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| Response Form to the Consultation Paper  |
| Draft technical advice on criteria for tiering under Article 25(2a) of EMIR2.2 |

**Responding to this paper**

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex III. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **29 July 2019.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

**Instructions**

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA\_QUESTION\_TATC\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA\_TATC\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_TATC\_ABCD\_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA’s website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Your input – Open consultations” 🡪 “Consultation on Position limits and position management in commodities derivatives”).

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

**Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading [Legal Notice](http://www.esma.europa.eu/legal-notice).

**Who should read this paper**

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from central counterparties (CCPs), clearing members and clients of clearing members.

**General information about respondent**

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| --- | --- |
| Name of the company / organisation | The London Stock Exchange Group |
| Activity | Central Counterparty |
| Are you representing an association? |[ ]
| Country/Region | UK |

**Introduction**

***Please make your introductory comments below, if any***

<ESMA\_COMMENT\_TATC\_1>

The London Stock Exchange Group (“LSEG” or “the Group”) is a financial market infrastructure provider, headquartered in London, with significant operations in Europe, North America and Asia. Its diversified global business focuses on capital formation, intellectual property and risk and balance sheet management. LSEG operates an open access model, offering choice and partnership to customers across all of its businesses.

LSEG operates multiple clearing houses. It has majority ownership of the multi-asset global CCP operator, LCH Group (“LCH”). LCH has two licensed CCP subsidiaries – LCH Ltd in the UK and LCH S.A. 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, LSEG operates Cassa di Compensazione e Garanzia S.p.A. ("CC&G"), the Italian clearing house, providing clearing services for a range of European securities as well as exchange traded equity and commodities derivatives.

Introductory remarks

LSEG welcomes the opportunity to comment on ESMA’s technical advice on criteria for tiering under Article 25(2a) of EMIR 2.2. After reviewing the advice we would like to note the following key comments:

* Although we are generally supportive of a principles-based approach, ESMA’s approach involves the collection of a large amount of information and it is unclear how some of this information relates to the criteria indicated in Article 25(2a) or would allow ESMA to assess the systemic relevance of a Third Country (“TC-CCP”) for the European Union (“EU”).
* We believe ESMA should clarify how the indicators chosen facilitate the determination of the systemic importance of a CCP for the EU, especially given that they are not described in a measurable way. The indicators set out information to be gathered from the TC-CCP, but do not provide any indication whether each response would suggest a greater or lesser systemic importance of the TC-PPC to the EU or how ESMA would use that information to come to a conclusion in that regard. We believe that further clarity in this regard should be provided.
* We believe that priorities should be assigned to the indicators as a means to identify those which are more important to the assessment. This would make the tiering assessment more predictable.
* In line with this, ESMA should have a subset list of information linked to these indicators for all CCPs as a starting point. At a second stage ESMA could ask for the full set of information only from those CCPs that may be more complex and likely to be deemed Tier 2.
* We believe that the relevance of specific indicators defined to assess the categories set out in primary legislation is unclear in several cases. For example, the choice of indicators to assess the impact of failure or disruption of a TC-CCP seem to relate to CCP’s risk management procedures rather than the impact of failure or disruption of a TC-CCP on EU.

Below we set out our responses to each of the questions raised in the Consultation Paper.

<ESMA\_COMMENT\_TATC\_1>

**Questions**

1. : Do you generally agree with the proposed indicators (Indicators 1, 2, 3, 4 and 5) to further assess the nature, size and complexity of the CCP's business? Please elaborate and if you disagree with any specific indicator, please suggest an alternative one to measure the relevant criterion.

<ESMA\_QUESTION\_TATC\_1>

Subject to our comments above, we generally agree with the proposed indicators chosen to assess the nature size and complexity of the TC-CCP’s business. We do have, however, some detailed comments on each of those indicators listed below.

***Indicator 1: Assess the ownership, business and corporate structure of the CCP including assessing in detail (i) the ownership structure specifying any qualifying holdings, (ii) other financial market infrastructures within the group to which the CCP belongs and (iii) whether the CCP acts in several capacities***

We believe that looking at the ownership and corporate structure of a TC-CCP in this context, does not necessarily provide an accurate indication of risk posed by the TC-CCP to the EU, as the ownership and corporate structure of a TC-CCP is not necessarily directly linked to the risk profile of a TC-CCP. It is further unclear how the indicator proposed will actually assist in determining the systemic relevance of the CCP in the Union. It would be beneficial on the other hand for ESMA to indicate ownership and corporate structures that would make a TC-CCP more systemically important to the EU.

We are of the opinion that a more relevant way to look at this indicator is to look at whether the TC-CCP is a standalone entity within a corporate group, fully resourced to cope with any extreme but plausible market conditions (as imposed under the EMIR framework). Where a CCP forms part of a broader corporate group, there is a potential risk of contagion, especially where the CCP is dependent on other entities/functions within the broader group. This risk should be mitigated through outsourcing arrangements consistent with the requirements of EMIR and ensuring that the CCP has robust resources.

Furthermore, we believe that more attention should be given to the existence (or otherwise) of limited recourse default funds and/or segregated services acting as firebreaks within a CCP’s structure against contagion which in our view can give a better indication as to the risk profile of a TC-CCP and its relevance to the EU.

***Indicator 2: Assess the financial instruments cleared by the CCP including (i) whether they are subject to the EU Clearing Obligation, (ii) whether they are denominated in EU CCYs and (iii) their complexity, price volatility and average maturity***

We agree with this indicator and we would highlight that this indicator should put particular emphasis on EU market focused products e.g. products that are designed to appeal directly to European market participants and/or contain a significant exposure to European legal entities. Moreover, non-linear products should also be taken under consideration by ESMA in relation to the risk presented to EU investors. When assessing indicator 2, there needs to be a clear distinction based on the nature or products cleared including between physically settled products such as sovereign debt products (i.e. Bonds, EU Government debt Repos) and cash settled products which are primarily used for hedging activities such as OTC and listed derivatives. For example, EU sovereign debt repos play a direct role in the central banks’ monetary policy operations which make them of particular importance for the EU. This is not the case of cash settled OTC derivatives which are commercial tools used for hedging risks. Besides, sovereign debt and cash equity products are closely linked to retail activity can have a more significant impact on EU’s financial stability than derivative products which are more wholesale and unrelated to central bank’s monetary policy.

LSEG agrees with ESMA that exposures to derivative instruments or other euro denominated or settled products should be considered in the assessment, particularly when the TC-CCP has the ability to charge or accept Euro denominated margin(s). Regarding complexity, the scope of financial instruments to be assessed should encompass all instruments that currently offered to EU market participants. Indeed, as pointed out by ESMA in its first annual report[[1]](#footnote-2) on EU derivatives markets, EU counterparties clear more USD products than EUR products (37% of the total notional of EEA derivatives in USD, 31% in EUR, 10% in GBP).

***Indicator 3: Assess the value and volume cleared by the CCP at the level of the CCP, at the level of each EU CM and at the level of non-EU CMs and whether they clear on behalf of EU clients and EU indirect clients [for OTC]***

We agree with ESMA’s proposal to assess the value and volume cleared by the TC-CCP. However, we believe that some of the metrics used could be misleading. Specifically, we believe that using notional to assess volumes of OTC derivatives is not a clear indication of risk and in some cases can lead to an over-estimation of the underlying risk managed by the TC-CCP. We would, however, recommend the use of Initial Margin (“IM”) as a better metric to assess the value of EU CMs exposure to the TC-CCP. Furthermore, we believe that metrics to be used to assess daily volumes of a TC-CCP should not be based on the notional outstanding as proposed in the consultation, as notional gives an indication of stock rather than the flow of transactions.

Regarding membership criteria, and in line with the legislative text of EMIR 2.2, we agree with ESMA that any TC-CCP that has a significant number of EU entities that act in a clearing member (“CM”) capacity (including a local branch or subsidiary or a EU parent entity that is acting as a CM) and where those CMs offer any form of clearing services to EU clients and EU indirect clients, should be taken under consideration for the tiering criteria.

***Indicator 4: Assess the transparency and liquidity of the relevant markets***

LSEG believes that, in the context of transparency and liquidity, ESMA’s assessment should be conducted at the level of the market cleared by the CCP rather than measuring the nature, depth and liquidity of the overall market. There can be wide differences in the liquidity of a particular instrument in two markets cleared by two different CCPs: for example, there are significant differences that can be observed in liquidity in a 5 yr EUR IRS depending on which CCP it is cleared on, for a variety of market reasons which are not necessarily linked to a potential risk to EU participants. This can be illustrated by the differences in prices and spreads for valuation and risks between two CCPs (‘CCP basis’). A CCP can only access the market it clears. This is of particular relevance for ESMA’s assessment as in case of a clearing member’s default, the CCP can only access to the market it clears to hedge and auction the position of the defaulter. Hence, a CCP’s ability to access global pools of liquidity can bring significant benefits to the default management process of a CM’s default.

It is against this background that we consider more accurate to measure the liquidity cleared by the said TC-CCP rather than the overall market liquidity when it comes to financial stability and more importantly to the risks that a TC-CCP can pose to the EU.

***Indicator 5: Assess the risk profile of the CCP***

We support the re-use of standard disclosures and self-assessments made under CPMI-IOSCO disclosure requirements. However, we do not believe that parameters listed in the second bullet point will provide a good representation of the risk that a TC-CCP can pose to EU markets as those parameters are not TC specific. Cyber-risks as indicated in the following section and potential IT disruption/failure can result in significant risks for all market participants and measures to address those risks should be included in all CCPs’ internal processes and procedures.

Furthermore, we believe that indicator 5 should consider the contagion risks within CCP clearing services especially if only specific clearing services are offered to EU clients. Limited-recourse default funds and/or segregated services can act as firebreaks within a CCP’s structure against contagion and where they exist, ESMA’s assessment of the risk profile of a TC-CCP and its relevance to the Union should only be based on the specific services offered in the EU.

<ESMA\_QUESTION\_TATC\_1>

1. : How would you envisage ESMA to consider risks and in particular cyber-risks in relation to the evaluation of systemic importance?

<ESMA\_QUESTION\_TATC\_2>

We believe that the impact of a TC-CCP’s failure to the EU is the primary risk that ESMA must consider (as stipulated in the Level 1 text). In that respect and given that markets are global, we believe that cyber-risks should not be a factor which solely determines the systemic importance of a TC-CCP which has a relevant exposure to EU markets and its participants. We believe that cyber-risks must be addressed in a collective manner across jurisdictions and effective communication and coordination between regulatory authorities is of vital importance to effectively manage cyber-risks.

As you are aware, cybersecurity initiatives in the financial sector have been launched at both EU and international level and we understand that PFMIs on cyber resilience have been adopted by most CCPs on a global level, strengthening the resiliency of the financial sector and enhancing safety of market participants’ data. It is our view that all CCPs, be that EU or TC-CCP, present the same or similar amount of risk to EU market participants from a cyber-security perspective. Therefore, we do not believe that a specific criterion should be applied distinction needs to be made in regard to cyber risks and that all TC-CCPs must have the necessary measures in place to address potential future threats.

<ESMA\_QUESTION\_TATC\_2>

1. : Do you generally agree with the proposed indicators (Indicators 6, 7, 8 and 9) to further assess the effect of a failure or disruption of the CCP? Please elaborate and if you disagree with any specific indicator, please suggest an alternative one to measure the relevant criterion.

<ESMA\_QUESTION\_TATC\_3>

***Indicator 6: Assess the margins, default fund contributions and eligible collateral***

We broadly agree with ESMA’s assessment with regard to margins, default fund contributions and eligible collateral, however we would welcome additional clarity from ESMA on how the data on margins, default fund contributions and eligible collateral would be used to assess potential risks.

Contrary to the parameters used in this assessment, we believe that the impact on EU CMs from the failure of a TC-CCP would relate to the resources they have committed to the default waterfall, and the likelihood of recovering collateral following a resolution or insolvency event (i.e. the robustness of bankruptcy remoteness arrangements for collateral). We also consider that uncommitted resources held at a CCP level in a highly liquid form compared to committed resources, would need to be considered carefully when assessing liquidity risks.

***Indicator 7: Assess committed/ uncommitted resources and liquidity resources***

We broadly agree with indicator 7, however, we would like to highlight the need for a clearer distinction between committed and uncommitted resources. We are of the opinion that, having significant cash available (i.e. liquid resources) at a CCP level (regardless of whether those resources are committed or uncommitted) provides the TC-CCP with a much more immediate response to an extreme but plausible market condition.

***Indicator 8: Assess settlement and payments, including the use of central bank money for settlement***

We believe that ESMA’s suggested parameters to assess settlement and payments, including the use of central bank money for settlement are primarily risks being managed by the TC-CCP rather than direct impacts to the EU’s financial stability. Specific features of settlement and payment arrangements, such as the approach to intermediaries or the technology approach (e.g. distributed ledgers) do not affect the potential impacts. As an alternative indicator we would view the share of a TC-CCP’s flow in the EU RTGS systems (directly or indirectly) to be more relevant to the overall importance of the TC-CCP to the EU financial system. Furthermore, we believe that a clear distinction needs to be made between physically settled cleared products and products used to support investors hedging strategies which are not directly involve physical settlement.

With regards to the extent to which central bank money is used for settlement, great efficiencies can be achieved in terms of liquidity provisions in the settlement space and one could argue that those efficiencies go hand in hand with greater interconnectedness with EU’s monetary system and consequentially greater monitoring capabilities. Therefore, we believe that ESMA should take care not to disincentivise direct connections to EU infrastructure by TC-CCPs, because greater risks may be presented if access is intermediated by a third party.

***Indicator 9: Assess the framework for recovery and resolution***

We believe that, in the absence of an EU recovery and resolution regime, ESMA’s approach in the assessment of a TC-CCP’s framework for recovery and resolution is not clear. Some factors of such a regime – such as the existence of a Crisis Management Group and the lower likelihood of insolvency – would reduce the potential impact on EU CMs. Other features (lack of transparency about likely actions by the resolution authority) could potentially increase impact.

LSEG believes that, in order to assess the framework for recovery and resolution and the effects of its failure or disruption to the stability of the EU a confirmation that a TC-CCP adheres to the PFMIs as adopted by its local regulator should be sufficient. Appropriate implementation of PFMIs would require a CCP to have practices in place to address recovery and orderly wind-down (i.e., resolution) scenarios, including that a CCP have appropriate plans to address scenarios that could potentially prevent it from being able to provide its critical services. It is against this background that we believe indicator 9 should recognise local jurisdictions’ adoptions of the PFMIs and the importance of this for a CCP to effectively manage the risks present in its markets and the extent to which the local regime provides for overseas regulators to be informed through crisis management arrangements

<ESMA\_QUESTION\_TATC\_3>

1. : Do you generally agree with the proposed indicators (Indicators 10 and 11) to further assess the CCP’s clearing membership structure? Please elaborate and if you disagree with any specific indicator, please suggest an alternative one to measure the relevant criterion.

<ESMA\_QUESTION\_TATC\_4>

***Indicator 10: Assess and identify the CMs, and in particular EU CMs, EU clients or EU indirect clients***

We agree with ESMA’s proposal to assess and identify CMs, and in particular, EU CMs. We would like to emphasise the importance that membership criteria play in a CCP’s lines of defences. Furthermore, possible contagion between services and mutualisation via the CCP’s default waterfall is also important and should be taken under consideration.

Regarding EU CMs participation to a TC-CCP, any TC-CCP that has a significant number of EU entities that are CMs (including a local branch or subsidiary or a EU parent entity that is acting as a CM) and where those CMs offer any form of clearing services to EU clients and EU indirect clients, should be taken under consideration for the tiering criteria. We believe that ESMA should have a more granular approach when it comes to the share of the CCP’s clearing activity. CM’s clearing activity, although not significant at a CCP level, could be substantial if looked at a product level so ESMA should look into having a more granular assessment too.

***Indicator 11: Assess access to the CCP and the clearing services provided by the CCP***

Although we agree with ESMA’s suggestion to assess access to a TC-CCP, we would like to note that assessing access and the clearing services provided by a TC-CCP is not an easy task and is primarily based on the CCP’s membership structure. The presence of distinct groups, and specifically accesses via non-traditional models can add further complexity in the process.

Regarding wider membership criteria, as indicated in previous questions, we agree with ESMA that any TC-CCP that has two or more EU entities that are CMs (including a local branch or subsidiary or an EU parent entity that is acting as a CM) and where those CMs offer any form of clearing services to EU clients and EU indirect clients, should be taken under consideration for the tiering criteria.

<ESMA\_QUESTION\_TATC\_4>

1. : Do you generally agree with the proposed indicator (Indicator 12) to further assess alternative clearing services? Please elaborate and if you disagree with any specific indicator, please suggest an alternative one to measure the relevant criterion.

<ESMA\_QUESTION\_TATC\_5>

***Indicator 12: Assess substitutes to the CCP clearing service***

We agree with ESMA’s proposal to assess substitutes to the TC-CCP’s clearing service but would further suggest that this assessment could include financial instruments denominated in currencies other than EU currencies provided that they are heavily relied upon by EU entities as per our comment on indicator 3.

<ESMA\_QUESTION\_TATC\_5>

1. : Do you generally agree with the proposed indicators (Indicators 13 and 14) to further assess relationships, interdependencies, or other interactions? Please elaborate and if you disagree with any specific indicator, please suggest an alternative one to measure the relevant criterion.

<ESMA\_QUESTION\_TATC\_6>

***Indicator 13: Assess outsourcing arrangements***

We believe that, the outsourcing of certain activities in itself should not be an indicator of the systemic importance of a TC-CCP, provided those outsourcing arrangements and managed by the CCP in accordance with the requirements of EMIR. In particular data protection standards should be consistent with the requirements set out under GDPR.

***Indicator 14: Assess the links or connections with other FMIs, other FIs and the broader financial system***

We agree with ESMA’s suggested parameters to assess links or connections with other FMIs other FIs and the broader financial system. We would note however, that direct connections to a CSD or payment systems should not necessarily be perceived by ESMA as a potential risk to the EU that could lead to a higher tiering as this could incentivise a TC-CCP to use more risky indirect links.

<ESMA\_QUESTION\_TATC\_6>

1. : Do you identify other benefits and costs not mentioned above associated to the proposed approach (option 3)? If you advocated for a different approach, how would it impact this section on the impact assessment? Please provide details.

<ESMA\_QUESTION\_TATC\_7>

We agree with option 3 as considered by ESMA, however, we note that additional clarity as to how some of the information collected will be used to determine systemic importance of a TC-CCP to the EU would be welcomed. Furthermore, we believe that as noted in our responses above, some indicators must be reviewed as we do not believe that they are relevant and their application to TC-CCP is questionable.

Finally, we are of the opinion that following cooperation arrangements between different supervisory authorities and ESMA, ESMA’s oversight should incorporate some level of deference to the extent that a TC-CCP is fully compliant with international standards such as CPMI-IOSO. Such approach would significantly increase efficiency in the supervision of TC-CCPs and strengthen financial stability.

<ESMA\_QUESTION\_TATC\_7>

1. ESMA Annual Statistical Report EU Derivatives Markets 2018 – page 8, https://www.esma.europa.eu/file/49540/download?token=AWwaSy5l [↑](#footnote-ref-2)