London Stock Exchange Group – Written evidence (FTS0064)

Introduction

1. LSEG (London Stock Exchange Group) welcomes the opportunity to contribute to the House of Lords' EU Financial Affairs Sub-Committee inquiry into the implications for equivalence of the Commission's Communication, titled "The European economic and financial system: fostering openness, strength and Resilience" encouraging *EU market participants to reduce their excessive exposures to systemic CCPs in third countries, and EU CCPs to build up their clearing capability*.

2. LSEG is a global financial markets infrastructure and data provider. Its diversified global business focuses on Data and Analytics, Risk and Balance Sheet Management and Capital Formation. The Group supports global financial stability and sustainable economic growth by enabling businesses and economies to fund innovation, manage risk and create jobs. The Group can trace its history back to 1698. We play a vital social and economic role in the world's financial system. With our trusted expertise, global scale, and foundational financial and transaction services — data, analytics, risk, collateral and processing solutions, capital formation and trade execution — we empower the sustainable growth and stability of our customers and their communities.

3. Post trade and risk management services are a key part of the Group's business operations and maintains of the multi-asset global CCP operator, LCH Group ("LCH") which operates subsidiaries in the UK (LCH Limited) and the EU (LCH SA, in France). Both are leading multi-asset class and international clearing houses, serving major international exchanges and platforms as well as a range of OTC markets. They clear a broad range of asset classes, including securities, exchange-traded derivatives, commodities, foreign exchange derivatives, interest rate swaps, credit default swaps and euro, sterling and US dollar denominated bonds and repos. In addition, whilst in the process of divesting the Borsa Italiana Group, LSEG continues to operate Cassa di Compensazione e Garanzia S.p.A. ("CC&G"), the Italian clearing house.

Executive Summary

4. As a systemically important financial markets infrastructure provider, LSEG has a responsibility to ensure the orderly functioning of markets and continuity of service for its customers and other stakeholders in any circumstance. With a global footprint and significant infrastructure businesses servicing markets across the UK, EU, US and Asia, the Group is well positioned to adapt to any eventual outcome in the relationship between the UK and the EU.

5. LSEG welcomes the conclusion of a Trade and Cooperation agreement between the UK and the EU, reached on 24 December 2020. We believe that regulatory cooperation is the foundation for effective and efficient oversight of financial markets infrastructures providing services on a cross-border basis, especially for CCPs.

6. We fully support ongoing dialogue between the EU and the UK to establish a structured regulatory cooperation on financial services, with the aim of establishing a durable and stable relationship between autonomous jurisdictions based on a shared commitment to preserve financial stability, market integrity, and the protection of investors and consumers.

7. In this submission, we discuss (1) the European Commission Communication, (2) LCH Ltd.'s approach to cross-border supervision, and (3) the potential impacts of a denial of recognition.

8. LSEG is focused on supporting EU customers to ensure they have uninterrupted access to our products and services, global multicurrency pool of liquidity, and can compete with non-EU firms on similar terms. Our priority is to ensure the orderly functioning of markets, continuity of service to our customers and supporting financial stability. This is also valid in the context of Brexit.

1. The Communication by the European Commission

9. Following the Communication by the European Commission 'The European economic and financial system: to foster openness, strength and resilience', we welcome the Commission's intention to discuss in detail measures to strengthen the resilience of financial-market infrastructures. Indeed, we believe that the creation of this Working Group provides an opportunity for EU firms to raise their concerns about the potential adverse effects of reducing their "excessive exposures to systemic CCPs in third countries". Any policy to deny recognition of UK CCPs, would have detrimental effects on EU financial stability and it would increase the risks and costs EU firms would face both from the transfer of their activity and in – the longer term – from a regulatory driven market fragmentation. We stand at the disposal of the European Commission to participate in this Working Group.

10. We believe we should collectively focus on the mechanism for the supervision of internationally active FMIs, including Third Country CCPs ("TC CCPs") of systemic importance to the EU. EMIR 2.2 is the right framework to ensure the supervision of those systemically important TC CCPs which are directly subject to EU rules and ESMA supervision.

11. These supervisory mechanisms and potentially additional requirements ensure EU firms can safely access UK CCPs to manage their risk efficiently. However, regulatory driven reduction of exposures to UK CCPs, as suggested in the EU's Communication would in fact increase systemic risk for EU firms and damage their competitiveness as we explain in this submission.

12. EU firms are currently accessing a significant portion of a Euro liquidity pool which is provided by non- EU firms (75%) on the EUR IRS market. Besides, EU firms clear more OTC Derivatives in USD (39%) than in EUR for example (33%). This is clear evidence why accessing a diverse, multi-currency pool of liquidity is of the utmost importance for EU firms' competitiveness and sound risk management. It also demonstrates why regulatory driven restrictions on individual currencies are not an effective solution as they introduce operational inefficiencies and broader financial stability concerns.

13. We believe a policy that would limit EU firms' access to TC CCPs, based on clearing transactions denominated in an EU currency would undermine the European Commission's and ECB's efforts to increase the international role of the Euro. Such a policy would discourage the clearing and overall use of the Euro on international markets, creating fragmenting clearing and potentially leading to more regionalised use of the Euro.

2. LCH approach to cross-border supervision

14. LCH is a multi-asset global CCP operator, majority-owned by LSEG. LCH has legal subsidiaries in the UK (LCH Ltd) and France (LCH S.A.). Given the global nature of LCH's activities and customer base, we also have operations in New York, Singapore, Sydney and Tokyo. LCH is a leading multi- asset class, international clearing house, serving major international exchanges and platforms as well as a range of OTC markets. It clears a broad range of asset classes, including securities; exchange- traded derivatives; commodities; foreign exchange derivatives; interest rate swaps; credit default swaps and euro; and sterling and Euro denominated bonds and repos.

15. On 21 September 2020, the European Commission announced the adoption of an 18-month equivalence decision for UK CCPs starting at the end of the implementation period. On 23 September 2020, the BoE and ESMA announced that they had agreed an MoU regarding arrangements for cooperation related to ESMA's monitoring and on-going compliance for UK CCPs. On 28 September 2020, ESMA announced LCH Ltd.'s temporary recognition under EMIR 2.2 as a Tier 2 (systemic) CCP, until 30 June 2022.

16. As a Tier 2 TC CCP, LCH Ltd is directly subject to EU Law ('EMIR' requirements) and directly supervised by ESMA. Besides, the European Court of Justice has unlimited jurisdiction to review ESMA supervisory decisions.[1] Furthermore, with the UK having onshored EMIR 2.2, UK CCPs are subject to similar if not identical regulatory regime to that of the European Union's CCPs. UK CCPs are to-date, the only TC CCPs globally to have been recognised under EMIR 2.2.[2] The direct application of EMIR requirements to LCH Ltd clearly shows there is no intention for our prudential or regulatory standards to evolve in a way that would diverge from EU requirements.

17. Besides, we believe that, given the international nature of OTC Derivatives markets and of CCPs supporting them, (i) regulatory convergence around CCP policies and risk management, as well as (ii) mechanisms supporting the cross-border operation of CCPs, are key to ensure financial stability and workable cross-border arrangements. By their very nature and role in supporting financial stability, CCPs should compete on the highest standards to support liquidity, our economies and growth.

18. In addition to the Bank of England's supervision in the UK, LCH Ltd is licenced in ten jurisdictions, including in the EU. We have been regulated by the CFTC in the US since 2011 and are regulated in several other G20 jurisdictions including Australia, Canada, Hong Kong, Japan and Singapore. We welcome direct supervision and are supportive of discussion on the strengthening of regulatory cooperation, disclosure and transparency, especially for internationally integrated businesses, which bring material benefits to users in multiple jurisdictions, including in the EU. We believe that internationally integrated markets served by internationally integrated services need internationally integrated supervision.

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[1] EMIR Article 69.

[2] https://www.esma.europa.eu/sites/default/files/library/third-country_ccps_recognised_under_emir.pdf – LCH Ltd / ICE Clear Europe Limited and LME Clear Limited already recognised as Tier 2 and Tier 1 respectively under EMIR 2.2.

19. As an international CCP, we are subject to several regulatory regimes and we operate to the highest standard applicable, and sometimes going beyond that. We, therefore, welcome the continuous application of EMIR requirements to LCH.

20. We believe that, the combination of direct supervision and direct application of EU law to LCH Ltd addresses the financial stability concerns of EU authorities particularly given the strong alignment of international supervisory regimes under the CPMI-IOSCO standards. This includes additional mechanisms to ensure the implementation of further requirements suggested under EMIR Article 25 (2b) including granting additional powers to the central bank of issue. We believe that, the direct application of EU requirements and direct supervision by ESMA, with a role for EU National competent authorities and central Banks in the day-to-day supervision of LCH Ltd via the CCP Supervisory Committee, should address concerns of EU authorities influence and control in the supervision of LCH Ltd.

21. Given the global nature of financial services and the OTC derivatives market in particular, it is imperative for market participants and Financial Market Infrastructures ("FMIs") to be able to operate on a cross-border basis within well-established regulatory frameworks, but most importantly in an open manner which promotes economic growth and healthy competition amongst market participants.

3. Potential impact of a denial of recognition

22. Global markets need internationally integrated CCPs to support their activities and ensure efficiencies and diversification of risk. This is demonstrated by LCH offering clearing services to members and clients in more than 60 jurisdictions and 27 currencies, and by the number of jurisdictions determined as equivalent or benefitting from similar deference mechanisms in CCP clearing. The Financial Stability Board ('FSB') and the G20 members' jurisdictions have consistently promoted cross-border arrangements between jurisdictions to avoid market fragmentation and enhance financial stability in the derivatives market, as market fragmentation is widely recognised as leading to increased costs and financial stability risks. It is worth noting that the EU has granted recognition to 37[3] CCPs in 15 jurisdictions designated as equivalent to ensure EU firms can access CCPs around the world and the material benefits these bring.

23. Participants in the derivatives market need access to global pools of liquidity to find the best possible prices for their customers and manage their risk efficiently, which is why they have continuously voiced concerns over the absence of equivalence or any denial of access to UK CCPs. LCH SwapClear provides a range of services in 27 currencies with volumes in USD, EUR and GBP in Q1 2021 amounting to 34%, 27% and 17% respectively of the outstanding notional. A key characteristic of the derivatives market is the availability of participants willing to take opposite risks to hedge their own and those participants are most likely to be found within a wide, diverse pool of

[3] https://www.esma.europa.eu/sites/default/files/library/third-country_ccps_recognised_under_emir.pdf – 21 CCPs in the APAC, 2 in Canada, 1 in Mexico, Switzerland, Brazil and South Africa, 5 in the US, 2 in the Middle East and 3 in the UK.

participants spanning multiple jurisdictions. This is why it is important from a cost and risk perspective to enable participants to access global pools of liquidity.

24. With regards to costs, the inability to access global pools of liquidity would reduce the number of firms who could provide hedges for derivative products raising execution prices and margining costs significantly. Based on a 2017 estimate, for each basis point (hundredth of a percentage point) of worsening execution prices, the increase in costs for EU firms would amount to approximately $25 billion annually. Furthermore, there would be additional capital costs in the form of margin requirements due to netting inefficiencies caused by the split of liquidity. Costs would most likely be passed on to end investors and firms' abilities to compete on equal terms on a global level would be diminished.

25. From a risk perspective, "captive" markets with a small number of market players and more correlated membership are more likely to be directional (that is, with imbalances between supply and demand), leading to increased risks borne by its members. Constrained liquidity and fewer participants to hedge risks would lead to increased financial stability particularly in case of a market turmoil. During turbulent market conditions and increased volatility, the need to be able to access global pools of liquidity is paramount to ease liquidity pressures. In addition, in case of members' default, the availability of a wider group of participants plays a key role in the success of managing the defaulter's portfolio and stabilising the market after such event.

26. The overwhelming response from LCH's members and clients indicates that there is no support for fragmentation of global liquidity and both our UK and EU customers want to be able to continue to access LCH services and obtain the numerous benefits of the extensive suite of products cleared by us in a single CCP.

27. The Bank of England's executive director for financial markets infrastructure, Christina Segal- Knowles, highlighted in her recent speech[4] the importance of having global pools of liquidity in order to make central clearing economical and that such pools should not correspond to national borders. She illustrated her point by providing key statistics including the number of non-UK incorporated clearing members at UK CCPs who make up 63% of the total number clearing members with £60 trillion of derivative contracts between UK CCPs and EU clearing members and £66 trillion between UK CCPs and US clearing members.

28. Our members and their clients in more than 60 jurisdictions recognise the benefits and efficiencies offered through LCH's global margin pool in terms of costs and risks and acknowledge that fragmentation particularly with the EU market would only lead to increased costs and systemic risks for both EU and non-EU financial markets. It is worth noting that 75% of the EUR volumes LCH SwapClear are originated outside of the EU, a clear indication of the

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[4] https://www.bankofengland.co.uk/-/media/boe/files/speech/2021/january/has-the-simpler-post-2008-financial-system-held-up-speech-by-christina-segal-knowles.pdf?la=en&hash=1D5368CE3851806186CCC076627CBC8461914606

importance of EUR as an international currency and why any restriction on EU firms access to LCH would have a significant impact for to non-EU firms.

29. In line with this, we believe that internationally integrated businesses, which bring material benefits to users in multiple jurisdictions, should be supported by global regulatory and supervisory oversight based on cooperation among authorities. We fully support ongoing the dialogue between the EU and the UK to establish a structured regulatory cooperation on financial services, with the aim of establishing a durable and stable relationship between autonomous jurisdictions based on a shared commitment to preserve financial stability, market integrity, and the protection of investors and consumers.

30. As mentioned above, the current equivalence for UK CCPs elapses on 30 June 2022. We believe we should collectively use of these 18 months to ensure the full implementation of EMIR 2.2, including ESMA supervision of the relevant TC CCPs and mechanisms to address any potential remaining concerns in view of the adoption of a more permanent equivalence decision for UK CCPs.

31. In parallel, ESMA will be conducting an assessment of systemic importance of TC CCPs in order to determine whether these are systemically important for the financial stability of the EU or one or more of its Member States. This assessment may conclude that a CCP should not be recognised to provide certain clearing services or activities in the EU (so-called 'denial of recognition'). This assessment would have to substantiate why the direct application of EMIR and direct supervision of the TC CCP by ESMA would not sufficiently address the financial stability risks identified and provide a quantitative technical assessment of the costs and benefits of such decision. We expect such assessment to take place during the temporary recognition.

32. Finally, the Working Group, established by the Commission, to assess technical issues relating to the transfer of EUR/EU denominated financial contracts cleared outside the EU to EU based CCPs, should be an opportunity to do this and to discuss the financial stability, costs and risk implications of imposing migration of some or parts of EU firms' clearing activities. We are in constant dialogue with EU authorities and are at the disposal of the European Commission should they wish to invite LCH in this Working Group.

Conclusion

33. The supervisory framework under EMIR 2.2 is an important tool to mitigate systemic risks to the EU through close regulatory cooperation and direct oversight of TC CCPs. In addition, when discussing these elements, we would suggest keeping in mind the effects of a restriction on euro-clearing on EU participants given their need to access to international pools of liquidity to hedge their activities (75% of the EUR volumes LCH SwapClear clears do not involve EU counterparties), but also the perception of the Euro as an international currency. Indeed, the trust in the stability and value of the Euro is a driving factor in its use as an international trading and reserve currency bringing benefits to the EU and Member States' economies, such as reduced borrowing rates for businesses and governments across Europe or reduced trading costs. A policy potentially restricting the use of the Euro risks affecting investor and market confidence in the Euro as a currency, which could affect its status as a global currency. There is a risk that, by undermining the position of the Euro and

reducing the benefits that come with it, such policy has wider consequences if it is seen as a shift towards a more local use of the Euro currency.

34. LSEG stands ready to contribute to the future work of the EU institutions on the assessment of systemic relevance of TC CCPs, discuss the financial stability, costs and risk implications of imposing migration of some or parts of EU firms' clearing activities to the EU and the need for EU firms to access to global pools of liquidity.

35. In the same manner, we would encourage and support the work on the future of UK-EU trade in services following the Trade and Cooperation Agreement. We believe that a framework fostering bilateral exchanges of views and analysis relating to regulatory initiatives, transparency and appropriate dialogue in the process of adoption, suspension and withdrawal of equivalence decisions and enhanced cooperation and coordination is necessary to ensure the well-functioning of financial markets, enhance financial stability and promote growth.

February 2021