in the responses to the questions in the self assessment to allow an adequate explanation of the changes and enable the competent authority to make an informed decision. This approach would ensure coordination between the CCP and their competent authority prior to a potential involvement of the college.

We therefore recommend that ESMA issues guidance to the effect that CCP regulators would not require college approval every time a CCP's list of stress scenarios (which for LCH, is over one hundred scenarios) is reviewed by the risk department. The need to take into account new scenarios or discontinue others swiftly is

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critical to a CCP's risk management. It would not be appropriate for such review to be implemented over a number of months.

EXAMPLE 2: THE CLEARING OBLIGATION

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- EMIR

  (i) Article 4 (*Clearing obligation*)

(b) Please provide us with an executive/succinct summary of your example:

LSEG supports a prompt implementation of the clearing obligation for those classes of standardised OTC derivatives for which a clearing obligation has been proposed.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

Whilst there is a lack of publically available empirical evidence to demonstrate our concerns, we would encourage the European Commission to consider our recommendations in (c) below to avoid placing EU CCPs at a competitive disadvantage to non-EU CCPs. Given that the clearing obligation has already been implemented in non-EU jurisdictions such as the United States, it is clear that if we cannot swiftly implement the clearing obligation in the EU, we risk disadvantaging EU CCPs in competition with those elsewhere.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

In order to avoid regulatory arbitrage between jurisdictions, we would encourage ESMA and the European Commission to finalise the regulatory process for the proposed clearing mandates as quickly as possible and to ensure that the approval of future proposed mandates is effected in a timely manner.

When an agreement on EU/US equivalence is reached, we would encourage the European Commission and ESMA to align, to the extent possible, the calendars for the entry into force of the clearing obligation for the first type of asset classes (targeted on 21 June 2016) and the recognition process for CCPs from equivalent third country jurisdictions in order to ensure a level playing field and avoid excessive bifurcation of liquidity in OTC derivatives.

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6. Reporting and disclosure obligations: the EU has put in place a range of rules designed to increase transparency and provide more information to regulators, investors and the public in general. The information contained in these requirements is necessary to improve oversight and confidence and will ultimately improve the functioning of markets. In some areas, however, the same or similar information may be required to be reported more than once, or requirements may result in information reported in a way which is not useful to provide effective oversight or added value for investors. Please identify the reporting provisions, either publicly or to supervisory authorities, which in your view either do not meet sufficiently the objectives above or where streamlining/clarifying the obligations would improve quality, effectiveness and coherence. If applicable, please provide specific proposals. Specifically for investors and competent authorities, please provide an assessment whether the current reporting and disclosure obligations are fit for the purpose of public oversight and ensuring transparency. If applicable, please provide specific examples of missing reporting or disclosure obligations or existing obligations without clear added value.

<u>EXAMPLE 1: TRANSACTION REPORTING</u>

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- EMIR
  - Article 9 (*Reporting obligation*)
- European Securities and Markets Authority Questions and Answers on the Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) (“EMIR Q&A”)
  - Part II (*Trade Repositories*), TR Question 17
- Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 202/92/EC and Directive 2011/61/EU (“MiFID II”).
  - RTS 23 - Obligation to supply financial instrument reference data.

(b) Please provide us with an executive/succinct summary of your example:

EMIR - Exchange traded derivative (ETD) reporting

The reporting requirements in EMIR appear to have been designed to report bespoke OTC derivatives, notably swap agreements, and have neglected the features of ETDs and some other types of OTC derivative (notably CFDs). UnaVista, the LSEG operated trade repository, receives a substantial volume of ETD reports (see Data Annex). A significant issue relating to ETDs is that they are not bespoke instruments and, as a result of their standardisation, their associated risk is considered at a position level for a particular instrument against a particular counterparty rather than at the trade level, for example on very standard positions such as equity index futures/options.

EMIR - Dual/single-sided reporting

We understand that there are market participants who suggest that dual-sided reporting in EMIR is itself a duplicative requirement which is not necessary to achieve the objectives set out in the EMIR reporting regime. But as the European Commission has seen with MiFID transaction reporting, single sided reporting can and does lead to a system where errors can continue in perpetuity, whereas dual sided reporting requires an end of day matching process that immediately identifies errors. As the European Commission has endorsed a best in class methodology and should seek to remedy implementation errors rather than abandon the high standard. Further, we believe that moving to a single-sided reporting regime would increase compliance complexity and burden after firms and infrastructure providers have built systems and processes to comply with dual-sided reporting, this creates further market disruption while firms are executing long-term plans to implement MiFID II reporting.

Global harmonisation of data standards

The EU has a unique opportunity to harmonise instrument identification across markets. Allowing for different numbering systems to coexist undermines the objective of further integrating EU capital markets. We are concerned at the negative impact on market efficiency/fragmentation of continuing to operate a differentiated regime. Regulators are seeking to standardise processes to make EU markets more efficient for all market participants to facilitate price discovery for one or more instruments, increase the trading of EU financial instruments cross-border and undertake cross-border supervision. Operating separate instrument identifiers would seem to create an unnecessary barrier toward efficiently doing any of these activities. Further such proprietary systems will lack proper governance and use of their numbering system may disrupt the market and lead to other unintended consequences.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.) [

For our response to this question, please refer to the confidential letter that we submitted, containing relevant examples, data and/or statistics, as appropriate.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

ETD Reporting

ESMA has recognised the legitimacy of position reporting (as per EMIR Q&A TR17), but has not detailed how the requirements for position reporting should be undertaken and this is not currently included in ESMA's reporting standards review. In particular, we seek clarification of how firms should define and calculate notional value at position level. This results in a lack of harmonisation across the TRs and it impacts some of the aggregations that the TRs are required to perform for public dissemination. UnaVista, endorses a calculation methodology of: Notional = Quantity * Price Multiplier * Price Strike (for options)/Settlement Price (for Futures). We urge the Commission and ESMA to establish clear Level 3 guidance or changes to existing RTS to clarify how firms and TRs can report ETD transactions effectively.

Dual/single-sided reporting

Rather than expend the effort and costs required to build systems and capabilities for single-sided reporting, regulators (ESMA in particular) and the reporting industry should work together to facilitate uniform reporting fields and data identifiers to ensure that dual-sided reporting is manageable and effective.

Global harmonisation of data standards

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In light of a recent discussion on Instrument identification under MiFID II and MiFIR, LSEG would like to endorse the approach adopted by ESMA, mandating the use of ISIN – a standardised, unique and unambiguous identifier used worldwide. Mandating of ISIN will also help CPMI-IOSCO work on common identifiers and will lead to broader global regulatory convergence.

7. Contractual documentation: standardised documentation is often necessary to ensure that market participants are subject to the same set of rules throughout the EU in order to facilitate the cross-border provision of services and ensure free movement of capital. When rules change, clients and counterparties are often faced with new contractual documentation. This may add costs and might not always provide greater customer/investor protection. Please identify specific situations where contractual or regulatory documents need to be updated with unnecessary frequency or are required to contain information that does not adequately meet the objectives above. Please indicate where digitalisation and digital standards could help simplify and make contractual documentation less costly, and, if applicable, identify any obstacles to this happening.

No comment

8. Rules outdated due to technological change: please specify where the effectiveness of rules could be enhanced to respond to increasingly online-based services and the development of financial technology solutions for the financial services sector.

EXAMPLE 1: BLOCKCHAIN & TECHNOLOGY

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

N/A

(b) Please provide us with an executive/succinct summary of your example:

Blockchain and distributed ledger

Blockchain and distributed ledger technologies are becoming a part of the financial mainstream and LSEG is pleased that policymakers and regulators are closely following and consulting with the industry on related issues such as virtual currency or distributed ledger technology. (ESMA's Call for evidence in April 2015[14]). Maintaining the dialogue with market participants and infrastructure providers will be of increasing importance going forward, as the technology, and the services that utilise it, develop.

LSEG is an interested party as a member of the Post Trade Distributed Ledger Group (PTDLG) and a founder of the Linux Foundation's OpenChain project[15]. LSEG is working to ensure that the chain it uses has regulatory and security built in it as part of its DNA, and not as an afterthought.

Currently, several start-ups and incumbent industry participants are beginning to develop and implement potential commercial applications (e.g. Nasdaq, ASX, DAH, R3).

[14] ESMA Call for evidence, Investment using virtual currency or distributed ledger technology (22 April 2015, ESMA/2015/532)
[15] Linux Foundation, OpenChain Project - Community effort to standardize common best practices for open software compliance. It is expected to reduce costs and duplication of efforts and ease friction points in the software supply chain. http://www.linuxfoundation.org/collaborate/workgroups/openchain.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

The statistical evidence is limited due to the fact that distributed ledger technology applied to financial services is still at its early stages of maturity.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Legislators and regulators should maintain a dialogue with the industry and its participants, e.g. via the Post Trade Distributed Ledger Group (PTDL), looking at how distributed ledger technologies could transform the way securities are traded, cleared, settled and reported.

Technology generally progresses on a faster development time scale than regulation, therefore, it is important that the EU designs rules that are technology neutral. We believe that going forward, the EU should be ensuring a proper balance between regulation and innovation, allowing the technologies to develop and keeping them under expert review. We suggest avoiding 'hard-wiring' technological requirements into the Level I proposals.

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9. Barriers to entry: please document barriers to market entry arising from regulation that the EU should help address. Have the new rules given rise to any new barriers to entry for new market players to challenge incumbents or address hitherto unmet customer needs?

EXAMPLE 1: CAPITAL REQUIREMENTS

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example)

- CRD IV
- CRR
- EMIR
  - Article 16 (*Capital requirements*)
  - Article 41 (Margin requirements)
  - Article 42 (*Default fund*)
  - Article 43 (*Other financial resources*)
    - Commission Delegated Regulation (EU) No 152/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on capital requirements for CCPs ("EMIR RTS on capital requirements for CCPs")

  - Article 1 (*Capital requirements*)
  - Article 2 (*Capital requirements for winding down or restructuring*)
  - Article 4 (*Capital requirements for credit risk , counterparty credit risk and market risk which are not already covered by specific financial resources as referred to in Article 41-44 of Regulation (EU) No 648/2012*)

    - EMIR RTS on requirements for CCPs

  - Article 35 (*Calculation of the amount of the CCP's own resources to be used in the CCP waterfall*

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- CSDR
- EBA final report on final draft regulatory technical standards on certain prudential requirements for central securities under the CSDR, EBA/RTS/2015/10, 15 December 2015 ("EBA final draft RTS on CSD prudential requirements")

(b) Please provide us with an executive/succinct summary of your example:

Capital charges

A key feature of recent financial services legislation has been to reform and strengthen capital requirements under the Basel III framework; this having been implemented in the EU mainly through the CRD IV and the CRR. While we understand that the CRR has a significant impact on many institutions and their ability to undertake market activity effectively, our response is mainly focussed on the impact of capital charges on FMIs.

EMIR capital

Wind-down and SITG

We consider that EMIR requirements on CCPs' wind-down capital and skin-in-the game ("SITG") capital is appropriately orientated towards the relevant risks it faces (covered by the regulatory capital). Indeed, EMIR and its delegated acts require authorised CCPs to have permanent and available capital sufficient to ensure an orderly winding-down or restructuring of the CCP's activities over an appropriate time span and to adequately protect the CCP against credit, counterparty, market, operational, legal and business risks (that are not already covered by margin requirements, default fund contributions, SITG and any credit lines). This must be a minimum of at least EUR 7.5m. The winding-down capital also includes the requirement for the CCP to be able to operate for a minimum period of 6 months following a resolution. Further, we believe that the placement of the 25% SITG layer directly after the resources of the defaulted member but before any resources of a non-defaulted member adequately ensures that the interests of CCP management are aligned with those of the clearing membership.

Trading book

Investments arising from cash assets posted to the CCP as margins, default fund contributions and other resources dedicated to the default waterfall are capitalised against market risk under the EMIR framework. According to Article 4 of the EMIR RTS on capital requirements for CCPs, market risk is required to be calculated on the basis set out under CRD IV. CRD IV requires the classification of an investment asset under the trading book or the banking book, depending upon the trading intent; positions held with a trading intent are those held intentionally for short-term resale and/or with the intention of benefiting from actual expected short-term price differences between buying and selling prices. ESMA's CRD4 Q&A No. 7 (4 June 2013) provides that while the investments held to meet regulatory requirements under Article 16 of EMIR may be held against the banking book, CCP investments based on cash assets posted as margins, default fund contributions and other resources of the default waterfall must be capitalised against market risk, because the CCP may need to liquidate them in case of a default of a clearing member

Deduction of tangible and intangible assets

With regard to the calculation of capital requirements under Article 16 of EMIR, we suggest amending the calculation method for CCP shareholder equity. We believe that there is a lack of consistency between EU

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jurisdictional requirements, with some NCAs requiring CCPs to subtract from shareholders' equity published in the last annual report: First Time Adoption (FTA) reserves, available for sale (AFS) and share awards reserves, as well as the sum of tangible and intangible assets. We understand that CCPs are also required to deduct the tangible and intangible assets from the calculation of the capital calculations, in light of the greater difficulties in liquidating such assets. But we do not understand the rationale for subtracting tangible assets from capital requirements, given that these assets may be liquidated over a reasonable period of time.

CSD Capital

The provisions of CSDR, and in particular the proposed capital requirements for CSDs in the EBA final draft RTS on CSD prudential requirements, require all CSDs to put in place a type of capital regime which has historically been applied to investment firms and banks operating as CSDs. The proposed regime imposes capital requirements to protect against risks which are not necessarily CSD-specific. For example, capital requirements related to wind-down have been inspired by CCP capital requirements under EMIR and do not accurately reflect the actual costs associated with winding-down a CSD.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

For our response to this question, please refer to the confidential letter that we submitted, containing relevant examples, data and/or statistics, as appropriate.

(e) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

EMIR capital

<u>Wind-down and SITG</u>

In the event that the European Commission considers it necessary to revise the capital requirements for CCPs in the future, we encourage the European Commission to ensure they remain risk sensitive and proportionate. In particular, CCP 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, which would lead to increased capital pressure on existing CCPs while new entrants to the market would be dissuaded from establishing themselves. Further, we would encourage the European Commission to ensure that the SITG layer is not re-calibrated in a way that strikes an incorrect balance between the interests of the CCP and the interests of the clearing members. In our view, the purpose of SITG is to align such incentives and not to subsidize the risks introduced by the clearing members to the market. This is appropriate because a CCP does not introduce such risks to the market; rather, its role is to manage them.

<u>Trading book:</u>

It must be highlighted that a CCP's investments arising from cash posted to the CCP as margins, default fund contributions and other resources linked with the default waterfall under Article 45 of EMIR are intended to be held until maturity, given that the default of a clearing member is not a frequent event. We therefore suggest that the rule for weighting the trading book method into the market risk be modified. We propose that the European Commission either provides a different weight for assets in portfolio, instead of using the CRD IV method, or to use the banking book method for assets held in accordance with Article 4 of the EMIR RTS on capital requirements for CCPs.

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Tangible and intangible assets:
We suggest that the European Commission confirm, either in the legislative text or in a Q&A document, the requirements for subtracting the total amount of tangible and intangible assets. We also suggest that this requirement is amended either: (i) to provide a weight to the sum of tangible and intangible assets in accordance with Article 4 of of the EMIR RTS on capital requirements for CCPs (i.e., 8% of 20%) or (ii) to subtract only the intangible assets from the shareholders' equity.

CSD Capital

Increases to CSD regulatory capital requirements acts as a barrier to entry for new 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 and do not act as an additional barrier to entry for smaller CSDs.

EXAMPLE 2: COLLATERAL EFFICIENCY

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CRR
  - Article 429 (*Calculation of the leverage ratio*)
  - Article 429a (*Exposure value of derivatives*)
  - Article 429b (*Counterparty credit risk add-on for repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions*)
  - Article 451 (*Leverage*)

- Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the leverage ratio

(b) Please provide us with an executive/succinct summary of your example:

Collateral efficiency

Inefficient use of collateral or poor capital recognition of collateral use can impact the ability of market participants to act as clearing members and provide market access to central clearing. A key example of this is the leverage ratio, which does not recognise the segregated margin posted to CCPs as exposure-reducing. As a result, there is less capacity for clearing members to offer client clearing services.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

Whilst there is a lack of publically available data to support our observations, we encourage the European Commission to seek input from relevant banks and investment firms in order to investigate the effect of the leverage ratio as a disincentive to a clearing member's willingness to offer client clearing services.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Collateral efficiency

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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.

EXAMPLE 3: CASH SETTLEMENT UNDER CSDR

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CSDR

- Article 40(2) (*Cash Settlement*)
- Article 54 (*Authorisation and designation to provide banking-type ancillary services*)

(b) Please provide us with an executive/succinct summary of your example:

Cash settlement under CSDR

A European central securities depositary ("CSD") that wishes to settle the cash leg of all or part of its securities settlement under Article 40(2) CSDR must be authorised either (i) to offer such services under the conditions specified in Article 54 CSDR i.e. be authorised as a bank; or (ii) to designate a bank (authorised in accordance with Article 8 of CRD IV) to undertake its cash settlement services.

Unless the designated bank falls below the Exemption Threshold (as defined below), the authorisation for CSDs falling within limb (ii) above will only be granted if the relevant designated bank complies with the strict conditions of Article 54(4), which provides, amongst other things, that such bank will be subject to an additional capital surcharge to reflect the risks resulting from the provision of intra-day credit to users of the CSD services. As a result, Article 54(4) imposes significant requirements for CSDs which are not banks (especially if they do not already have a bank within their corporate group to undertake such activities) and effectively reduces the scope of services that CSDs without a banking licence can undertake.

The CSDR provides an exception to the Article 54(4) requirements for banks who offer to settle cash payments for a CSD, provided that the value of such cash settlements (calculated over a 1 year period) is less than 1% of the total value of all securities transactions against cash settled in the books of the relevant CSD and does not exceed a maximum of 2.5 billion Euros per year (the "Exemption Threshold"). This Exemption Threshold is set at a level which is too low to be useful to non-bank CSDs that are struggling to find a bank willing to accept the imposition of the additional Article 54(4) conditions. Further, the Exemption Threshold fails to account for the fact that the provision of CSD services is often provided on a cross-border (and therefore cross-currency) basis. As a result, some European CSDs may no longer be able to offer cash settlement services for securities denominated in non-domestic currencies (for instance, US dollar or Hong Kong dollar denominated shares) because of the lack of non-EU banks willing to comply with the CSDR requirements and the difficulty of access to non-European central banks. This result is undesirable, both from a global competition perspective and in light of the CSDR objective to encourage cash settlement at CSDs.

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(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

At present there are very few CSDs in Europe which also hold a banking licence and, to date, we have seen no evidence that commercial banks intend to become designated under Article 54 of the CSDR in order to provide cash settlement services to CSDs. In our view, European banks are disincentivised to act as a CSDR designated bank due to the onerous requirements of Article 54(4) and it is unlikely that non-EU banks falling outside the scope of the CSDR to voluntarily accept the Article 54(4) conditions as they are currently calibrated. Whilst there is a lack of publically available data to support our observations, we encourage the European Commission to seek input from relevant banks in order to investigate the effect of the Article 54(4) requirement as a disincentive to offering cash settlement services to CSDs.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

We encourage the European Commission to raise the Exemption Threshold to incentivise more banks to offer cash settlement services to CSDs. For example, we suggest that a 10% threshold (and a corresponding increase in the 2.5 billion Euro limit) would be more appropriate. In addition, we suggest that the European Commission delegate power to ESMA, in consultation with National Competent Authorities (NCAs), to review the threshold on a regular basis so that it may be adapted from time to time as necessary to account for changing market circumstances.

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Part D: Interactions of individual rules, inconsistencies and gaps

10. Links between individual rules and overall cumulative impact: given the interconnections within the financial sector, it is important to understand whether the rules on banking, insurance, asset management and other areas are interacting as intended. Please identify and explain why interactions may give rise to unintended consequences that should be taken into account in the review process. Please provide an assessment of their cumulative impact. Please consider whether changes in the sectoral rules have affected the relevancy or effectiveness of the cross-sectoral rules (for example with regards financial conglomerates). Please explain in what way and provide concrete examples.

EXAMPLE 1: PORTFOLIO MARGINING

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- EMIR
- Article 41 (*Margin requirements*)
- EMIR RTS on requirements for CCPs
- Article 27 (*Portfolio margining*)

(b) Please provide us with an executive/succinct summary of your example:

Portfolio margining for derivatives

Portfolio margining is an important tool for market participants to be able to transact in derivatives while managing their capital adequacy effectively. Article 41 EMIR provides that a CCP may calculate margins with respect to a portfolio of financial instruments provided that the methodology used is prudent and robust, and Article 27 of the EMIR RTS on requirements for CCPs imposes further conditions on how portfolio margining is implemented in practice. We believe, however, that it is desirable to more tightly define some of the terms used in the context of correlations, and to address the importance of appropriate portfolio margining in a default management situation.

Significant and reliable correlations
We consider that it is too simplistic to assess the significance and reliability of individual correlations separately. Rather, the level and reliability of portfolio margining techniques depend upon the entire correlation structure embedded in the portfolio, and require a portfolio-level assessment standard.

The risk mitigation impact of low correlation
Both positive correlation and the absence of correlation have an impact on the joint price risk of a portfolio, and therefore on portfolio risk management. When two contracts are positively correlated, one expects a price increase in one contract to be accompanied by a price increase in the other contract. Conversely, if two contracts are not correlated, one expects prices to move independently. A price increase in one contract is then neither more nor less likely to be accompanied by a prince increase in the other contract. This intuitive concept can be made more precise through statistical definitions of dependence, covariance and correlation.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

For our response to this question, please refer to the confidential letter that we submitted, containing relevant examples, data and/or statistics, as appropriate.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

In seeking to introduce standards in respect of correlation measurement, we believe 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.

11. Definitions: different pieces of financial services legislation contain similar definitions, but the definitions sometimes vary (for example, the definition of SMEs). Please indicate specific areas of financial services legislation where further clarification and/or consistency of definitions would be beneficial.

EXAMPLE 1: DEFINITION OF AFFILIATE

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- EMIR
- Article 2 (*Definitions*)
- CRR
- Article 4(1)(38) (*Definitions*)

(b) Please provide us with an executive/succinct summary of your example:

Definition of affiliates

EMIR does not provide a definition of the "affiliate" of a clearing member.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

The definition of "affiliate" is important in the context of account segregation and would clarify when the positions and collateral of affiliates should or should not be included in a clearing member's client accounts.

For example, an appropriate definition of affiliate would be useful in the context of account segregation to clarify that the positions and collateral of "affiliates" should not be included in a client's account; instead they should either be included in a clearing member's proprietary account (House account) or in a separate dedicated account. This approach would avoid clients' exposure to entities belonging to the clearing member's group. In

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addition, it would be beneficial to have the definition and treatment of affiliates aligned between CFTC rules and EMIR with regard to EU-US equivalence. Finally, under the above proposal, affiliates would no longer be treated as clients, solving the issue (as raised by ESMA in its consultation on client accounts closed in September 2015) that clearing members may use affiliates to benefit from a lower "margin period of risk" (MPOR) in a gross margin account.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

Whilst there is a lack of publically available data to support our observations in (c) above, we encourage the European Commission to seek input from CCPs and clearing members to assess the impact of the lack of a definition of "affiliate" and to assist in the formulation of an appropriate definition. It is important that any such definition provides a clear and harmonised understanding of where affiliate's positions and collateral would sit among different account structures. We note that the CRR contains a reference to the term 'close links' in Article 4(1)(38). The European Commission may consider the CRR as one possible source of the definition for affiliates to be added to in Article 2 of EMIR.

EXAMPLE 2: DEFINITION OF EXCESS MARGIN

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- EMIR

- Article 39(6) (*Segregation and portability*)

(b) Please provide us with an executive/succinct summary of your example:

Definition of excess margin

EMIR does not provide a definition of excess margin even though this term is used in Article 39(6). The lack of clarity means that CCPs and clearing members face legal uncertainty as to what is considered excess margin and how it should be treated, particularly in the context of account segregation.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

Whilst there is a lack of publically available data to support our observations, we encourage the European Commission to seek input from CCPs and clearing members to assess the impact of the lack of a definition of "excess margin" and to assist in the formulation of an appropriate definition.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

We believe that amendments to EMIR should define the term "margin in excess" as the following:
'margin in excess' means, in respect of a client which has opted for individual client segregation, an amount of margin provided by such client to its clearing member that is over and above the amount called by the CCP, in respect of the relevant individually segregated account.

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12. Overlaps, duplications and inconsistencies: please indicate specific areas of financial services legislation where there are overlapping, duplicative or inconsistent requirements.

No comment

13. Gaps: while the recently adopted financial legislation has addressed the most pressing issues identified following the financial crisis, it is also important to consider whether there are any significant regulatory gaps. Please indicate to what extent the existing rules have met their objectives and identify any remaining gaps that should be addressed.

No comment

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Part E: Rules giving rise to possible other unintended consequences

14. Risk: EU rules have been put in place to reduce risk in the financial system and to discourage excessive risk-taking, without unduly dampening sustainable growth. However, this may have led to risk being shifted elsewhere within the financial system to avoid regulation or indeed the rules unintentionally may have led to less resilient financial institutions. Please indicate whether, how and why in your view such unintended consequences have emerged.

EXAMPLE 1: ACCESS TO CENTRAL BANK LIQUIDITY

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- EMIR
  - Article 85(1)(a)(*Reports and review*)
- CRD IV

- Article 8 (*Authorisation*)

(b) Please provide us with an executive/succinct summary of your example:

Central Bank liquidity

EMIR rules on placement of margin received by CCPs are based around the need for a CCP to manage large cash balances daily. Over the coming years, with the introduction of mandatory clearing requirements, CCPs expect cash balances from margin requirements and default fund contributions to continue to increase. In this context, the investment of cash is and will continue to be a key part of a CCP's business as usual activities. Having the ability to deposit cash at central banks' accounts on a business as usual basis would significantly support CCPs' liquidity management and limit their exposure to commercial banks. Additionally, we believe that allowing CCPs to access deposit facilities would increase transparency for central banks on how their respective cash currency is managed by CCPs in the event that one or more large clearing member(s) default in periods of market stress.

Without access to central bank liquidity, a CCP will manage its liquidity profile by storing cash margins in the repo markets (as LCH currently does). The liquidity profile is constructed so that enough cash is available each day to meet normal operational liquidity needs, with a buffer should a default event occur. Critically, in the days after a default, a CCP needs to liquidate collateral and use it to meet member variation margin calls. This creates the need for the CCP to store cash during this short period, as it cannot be tied up in investment activity.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

We believe that access to central bank liquidity would enable the CCP to manage a default effectively without the need to liquidate repo collateral, which would avoid procyclicality and may even have counter cyclical effects on the market. As mentioned in our response to (b) above, during the days following a default, it is important for CCPs to be able to access cash on demand. If such cash is tied up in overnight repos, CCPs would have to promptly liquidate the collateral assets into cash and it is likely that we will be carrying out such liquidation at the

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same time as the rest of the market, that is looking to do the same (e.g. in the case of a default of a large bank). However, if CCPs are able to deposit cash at central banks, then in stressed market conditions, those balances would be available on demand, and CCPs would also have the ability to deposit cash realised on the sale of repo collateral in such accounts, which will avoid the procyclical effects on the market of rapid liquidation of assets.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

We 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. During such a stress event a CCP must 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, one concludes that measures should be taken to facilitate CCP access to central bank liquidity.

While we do not believe that EMIR needs to be amended to achieve the above access, we do suggest that Chapter 1 of Title I of CRD IV be amended to remove CCPs from the scope of CRD IV. Member States and central banks should not need to require EMIR authorised CCPs to be authorised under Article 8 of CRD IV to access central bank liquidity (as the Eurosystem and Bank of England already provide under their respective policies). In our view, the right of access to central bank liquidity for EMIR-authorised CCPs derives from policies based on EMIR and not CRD IV authorisation.

Finally, we believe that the European Commission's review of EMIR, in line with Article 85(1)(a) EMIR, should reinforce that a deposit facility at one or more central bank(s) would be a significant step in supporting a CCP's liquidity management and limit their exposure to commercial banks.

EXAMPLE 2: BAIL-IN EXEMPTION

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- BRRD
  - Article 44(2) and 44(3) (*Scope of bail-in tool*)
- EBA's Final report on draft regulatory technical standards on the valuation of derivatives pursuant to Article 49(4) of the Bank Recovery and Resolution Directive (BRRD), EBA/RTS/2-15/1, 17 December 2015 ("*Draft RTS on valuation of derivatives*")

(b) Please provide us with an executive/succinct summary of your example:

Exemption of cleared derivatives from the bail-in tool

In order to promote the effectiveness of CCPs in the reduction of systemic risk and risk contagion in the financial markets, it is important to ensure that all liabilities arising from cleared derivatives are excluded from resolution authorities' bail-in powers.

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(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

Including cleared derivatives in the bail-in tool would have serious (and highly undesirable) consequences on to the effectiveness of a CCP's default management procedures. If a clearing member defaults, and its contracts with the CCP are subject to bail in, the CCP would be prevented from defaulting the member and/or liquidating the defaulter's positions. In such circumstances, the CCP would not be able to re-establish a matched book, which would increase risk-contagion to other market participants.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

We note that Article 44(2)(b) of the BRRD exempts secured liabilities from the bail in tool. In our view, this exemption would cover liabilities owed by a clearing member to the CCP because such liabilities are secured by margin and default fund contributions. For certainty, however, we would encourage the EU regulators to clarify in regulatory technical standards that liabilities owed to CCPs are exempt from the bail in tool in pursuant to Article 44(2).

In this regard, we appreciate and support the EBA's statement in recital 10 of the Draft RTS on valuation of derivatives that any exercise of the bail in power in relation to derivative contracts should be subject to the exemptions set out in Article 44(2) BRRD and to the discretionary exemptions laid down in Article 44(3) of BRRD.

As an alternative, European regulators may consider providing a full exemption of all cleared derivatives from the bail-in tool (i.e. widening the existing limited exclusion from the bail-in tool of derivatives with a remaining maturity of less than seven days). In our view: (i) enabling derivatives with a remaining maturity of over 7 days to be subject to the bail-in provisions of the BRRD undermines the objectives of EMIR to ensure that a CCP's default management process is sufficiently robust; and (ii) in any event, as set out in the paragraph above, such cleared contacts should already be exempt under Article 44(2)(b).

<u>EXAMPLE 3: CSDR BUY-IN</u>

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- CSDR
  - Article 7 (*Measures to address settlement fails*)

(b) Please provide us with an executive/succinct summary of your example:

The current rules on the buy-in procedure under the CSDR do not account for the fact that CCP's operate settlement netting models. This has the potential to cause additional settlement complexity, reduced netting efficiency and may ultimately increase the number settlement failure.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

For our response to this question, please refer to the confidential letter that we submitted, containing relevant examples, data and/or statistics, as appropriate.

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(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

We would encourage the European Commission to ensure that the final regulatory technical standards on the operation of the buy-in process under the CSDR are appropriately calibrated to ensure that the exemptions from the buy-in process do not affect the operation of a CCP's settlement netting models, which have the significant advantage of reducing the number of and volumes of payments and deliverables required to take place.

15. Procyclicality: EU rules have been put in place to make the financial system les procyclical and more stable through the business and credit cycle. Please indicate whether some rules have unintentionally increased the procyclicality of the financial system and how.

(a) To which Directive(s) and/or Regulation(s) do you refer in your example? (If applicable, mention also the articles referred to in your example.)

- EMIR
- Article 25 (*Recognition of a third country CCP*)
- EMIR RTS on requirements for CCPs
- Article 2 (*Information to be provided to ESMA for the recognition of a CCP*)
- Article 28 (*Procyclicality*)

(b) Please provide us with an executive/succinct summary of your example:

Procyclicality Buffers

EMIR regulatory standards on CCPs require buffers to be applied to margin models to ensure that margin calls avoid, where possible, disruptive or big step changes and have predictable procedures for adjusting margin requirements in response to changing market conditions. Such buffers are helpful in reducing the procyclicality inherent in variation margin payments and need to be taken into account when understanding a CCP's ability to facilitate margin management, including where used by third country CCPs seeking recognised status.

(c) Please provide us with supporting relevant and verifiable empirical evidence for your example: (please give references to concrete examples, reports, literature references, data, etc.)

Article 28 of the EMIR RTS on requirements for CCPs set out the current standards for CCP procyclicality buffers.

(d) If you have suggestions to remedy the issue(s) raised in your example, please make them here:

We believe that the current standards in place (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 procyclicality 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 procyclical nature of all the products they clear and markets they serve.

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However, we would encourage the European Commission and ESMA to consider requiring similar procyclical measures when assessing the recognition of 3rd country CCPs under Article 25 EMIR and Article 2 of the EMIR RTS on requirements for CCPs.

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