

EBA

One Canada Square (Floor 46)
Canary Wharf
London E14 5AA| UK

10 July 2015

LCH.CLEARNET GROUP RESPONSE TO THE SECOND JOINT CONSULTATION ON DRAFT RTS ON RISK-MITIGATION TECHNIQUES FOR OTC-DERIVATIVE CONTRACTS NOT CLEARED BY A CCP

Dear Sirs,

This letter provides the submission of LCH.Clearnet Group Limited ("LCH.Clearnet") to the Second Joint Consultation on draft RTS on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP (EBA/JC/CP/2015/002), to be read in conjunction with the answers to the specific questions uploaded to the required Consultation Form on the EBA website.

LCH.Clearnet¹ is a leading multi-asset class and multi-national 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 and sterling denominated bonds and repos. LCH.Clearnet works closely with market participants and exchanges to continually identify and develop innovative clearing services for new asset classes. LCH.Clearnet is majority owned by the London Stock Exchange Group, a diversified international exchange group that sits at the heart of the world's financial community.

LCH.Clearnet welcomes the opportunity to provide further feedback to the ESAs regarding the risk mitigation techniques for OTC derivative contracts not cleared by a CCP; this is an extremely important topic which will help shape the future of the OTC derivatives market. LCH.Clearnet provided a coordinated response to the first consultation paper in conjunction with EACH, the European Association of CCP Clearing Houses.

As a multi-asset class and international clearinghouse we have been responsible for deploying prudent risk management techniques across both OTC derivatives and ETD for many years. This experience gives us a unique viewpoint on this subject. We have invaluable experience in model design, collateral management, and the operational processes of calling, collecting and settling Initial and Variation Margin.

¹ LCH.Clearnet Group Limited consists of three operating entities: LCH.Clearnet Limited, the UK entity, LCH.Clearnet SA, the Continental European entity, and LCH.Clearnet LLC, the US entity. Link to Legal and Regulatory Structure of the Group: http://www.lchclearnet.com/about_us/corporate_governance/legal_and_regulatory_structure.asp

LCH.Clearnet continues to be fully supportive of the G20 commitment to promote financial stability and reduce systemic risk in the OTC derivatives markets through the increased use of central counterparties. We recognise that clearing is not suitable for all products; however, where possible, standardised OTC derivatives should be cleared by a central counterparty. The benefits of CCP clearing have been recognised over many years in the OTC markets and any regulation should look to build upon the CCP model. Given the importance of the G20 objective, we believe it is imperative that international regulatory and capital rules do not, whether directly or indirectly, disincentive the use of central clearing for the promotion of financial stability.

LCH.Clearnet believes that due consideration should be given to the following areas in the context of margin requirements for non-centrally cleared derivatives:

- **Commensurate Margin**
- **International consistency**
- **Regulatory certainty**

The above aspects are discussed further below.

Commensurate Margin

CCP margin models are subject to rigorous quantitative and qualitative regulatory requirements, and are maintained in compliance with such regulations. In addition, CCPs employ extensive stress testing and a funded default waterfall which provides additional protection that is not available in a non-centrally cleared environment. LCH.Clearnet recognises that the margin requirements for non-centrally cleared contracts are likely to necessitate differences reflecting the absence of a CCP framework; however we believe these differences should not disincentivise the use of CCPs. Should a CCP be authorised to offer a clearing service for a specified asset class this should be seen as recognition by the CCPs' regulators that centrally clearing this asset class will further promote financial stability and reduce systemic risk. In such cases and in order to promote and incentivise the reduction of systemic risk the overall capital and funding costs associated with centrally clearing these products should never be more than holding the equivalent contracts in a non-centrally cleared environment.

International consistency

Significant divergences across major jurisdictions, resulting from the transposition of the BCBS IOSCO framework, can have unintended consequences for the OTC derivatives market. Disparities in IM and VM calculations, eligible collateral and collection requirements for margin will all have an impact on a participant's funding costs and the pricing of derivatives contracts. Without international consistency the true value of a derivatives contract will be different per regulatory regime. This may give rise to regulatory arbitrage and bifurcation of the global liquidity pool. Consequently, a harmonized approach between regulators is essential to ensuring the OTC derivatives markets continue to operate efficiently.

Regulatory Certainty

The need for regulatory certainty should be a primary consideration for regulators. With the first participants set to exchange Initial Margin in September 2016, the market must be given sufficient certainty of the rules to allow for implementation. Where changes to the rules are envisaged, these should be well



communicated to the market to promote certainty, maintain international consistency, and minimise implementation costs for participants. We support the early communication of final rules to allow participants adequate time for implementation in advance of September 2016
Any delay to the implementation dates, must be internationally coordinated to ensure the effective functioning of the OTC derivatives market.

We trust that our comments will assist you when considering the final RTS on the consultation topic. Should you have any queries in relation to our comments, please do not hesitate to contact Valentina Cirigliano at Valentina.Cirigliano@lchclearnet.com or Corentine Poilvet-Clediere at Corentine.Poilvet-Clediere@lchclearnet.com.

Yours sincerely

Valentina Cirigliano
Regulatory Strategy Manager

A handwritten signature in blue ink, appearing to read "Valentina Cirigliano".

cc: Corentine Poilvet-Clediere
Head of Post Trade Regulatory Strategy