BASEL III CONSULTATION

4 February 2011

Introduction

LCH.Clearnet SA welcomes the opportunity to comment on the paper outlining the proposal for capital requirements relating to CCP exposures. LCH.Clearnet SA would like to recognize the contribution of EACH and are fully supportive of this document; nonetheless we would like to highlight some important elements and specifics relating to its status as bank in the Eurozone already subject to capital adequacy rules.

First of all, LCH.Clearnet SA emphasizes its support for the extension of the deadline for comments. The proposed capital rules are not only new for CCPs and complex but could also function as drivers for (or give incentives to) the financial structures of CCPs. Additional time could be used to perform further analysis and to engage in discussions with our regulators and EACH so as to further improve the proposed rules.

Main comments

There are three main elements mentioned in the EACH document which LCH.Clearnet SA would like to highlight:

1 Difference of capital charges between trade exposures and default fund

2 The calculation of required financial resources

3 Lower capital adequacy charges for default remote collateral

Difference between trade exposures and default fund

There is a large difference in the proposed rules between the capital charges on trade exposures and default fund exposures, the first being charged at 0.16% and the latter at least 100%, there being a

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difference in capital charge equal to at least a factor 625. As a consequence, there is a strong incentive to over collateralise exposure so as to avoid default fund exposures.

In this respect it should be noted that losses on default fund contributions have been exceptional and that by collateralizing exposures on an individual basis, the efficiency of using a CCP is greatly reduced. The Default Fund is also a flexible resource, making it possible to cover many different stress scenarios and conditions. The default fund also has a function in incentivizing clearing members to perform appropriate oversight of the CCP risk systems by means of their participation in the Risk Committee, and by providing in this Committee, important information on potentially dangerous market behaviour or positions.

In conclusion, a default fund contribution has a different risk profile to a trade exposure, however LCH.Clearnet SA recommends that the proposed treatment of Default fund contributions be reconsidered.

Calculation of required financial resources

As highlighted in the EACH paper, the proposed CEM approach is not sophisticated. The weighted approach and netting rules are not in line with the current exposure measurements of CCP. We recall that the current CPSS-IOSCO requirements stipulate that CCPs perform margin calls to cover normal market risks, but that a default fund is in place to cover stress movements of (at least) the largest clearing member. The new Basel rules should therefore also be reflective of the main purpose of a CCP, namely to ensure that it survives the default of the largest clearing members(s), and at the same time that it meet its obligations towards surviving clearing members.

Most of the CCPs follow the CPSS IOSCO principles but each CCP has its own calculation methodology and underlying assumptions. A bottom-line risk calculation across CCPs would be a good approach so as to ensure the same level of security across the CCP; such a bottom line could be enforced by ESMA when regulatory practices diverge.

In this respect LCH.Clearnet SA would also like to highlight that it is currently performing capital adequacy calculations under the supervision of the ACP which are functioning in a satisfactory manner. A standard market risk approach is applied whereby the applicable percentage, as described in the local implementation of the Basel rules, is used to perform an exposure measurement calculation assuming the default of both the largest rated and unrated member. Any exposures outside of the available financial resources are covered by LCH.Clearnet SA capital. Should this proposal lead to a replacement of the current calculation or an additional calculation, this would be a clear step back with related implementation efforts.

An element of attention is the proposed calculation of capital adequacy rules for CDS products cleared by a CCP. LCH.Clearnet SA would like to receive additional information on the treatment of these products under the new Basel rules from its regulator and/or the Committee. LCH.Clearnet SA would advocate a conservative but realistic approach to the exposure calculation for these types of products.

Default remote collateral

It is our understanding that collateral which is recognized as “default remote”, for example deposits of collateral using a pledge agreement, will not be subject to any capital charge. LCH.Clearnet SA would like to highlight that the promotion of pledging by means of the proposed calculation could lead to an erosion of credit lines of the CCP and potentially to an increase in systemic risk. LCH.Clearnet SA receives from its member collateral deposits by means of transfer of ownership. These securities are used to create a credit line at Banque de France, which can be used in the event of a default to provide the necessary liquidity to secure settlement in case of a member default. If the securities are outside of the CCP, this will reduce the available credit lines. At the same time, LCH.Clearnet SA would like to highlight that its method for depositing collateral is also safe for our members due to the high level of protection provided by the French law which prohibits that debtors have any rights on the deposited collateral.

Closing comments

It is our understanding that the current rules are intended to promote risk conscious behaviour and propagate well funded CCPs with appropriate risk management structures. LCH.Clearnet SA fully supports such principles but the Committee should be mindful that proposed rules may also have undesired consequences or could lead to suboptimal results.

We would also urge to maintain consistency with current requirements (CPSS-IOSO, ACP capital rules) and new legislation (EMIR, Frank Dodd) which also attempt to achieve the same aim. Any new capital rules introduced by the Basel committee should work hand-in-hand with the previously mentioned regulations to promote the desired behaviour.

In light of its status as a bank in the Euro zone and the fact that it currently performs capital exposure calculations, LCH.Clearnet SA would like to engage in discussions with the Committee itself or via the EACH working group to further develop these rules which are of great importance for our members.