EMIR 3 and the importance of access to global markets

As key financial market infrastructures, Central Counterparties (CCPs) are important to protecting financial stability and liquidity during turbulent periods. They support the growth of the economy by facilitating efficient management of capital and act as superior risk managers. LSEG's CCPs (LCH Ltd and LCH SA) in both London and Paris fulfil this essential role. Our market leading risk management framework underpins everything that we do to ensure credit and liquidity resilience of our clearing services and adherence to strictly prescribed risk management standards.

Mandatory central clearing for a range of Over-the-Counter (OTC) financial instruments was a vital part of the response to the global financial crisis, as world leaders made commitments at the G20 Pittsburgh Summit in 2009 to improve transparency and mitigate risks. These commitments materialised at a national level through frameworks within which CCPs could operate and be supervised in the most efficient way.

Despite local implementation, these frameworks catered for the fact that OTC Derivatives markets are global – and there is widespread acknowledgement that clearing services spanning across jurisdictions should continue be subject to cross-border supervision. For example, the European Market Infrastructure Regulation (EMIR) that ensures wide access by EU firms to non-EU CCPs via a mechanism of equivalence.

Derivatives markets are global

OTC derivative markets are global, and the clearing services supporting these markets are global too. For example, LCH SwapClear operates a global Interest Rates Derivatives (IRD) clearing service in 27 currencies[1] and provide services to customers in 60 jurisdictions. As a result, we are licenced in 11 jurisdictions[2], including with the European Securities and Markets Authority (ESMA) as well as the Bank of England and other major regulators around the globe. One demonstration of the cross-border nature of IRD markets is that they are deeply multicurrency (Figure 1). Whilst an important one, the EUR denominated IRD, is only contributing to this global market.

[1] USD, EUR, GBP, AUD, CAD, NZD, ZAR, JPY, SEK, CHF, CZK, NOK, CNY, KRW, PLN, SGD, INR, HKD, ILS, HUF, THB, TWD, MXN DKK, BRL, CLP, COP.

[2] LCH Limited is licenced by: The Bank of England, the European Securities and Market Authority (ESMA), the Commodity Futures Trading Commission (CFTC), Swiss Financial Market Supervisory Authority (FINMA), Banco de Mexico (BdM), Ontario Securities Commission (OSC), Autorité des Marchés Financiers (AMF Québec), the Australian CS Facility, the Monetary Authority of Singapore (MAS), the Japanese Financial Services Agency (JFSA), the Hong Kong Securities and Futures Commission ATS-CCP.

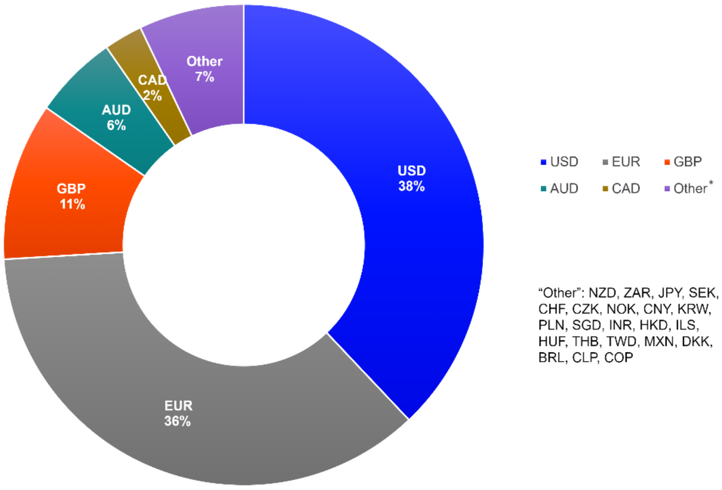

Figure 1: LCH's SwapClear Volumes by currency

EU Firms are active contributors of this global pool of liquidity

Overall, flows from EU Firms across all currencies represented c.17% of the total IRD notional registered at SwapClear in 2022, with 83% of the liquidity originating outside the EU (Figure 2). EU Firms tend to clear as much in non-EUR as in EUR, with 2022 data showing that notional registered in EUR represented c.10 % of SwapClear's total IRD notional in 2022 against c.7% for other currencies. EU Firms require access to global liquidity pools to hedge their risks and service their customers in all currencies in an efficient manner.

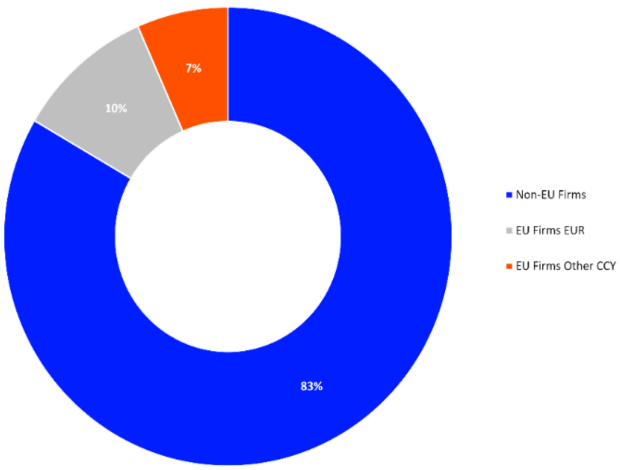

Figure 2: LCH's SwapClear EU vs non-EU domiciled firms clearing % for 2022 FY.

The EUR is an international currency

EU Firms represented c.30% of the EUR IRD notional registered in 2022 at SwapClear. 70% of the EUR IRD notional registered at LCH's SwapClear originated outside the EU (figure 3), demonstrating that the EUR is an international currency. EU Firms must be able to access global liquidity in EUR without constraints to ensure they can hedge real-economy risks (mortgages, trade exposures, pension investments etc.) in a safe and sound manner.

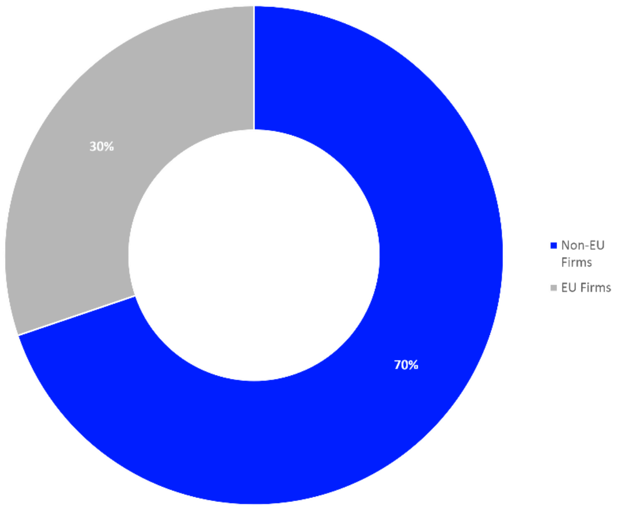

Figure 3: LCH's SwapClear EUR clearing % for 2022 FY

Constraints to market access create artificial fragmentation, as well as costs and risks to EU Firms and the EU economy

The international nature of OTC Derivatives markets, and IRD in particular is not recognised in the recent EMIR 3 Proposals[3] that force EU Firms to clear part of their EUR OTC Derivatives in the EU. The proposals include a requirement for financial and non-financial counterparties subject to the clearing obligation to hold active accounts at CCPs established in the EU (Active Account Requirement ("AAR")). EU Firms would be required to clear a certain proportion of the trades in asset classes identified as of substantial systemic importance at EU CCPs. Asset classes in-scope of the AAR are (i) IRS in EUR and Polish Zloty (PLN), (ii) Credit Default Swaps (CDS) denominated in Euro and (iii) Short-Term Interest Rate Derivatives (STIR) denominated in Euro.

EU market participants have raised concerns in relation to the increased financial risks and costs associated with the AAR proposal. Access to diversified market infrastructures serving global markets provide market efficiencies that benefit not only EU clearing members and their clients (including end-users) but the entire EU economy. Limiting the access of EU Firms to non-EU infrastructures will come at a cost in the form of additional margins and higher prices and risks to financial stability for EUR derivative contracts which will be negotiated in a less liquid market[4]. Crucially, such higher costs would make the real EU economy participants i.e., pension funds, manufacturing sector etc. less competitive

[3] https://ec.europa.eu/info/law/better-regulation/

[4] LSEG's Response to the Commissions EMIR 3 Proposals: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13378-Derivatives-clearing-Review-of-the-European-Market-Infrastructure-Regulation/F3387949_en

and unattractive compared to their international peers. Instead, EU market participants should be free to access any CCP irrespective of their location so long as they are appropriately supervised.

Forcing market behaviours will result in higher execution, clearing and operational costs for the industry, and ultimately increased financial stability risk for the EU. Global markets, both from a systemic risk perspective and efficiency for the real economy, are best served by global CCPs. Therefore, instead of focusing on restricting access to global markets, the EU should focus its attention on enhancing the cross-border supervisory framework to address any outstanding stability risks.