LCH.CLEARNET

European Banking Authority
One Canada Square (Floor 46)
Canary Wharf
London E14 5AA UK

27 February 2015

LCH.Clearnet Group response to the European Banking Authority ("EBA") Consultation Paper on Draft Regulatory Standards on criteria for determining the minimum requirement for own funds and eligible liabilities ("MREL") under Directive 2014/59/EU.

Dear Madam, Sir,

This letter provides the response of LCH.Clearnet Group ("LCH.Clearnet") to the EBA's Consultation on draft Regulatory Standards on criteria for determining MREL.

LCH.Clearnet 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 identify and develop innovative clearing services for new asset classes.

LCH.Clearnet welcomes the opportunity to respond to the consultation paper and provide input into the development of the relevant technical standards. Our interest in this issue is a result of the regulatory arrangements for LCH.Clearnet SA, which is incorporated in France and authorised as a Central Clearing Counterparty (CCP) under EMIR[1]. LCH.Clearnet SA is also currently regulated as a credit institution in France placing it within the scope of BRRD. Although LCH.Clearnet SA does not engage in typical banking activities, as a CCP it is required to hold the status of a credit institution under French law.

General Comments

LCH.Clearnet believes the BRRD provides an important framework to help mitigate the risk of banks' failure. However, in this context we do not believe the policy intention is to bring CCPs within the scope of the BRRD or Regulatory Standards on criteria for determining MREL. Under EMIR, CCPs are subject to stringent rules on risk management and investment policy. CCPs are also subject to capital requirements similar to banking capital regulations but with several particular requirements around business risk, wind

[1] Regulation (EU) No 648/2013 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

down capital, capital buffers and specific definition of regulatory capital. As a result a CCP has a very different structure for the coverage of stressed market events compared to a credit institution. For example:

- The capital structure required by EMIR is different to that of a credit institution
- It is not possible to make a peer group comparison between banks and CCPs with a banking license
- EMIR sets out the relevant capital requirements for CCPs and the financial resources requirements to cover losses arising from the CCPs' clearing services

We would therefore encourage the EBA to consider drafting the technical standards to reflect the specific nature of financial market infrastructures (FMIs) with a banking license, including CCPs.

Responses to the consultation

Question 1: The draft text above describes comprehensively capital requirements under the CRR/CRD IV framework, which includes minimum CET1, AT1 and total capital requirements, capital buffers required by CRD IV, Pillar 2 capital requirements set on a case-by-case basis, and backstop capital measures (Basel I floor and leverage ratio). The EBA is seeking comments on whether all elements of these capital requirements should be considered for the assessment of the loss absorption amount. Do you consider that any of these components of the overall capital requirement (other than the minimum CET1 requirement) are not appropriate indicators of loss in resolution, and if so why?

As a CCP, LCH.Clearnet SA is required to be licensed as a credit institution under French law. However, LCH.Clearnet SA does not hold eligible liabilities; it only holds Core Equity Tier 1 ("CET1") capital at a level compliant with both the EU Capital Requirements Regulation (CRR) and EMIR.

It is important to note that EMIR only recognises liquid own funds as regulatory capital and excludes any other instruments such as subordinated debt. Any additional liabilities held by a CCP would only cover banking capital requirements and not those imposed on it in its function as a CCP.

Moreover, the risks associated with the clearing activities of a CCP are covered by the resources the CCP holds as part of its default waterfall[2]. The capital of the CCP (excluding its contribution to the default waterfall, the so-called 'skin in the game') is designed to mitigate the losses being triggered by non-clearing activities. If a CCP were obliged to comply with the proposed criteria for determining MREL, its CET1 capital would be drastically increased but without any changes to the risk profile of the CCP.

Banking capital requirements are set and assessed on a risk-by-risk basis (credit, market, business risks, etc). The proposed approach to MREL, which envisages having the full amount of capital requirements as a loss absorption amount, would imply that losses relating to all these individual risks crystallise more or less at the same time. In our view this does not appear to be plausible and ignores the idiosyncratic nature of the events which these additional capital requirements attempt to cover.

In addition, LCH.Clearnet emphasises that the recapitalisation amount proposal does not seem to be compatible with the wind down capital requirement required by EMIR. Under EMIR, a CCP must hold sufficient capital at all times to cover in aggregate (i) the winding down or restructuring of its activities, (ii) its operational and legal risks, (iii) its credit, counterparty and market risks and (iv) its business risks. The

[2] The default waterfall of LCH.Clearnet entities is based on Clearing Member's margins, LCH.Clearnet's own contribution (a percentage of its regulatory capital), Clearing Members' contribution to the mutualised default fund and additional resources as determined in LCH.Clearnet's rulebook.

winding down or restructuring capital requirement is based on the annual gross operational expenses. It should be clarified that this capital requirement is a relevant amount available specifically to cover the costs necessary to keep a CCP functioning for a certain period while winding down and should therefore be considered as the relevant amount under Article 3 of the draft RTS for CCPs.

We believe that for CCPs EMIR provides an appropriate basis to ensure sufficient resources are available to withstand losses under very extreme conditions and guarantees that the CCP can wind down its activity in an orderly manner. The proposed requirement under MREL would be a disproportionate requirement on CCPs such as LCH.Clearnet SA that already comply with the equivalent EMIR requirements and related EBA RTS for CCPs, specifically designed to contain the systemic impact of a CCP's failure. In addition, CCPs with a banking license would be unfairly discriminated against CCPs without such license, thereby creating a competitive distortion in the market. We therefore suggest adding the below new recital in the proposed RTS:

Recital 6A (new)

Resolution authorities should assess the availability of non-capital loss absorbing buffers, such as default waterfalls, for central counterparties required under Regulation (EU) No 648/2012 instead of holding own funds as a loss absorption amount for losses relating to clearing activities.

Question 2: Should paragraph 5 refer only to the resolution authority *increasing* the loss absorption amount, rather than *adjusting* it? Are there specific circumstances under which resolution authorities should allow a smaller need to be able to absorb losses before entry into resolution and in the resolution process than indicated by the capital requirements (for example, due to the use of national discretions in setting capital requirements)?

LCH.Clearnet is of the view that the resolution authority should be able to consider the specific case of CCPs that are supervised both as CCPs and as credit institutions, and determine that the capital requirements applicable to a CCP should be taken into account when considering MREL. More precisely, not only should EMIR capital requirements be taken into account, but also MREL under BRRD should not lead to inconsistent results with the CCP recovery and resolution legislation that is expected to be published shortly.

Question 3: Should any additional benchmarks be used to assess the necessary degree of loss absorbency? If yes, how should these be defined and how should they be used in combination with the capital requirements benchmark? Should such benchmarks also allow for a decrease of the loss absorption amount compared to the institution's capital requirements?

As noted above, LCH.Clearnet does not believe that a credit institution's capital requirement is a relevant benchmark for determining the loss absorbency capacity of a CCP. For CCPs, default fund requirements are calculated to withstand the losses of the largest two clearing members in extreme but plausible market conditions, (Article 42(3) of EMIR).

Question 4: Do you consider that any of these components of the overall capital requirement are not appropriate indicators of the capital required after resolution, and if so why?

Under Article 2 of Regulation (EU) No 152/2013, CCPs are required to hold a sufficient amount in reserve to ensure that operational expenses for a period of at least 6 months (or however long its competent authority believes is necessary) to effect an organised winding-down of its clearing service. We believe this is the appropriate approach for CCPs and propose the following amendment to Article 3(6):

LCH.CLEARNET

(6) The capital requirements referred to in paragraph 5 are in particular the following:

[...]

e. own funds requirements applicable to CCPs pursuant to Article 2 of Regulation (EU) No 152/2013.

Question 5: Is it appropriate to have a single peer group of G-SIIs, or should this be subdivided by the level of the G-SII capital buffer?

Should the peer group approach be extended to Other Systemically Important Institutions (O-SIIs), at the option of resolution authorities? If yes, would the appropriate peer group be the group of O-SIIs established in the same jurisdiction?

Should the peer group approach be further extended to other types of institution?

We do not believe that the peer group approach is appropriate for CCPs with a banking license. As highlighted above, the activities of a CCP are very different to those of a credit institution.

We hope that our comments will assist the EBA as it develops the Regulatory Technical Standards on MREL and would be happy to discuss our comments in greater detail.

Yours sincerely,

Laurent Saubusse
Deputy Chief Compliance Officer
LCH.Clearnet SA