23 August 2017

London Stock Exchange Group response to the European Securities and Markets Authority ("ESMA") Consultation paper on Guidelines on CCP conflicts of interest management

Introduction

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 today multiple clearing houses. It has majority ownership of the multi-asset global CCP operator, LCH Group ("LCH"). LCH has legal subsidiaries in the UK (LCH Ltd), France (LCH S.A.), and the US (LCH LLC). It is a leading multi-asset class and 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, energy, freight, 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.

LSEG welcomes the opportunity to comment on ESMA's Guidelines on CCP conflicts of interest management.

General remarks

LSEG is fully supportive of ESMA's objectives to promote supervisory convergence and ensure consistent implementation of the EMIR requirements. We welcome the publication of the guidelines on CCP conflicts of interest, which should be helpful for both National Competent Authorities and CCPs.

We have provided detailed responses to the questions below, but would also like to share some general views on ESMA's proposed guidelines:

1. **Scope of the guidance:** we believe certain aspects of the guidelines would benefit from further clarification. For example, it should be clear that some situations are outside the CCP's control, in particular the conflicts of interest arising between a clearing member and its clients. Concerning conflicts of interests between a CCP and its interoperable CCP, the guidelines should clarify what is expected from the CCP in a more granular way.

2. **CCPs belonging to a group:** we welcome the definition of measures to cover the specific case of CCPs belonging to a group. However, these measures should be carefully calibrated to balance the need to achieve coordination in a group structure with the principle of independence of the CCP with respect to the other entities belonging to the group.

3. **Consistency with member states' national laws:** we note that care will be needed to ensure that the provisions in the guidelines are aligned with the legal framework in the various member states (e.g. the Italian Civil Code concerning organisational requirements, or requirements in France applying to whistle-blowing). This approach would avoid duplicative or potentially conflicting requirements.

4. **Objective orientated:** we would suggest being less prescriptive on some aspects of the guidance.There are several instances where the objectives pursued by the guidance could be fulfilled in a different, less prescriptive way (e.g. number of contracts and mandates by board

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members, rules concerning the ownership of financial instruments, and rules concerning gifts). We have provided some suggestions under the specific comments section below.

Specific comments

Q1. Do you agree with the definition and with the scope here above described?

We welcome the inclusion in these guidelines of a definition and scope of conflicts of interest, and fully support the objective to ensure common, uniform and consistent application of the requirements on CCP conflicts of interest management. We understand that the definition is non exhaustive ('at least') and support it. We would suggest making it even clearer: in particular it should be expressively stated that the definition of the guidelines is non exhaustive and without prejudice to existing legal requirements to which the CCP may already be subject, for example as a matter of corporate law.

Furthermore, with respect to the sources of potential conflict of interests which should be considered by the CCPs outlined in paragraph 19, we believe that the last item in the list regarding conflicts "*between clearing members, clients or between a clearing member and a client*" is out of scope for the purpose of these guidelines. Indeed, it refers to circumstances which are outside the control of the CCP, and which the CCP cannot reasonably prevent or monitor. We would, therefore, suggest the deletion of this item.

Moreover, while it is fully appropriate that the scope of the guidelines includes the potential conflicts of interest that may arise between the CCP and an interoperable CCP, we would welcome concrete examples of situations of potential conflict of interests between a CCP and its interoperable CCP may arise, similar to the manner in which it is done for CCPs belonging to a group.

We understand the need for CCPs to appropriately manage a potential or actual conflict of interest throughout its duration, and support the aim of the requirement set out under paragraph 20. However, we believe that the first sentence of paragraph 20 could be clarified: if a conflict of interest 'continues to have effect', the conflict itself has by definition not 'ceased'. We understand that what is meant is that the conflict of interest might still have effect although **the situation or circumstances from which the conflict arises** may have ceased. We are proposing to clarify this in the draft. In addition, we would like to point out that it would be very difficult for the CCP to define *ex-ante* a length of time to cover this scenario, and would recommend clarifying that it will be determined on a case by case basis. Thus, we would suggest the following revised text for paragraph 20:

> *"20. **It may be appropriate for** CCPs ~~should~~ **to** define a length of time ~~during which~~ **when** ~~the~~ **a** potential or ~~real~~ **actual** conflict~~s~~ of interest ~~are presumed to continue~~ **is still considered** to have effects ~~after the conflict ceased~~ **even once the situation or circumstances that led to the conflict being identified have ceased**. Different timelines may be set-up by the CCPs**, on a case by case basis,** depending on the type of conflict situation or concerned relevant person."*

Q2. Do you think that the CCPs should implement such organisational arrangements to avoid an inappropriate use of confidential information?

We support the principle that confidential information should not be utilised inappropriately. With reference to the requirement outlined in paragraph 23, we would like to highlight that i) the CCP's staff members, including subcontractors or consultants, as well as ii) clearing members involved in the risk committee and in the default management groups may already be subject to confidentiality obligations as part of their contractual agreements with the CCP. In those instances, the signature of a specific additional confidentiality agreement would be duplicative and unnecessary. Therefore, we would recommend a more flexible approach in the guidelines and would suggest that the requirement to sign a specific confidentiality agreement only applies if the relevant confidentiality provisions are not already included in a contractual or other arrangement between the parties.

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Q3. Do you consider that the proposed rules of conduct as appropriate to limit the risks of conflicts of interest?

While it is essential for CCPs and their staff members to take the necessary measures regarding conflict of interests, there are situations where conflicts cannot reasonably or proportionately be "avoided", for instance in the case where a CCP staff member's spouse works for a Clearing Member.

Therefore, we would suggest the following revisions to the second bullet point in paragraph 24:

"24. CCPs should take the necessary measures for their staff members to:

[...]

- avoid ~~a~~ **where possible, and** ~~–~~ ***be aware (have an understanding) of potential areas of conflicts of interest; declare any*** *situation in which they have or can have a direct or indirect interest that conflicts with the CCP's interests;* ***and comply with any appropriate mitigating actions which may be required by the CCP in the circumstances****."*

Concerning the requirement set out in the first bullet point of paragraph 26, we believe that the adoption of "*rules related to the limitation of the number of contracts or mandates board members and executive directors may have*" is not mandatory to appropriately mitigate the risk of conflict of interests. Independence is a quality that can be possessed by individuals, and is an essential component of professionalism and professional behaviour. The fact that a board member performs more than one role in one company does not necessarily affect, in itself, the objectivity of its decisions. In this instance, we believe it would be important to consider whether the board member or director performs tasks related to the day-to-day operational management in the different entities, or if he/she carries out a non-executive role. Moreover, for companies acting in specific and specialised sectors such as post-trading services, cross-directorships are essential to ensure board members have the relevant expertise. This approach does not prevent members from making the correct and impartial decisions on a given issue.

If a limit on contracts or mandates has to be set, we suggest the adoption of a proportionate approach, similar to the one adopted under CRD IV. It provides that the number of directorships which may be held simultaneously by a member of the management body shall take into account the individual circumstances and the nature, scale and complexity of the company's activities. In addition, the approach should not only focus on the number of contracts or mandates served by the board member or director in the company, but also consider qualitative elements, such as an assessment of the overall independence and ability to make independent decisions.

In addition, we believe that the second bullet point of paragraph 26, requiring that CCPs should "*not appoint external auditors having a link or receiving a benefit from the CCP*", is already covered by the requirement set out under Regulation (EU) No 537/2014 on statutory auditing, which requires a statutory auditor or an audit firm to be independent of the audited entity and not involved in the decision-taking of the audited entity.

Q4. Do you believe that the CCPs should apply such rules concerning the gifts?

We support the requirement under paragraph 27 that CCPs policy contain clear rules regarding the acceptance of gifts, including entertainment.

Given this requirement, we do not believe that further granularity, as currently set out under paragraph 28, is required and would therefore suggest the deletion of this paragraph. Moreover, the use of "*threshold*" and "*value*" suggests only a maximum level at which an employee cannot accept a gift. The value of a gift may not be the sole criterion to determine whether it is acceptable or not. Therefore to the extent this requirement is retained, reference to a "*framework*" rather than "*threshold*" may be more appropriate and encompass a wider range of acceptability criteria. At a minimum, we would suggest the following revised text for paragraph 28:

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"28. In that sense, CCPs should set up a ~~threshold in a reasonable manner to determine if the beneficiary is allowed to accept or to keep the gift~~ ***framework for the declaration and approval of any gifts with appropriate thresholds and acceptability criteria****. In case of doubt on ~~the value of the gift~~* ***whether the acceptance of a gift complies with the framework****, the chief compliance officer in principle is in charge to decide."*

Q5. Are you in favour that CCPs should adopt the above clear rules on the ownership of the financial instruments?

While we fully support the objective to mitigate the risk of conflicts of interest related to CCP staff investing or divesting in financial instruments, we think the focus of this section should be on 'dealing' in financial instruments, rather than ownership *per se*, except in specific cases identified to be higher risk. This proposed approach balances personal privacy against the risk of conflict, and allows efforts to be focused on actions taken by staff. In addition, a prescriptive requirement for disclosure of all holdings at the hiring and on annual basis may be overly burdensome both for the staff members and the CCP. LSEG proposes that CCPs should ensure they have the right to request portfolio information from staff, but not the obligation to do so.

We also recommend that ESMA adopts a less prescriptive approach with respect to the identification of the corporate function responsible for receiving and managing the disclosure on staff portfolio information. The guidelines currently restrict this role to the chief compliance officer under paragraph 31, whereas CCPs belonging to a group may have such tasks performed centrally at group level, rather than at the level of the individual CCP. In addition, this may contradict existing requirements to which a CCP be may be subject to under internal policies adopted to ensure adherence to the Market Abuse Regulation.

Q6. Do you consider that the CCP staff should be trained on the applicable law and policies concerning the conflicts of interest as above described?

We agree that CCP staff should be trained on the applicable law and policies concerning the conflicts of interest and have no specific comments on this section.

Q7. Do you agree on the above-proposed rules?

We agree with the proposed rules, but we would suggest clarifying that the responsibility to monitor the efficiency of the CCP arrangement to prevent and manage the conflicts of interest can be delegated to a Board committee (e.g. the Audit Committee).

Q8. Do you agree on the above specific organisational arrangements a CCP pertaining to a group should adopt to avoid and mitigate the risk of conflicts of interest?

We welcome the definition of measures to cover the specific case of CCPs belonging to a group. However, appropriate consideration and flexibility should be given having regard to the characteristics of the governance models for the CCP concerned including those adopted under national company law in Europe. In Italy, for instance, the Italian Civil Code requires that an external and independent body (the board of auditors) monitors, *inter alia*, the adequacy of the organisational, administrative and accounting systems of the company and its actual functioning. We recommend this approach to ensure the guidelines contain sufficient flexibility in order to ensure that they are compatible with the legal framework of the various jurisdictions in Europe.

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In relation to paragraph 39, we agree with the policy objective to ensure appropriate representation of CCPs within the corporate structure of the group of which the CCP forms part. However, the need to achieve representation and coordination in a group structure should be balanced with the principle of independence of the CCP with respect to the other entities belonging to the group as well as the existing governance arrangements (for example, where the CCP is not wholly owned).

In particular, we would like to highlight that in a large group, the proposed guidelines could lead to a disproportionate proliferation of group company board members, which would not be in the best interests of corporate governance. For instance, under these guidelines, each of the 3 CCPs in LSEG would need to be represented not only on the LSEG board but also on those of other subsidiaries within the Group which may not be feasible or practical.

In addition, since some of these group entities may act as service providers to the CCPs. There is potential for such cross-membership to exacerbate, rather than to mitigate, conflicts. For instance, a CCP representative on a service provider's Board may find that it is required to be recused on numerous occasions, for example when matters relating to the CCP are discussed or other competing CCPs or trading venues.

Therefore, we would recommend that the guidance further clarify what is meant by "*well-represented and in a balanced manner"* and provide flexibility for the CCP to make this determination. In addition, we would suggest that this recommendation be limited to the consolidation group of which the CCP forms part, and not necessarily apply within the entire corporate group.

With respect to paragraph 42, which requires, when needed, the appointment of supplementary independent board members to counterbalance the number of representatives of group members, we believe the goal is already achieved by virtue of the requirements under EMIR which currently require at least one-third, and no less than two, members of its board are independent. We fully support this requirement and believe it is sufficient to ensure a balance of interests. Moreover, the guidance should take into account the ownership structure of the CCP.

In relation to paragraph 44, we would recommend clarifying whether this paragraph means that executives of another group company may not sit on a CCP's board, or if the proportion of such board members should be limited.

Concerning paragraph 46, which requires that "*the wage and bonuses of senior managers to be correctly balanced compared to that attributed by the other company*", we would recommend to include additional criteria rather than just financial, and consider the overall performance objective and incentives for senior managers. Indeed, the final objective to avoid any biased decision could not be achieved solely through salary calibration, since remuneration depends on a series of factors which include: adequate risk management, the activity performed by senior managers, their degree of responsibility, and the financial results registered by the other group entity. We would therefore suggest revising paragraph 46 as follows:

> *"46. The senior management's responsibilities should be clearly defined, ~~the wage including the bonuses of the senior managers should be correctly balanced compared to the one attributed by the other company in order to avoid any biased decision~~* ***and the performance objectives and incentives of the senior managers should be aligned at the level of the group where appropriate. Caution should be exercised to avoid creating wrong incentives****. A close monitoring of the potential conflicts of interest should be performed by the chief compliance officer, the board or the independent board members."*

The same principle should also be applied at the level of the staff, and we suggest the corresponding changes to paragraph 48:

> *"48. ~~The wage including bonuses~~* ***The performance objectives and incentives*** *of the concerned staff should be* ***aligned at the level of the group where appropriate*** *~~correctly balanced compared to the one attributed by the other company in order to avoid any partial decision or performance of tasks~~.* ***Caution should be exercised to avoid creating wrong incentives****. The level of the bonuses or any other financial*

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advantage rewarding the employees' performance in the CCP tasks should be assessed and ultimately decided by the CCP."

In relation to paragraph 49 on outsourcing, we suggest making the requirement more general to include non-financial penalties and incentives. Indeed, for some corporate functions which perform qualitative tasks (e.g. legal, regulatory business units), it is difficult assess achievement against key performance indicators, and therefore set penalties for their breach. Instead of "*penalties*", we would suggest referring to "*escalation and enforcement mechanisms".* Moreover, we believe that the reporting requirement to the board of the subcontractor's performance should only be carried out in case of anomalies in the functioning of the outsourced critical functions. We suggest the following revised text:

"49. Where the service provider is part of the CCP's group, at least, the following supplementary measures should be taken by the CCP:

[...]

- key performance indicators should be clearly defined and ~~penalties~~ ***escalation and enforcement mechanisms*** *in line with the standard market practices should be fixed and enforced if necessary. The subcontractor performance should be reported to the board* ***in case of anomalies in the functioning of the outsourced critical functions****;"*

Q9. Do you think that the above-described procedure is appropriate to investigate, to solve, to monitor and to record the conflicts of interest?

We would suggest care in ensuring the provisions on whistle-blowing are aligned with best practice and the legal framework in the various member states. For example, in France, there is a defined scope of issues that may be raised through whistle-blowing[1].

In paragraph 53, we think it would be necessary to mitigate the risk of vexatious or vindictive accusations being made, by revising the wording as follows:

"*53. The whistle-blower should not be blamed ~~in any circumstance~~ if it raises a conflict or potential conflict of interests* ***in good faith****.*"

In paragraph 59, we are concerned that this incentivises CCPs not to set internal standards or requirements higher than the guidelines, so we suggest that only material breaches of the guidelines need to be reported to regulators, once the breach has been escalated and notified to the CCP's senior management/board. We also suggest changing the wording to reflect practical timing constraints as follows:

"59. In case of breach of ~~the policy~~ ***these guidelines****, the CCP should report* ***promptly*** *any material breach to the national competent authority ~~within 48 hours~~* ***after the breach has been escalated and notified to the CCPs senior management / board***."

Paragraph 60 sets out a requirement for a register to track and record various items. However, in practice, some of these items will be set out in policies and procedures; and we would also expect the potential use of separate registers or systems for different controls. Therefore, we would suggest revising the paragraph as follows:

"60. CCP should implement ***processes and procedures*** *~~a register~~ to track and record:".*

[1] As per the *autorisation unique* (AU-004) of the *Commission Nationale de l'Informatique et des Libertés* of 8 December 2005 amended on 30 January 2014.

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