

Via Electronic Submission

6 July 2016

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Revisions to the Basel III Leverage Ratio Framework

Dear Sirs/Madams:

LCH.Clearnet Group Limited ("LCH Group") welcomes the opportunity to respond to this request for comment from the Basel Committee on Banking Supervision ("BCBS" or "Committee").¹ We commend the Committee on these proposed revisions to the design and calibration of the Basel III leverage ratio framework.

LCH Group is an international, multi-asset class group of clearing houses, or central counterparties ("CCPs"), that manage risk of many diverse portfolios of cleared derivatives.² LCH Group has supported regulatory reform enhancements to the global structure governing derivatives markets that have resulted in a comprehensive, stronger, and more robust risk management framework for CCPs, clearing members, and end-users of derivatives. We continue to work with prudential and market regulators along with our industry partners and clients to strengthen the resiliency of CCPs and the safety and soundness of the broader derivatives markets.

LCH Group endorses the grounds for a leverage ratio as a barrier to excessive leverage and a supplementary measure to the risk-based capital requirements in the broader Basel III capital framework. We share the concern of the regulatory community and industry that clearing brokers should be appropriately capitalised for the risks they bear. Clearing brokers guarantee the performance of their clients to CCPs and we rely on clearing brokers having sufficient capital to honour that guarantee.

¹ Revisions to the Basel III leverage ratio framework, Basel Committee on Banking Supervision, <http://www.bis.org/bcbs/publ/d365.pdf> (April 2016).

² LCH Group consists of three operating entities: LCH Ltd (UK), LCH SA (France), and LCH LLC (U.S.). Additional detail on the legal and regulatory structure of the group can be found at: http://www.lchclearnet.com/about_us/corporate_governance/legal_and_regulatory_structure.asp.

LCH Group provides the following specific comments in response to the consultation:

I. Consistent with our prior comments to the Committee, LCH Group believes the risk-reducing effect of segregated initial margin (“IM”) should be recognised in calculating the exposure measure in the leverage ratio.

LCH Group regards the segregated IM collected from its members to cover their proprietary market risk positions as exposure reducing. Thus, we regard segregated IM collected by clearing members from their clients and passed on to the CCP as having the same effect. Where a clearing member collects no collateral from a customer to whom it has exposure, it is important that it sets aside capital against that exposure. As the amount of collateral collected by the clearing member increases, and where the collateral collected is not available to the clearing member, it is unnecessary to require that clearing member to set aside the same amount of capital.

II. Failure to recognise the risk reducing effect of IM would have a disproportionately negative impact on real money clients at the same time central clearing mandates expand across G20 jurisdictions.

We have examined the potential negative impact of not recognising the exposure reducing effect of IM on LCH Group’s SwapClear interest rate clearing service. A comprehensive analysis of SwapClear’s clearing membership indicates that failing to recognise the exposure reducing effect of IM under the SA-CCR methodology would more than double the amount of capital required across the service. Our analysis demonstrates that real money client portfolios, such as pension funds, would bear the greatest capital burden.

Clearing members will be forced to pass these increased capital costs down to their clients, making central clearing more expensive as the number of affected clients and products subject to clearing mandates continues to increase globally. Thus, recognising IM in the exposure calculation would materially preserve and promote increased clearing capacity amongst clearing members for real money clients without creating material additional capacity elsewhere.

III. Failure to recognise IM could increase systemic risk by constraining porting in the event of a clearing member default.

Making collateralised positions more capital intensive introduces further risk in the financial system by constraining client porting in the event of the default of a clearing broker. In the event of such a default, solvent clearing members may be less likely or even unable to accept the portfolio of defaulting clearing members if the capital costs are too high. This could accelerate downward price pressure at the worst time and add increased uncertainty and complexity during times of market distress.

We acknowledge the Committee must balance the relevant principles specific to leverage ratio framework against these broader G20 goals and systemic risk concerns. As central counterparty risk managers, we believe IM is the front line defence in the clearing industry which protects clearing members, clients and the broader financial markets from counterparty risk. Failure to recognise this risk reducing effect is contrary to the broader goals of prudential and market regulators to promote an appropriate balance between margin and capital and to ensure a more resilient clearing industry.

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We appreciate the opportunity to comment on the proposed revisions to the leverage ratio framework. Please do not hesitate to contact us regarding any questions raised by this submission or to discuss our comments in greater detail.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Suneel Bakhshi', with a stylized flourish at the end.

Suneel Bakhshi
Group Chief Executive, LCH Group