



Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel,
Switzerland

14 January 2013

Dear Sirs,

LCH.Clearnet welcomes the possibility of responding to the FSB's consultative document "Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos".

LCH.Clearnet is the world's leading clearing house group, serving major international exchanges and platforms, as well as a range of OTC markets. It clears a broad range of asset classes including: cash equities, exchange traded derivatives, commodities, energy, freight, interest rate swaps, credit default swaps and bonds and repos; and works closely with market participants and exchanges to identify and develop clearing services for new asset classes.

With particular relevance to Shadow Banking, LCH.Clearnet is a market leader in fixed income clearing. LCH.Clearnet has been serving the fixed income markets since 1998. Today, we are the second largest clearer of fixed income and repo products in the world. These services enable participants to benefit from centralised risk management, balance sheet netting, settlement netting and operational efficiencies.

Our fixed income clearing product was the first to offer a multi-market centralised and clearing netting facility for the European Government repo and cash bond markets. Our service currently clears over ten European markets and is complemented by the Sterling and euro General Collateral ("GC") services for both cash and repo transactions.

Below are our answers to certain specific questions in the document.

General questions

Q2. Do the policy recommendations in the document adequately address the financial stability risk(s) identified? Are there alternative approaches to risk mitigation (including existing regulatory, industry, or other mitigants) that the FSB should

LCH.Clearnet Group Limited Aldgate House, 33 Aldgate High Street, London EC3N 1EA
Tel: +44 (0)20 7426 7000 Fax: +44 (0)20 7426 7001 www.lchclearnet.com
LCH.Clearnet Group Limited | LCH.Clearnet Limited | LCH.Clearnet SA | LCH.Clearnet LLC

consider to address such risks in the securities lending and repo markets? If so, please describe such mitigants and explain how they address the risks. Are they likely to be adequate under situations of extreme financial stress?

In general we believe that the recommendations address the risks identified. However, we would like to draw particular attention to recommendation 6 on the minimum standards that regulatory authorities should introduce for the methodologies to calculate collateral haircuts.

We support the proposal to introduce minimum regulatory haircuts. In the case of cleared repos, every direct participant has a bilateral relationship with the CCP and is subject to a minimum effective haircut implied by the CCP's initial margin level. We believe that the same discipline should apply in the case of repos that are not cleared by CCPs, i.e. where participants have a direct exposure to each other.

Improvement in market transparency

Q6. Do you agree with the information items listed in Box 1 for enhancing transparency in securities lending and repo markets? Which of the information items in Box 1 are already publicly available for all market participants, and from which sources? Would collecting or providing any of the information items listed in Box 1 present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided to replace such items.

The following answers are in respect of repo markets only.

We believe it may be useful to explicitly capture whether the trade is a repo or a reverse-repo and to capture securities at ISIN level. This would be useful for 'specials' repo as an indication of how valuable a bond is.

It would also be helpful to clarify if the information items support triparty/DBV (delivery by value) repo transactions where there could be multiple lines of collateral allocated and multiple haircuts/levels of initial margin associated with just one trade. We are not aware of any trade level or firm level data being currently available from any public source.

There may be the need to collect Initial Margin values rather than haircut information for CCP trades. For government debt there can be significant differences in Initial Margin levels based on the duration of the bond which is being traded. Thus the level of haircuts for repo transactions even within the same government debt could vary considerably.

Q7. Do you agree TRs would likely be the most effective way to collect comprehensive market data for securities lending and/or repos? What is the appropriate geographical and product scope of TRs in collecting such market data?

Yes, we believe that TRs would be appropriate for this purpose and should be capable of holding all securities lending and repo products. In terms of geographical scope, it is important to ensure that TRs are capable of holding at least trades for any transaction in any specific market.

We note that the level of risk in open repo transactions are directly linked with the depth of the cash market, as well as to the level of liquidity (and level of maturity) of the repo market concerned, therefore we suggest that cash bond trades should also be reported to TRs.

Q8. What are the issues authorities should be mindful of when undertaking feasibility studies for the establishment of TRs for repo and/or securities lending markets?

We recommend that to ensure consistency and avoid duplication in reporting, parties to a transaction should, where possible, report it once only. Particularly in the case of a repo with a CCP, it should not be necessary for both parties to report separately. This will allow market participants to manage the cost of such activity, and will minimise the risk of double counting and ensure data integrity.

We welcome the FSB's intention set out in recommendation 2 to establish a working group to undertake a feasibility study for one or more TRs at a global level.

As has been raised in the context of reporting of derivatives, the issue of duplication is particularly relevant where parties operate cross-border; for example a very likely scenario is one where two US counterparties trade a European repo. Ideally, The FSB should consider a system whereby there is a single reporting counterparty for each trade.

Q11. Are the factors described in section 3.1.2 appropriate to capture all important considerations that should be taken into account in setting risk-based haircuts? Are there any other important considerations that should be included? How are the above considerations aligned with current market practices?

The FSB argues that haircut methodologies should be designed to limit their procyclical effects and, therefore, avoid a sudden increase in repo haircuts during stressed market environments, which could create a liquidity shortage for firms that rely heavily on this market for funding. Firms should adopt a funding strategy that is robust in all circumstances, including stressed market conditions. In support of this argument, we refer you to the comments made above in our response to Question 2.

Q14. Are there additional factors that should be considered in setting numerical haircut floors as set out in section 3.1.3?

It has to be clear how numerical haircut floors would apply to a portfolio of long and short positions (in the same security, same issuers but different maturity, and different but correlated issuers). Please also see our answers to questions 17 and 18.

As a general comment on numerical haircuts, the numerical haircut framework would have to be based on a model. We believe it would be logical for this to become the de facto model that firms would adopt to ensure they were compliant, the maintenance of which should be entrusted to an independent party (possibly as a regulated activity). It is however important that market participants do not simply charge the minimum because other factors apply including counterparty risk and the credit risk (not just the volatility) of the underlying collateral.

Q16. In your view, what is the appropriate scope of application of a framework of numerical haircut floors by: (i) transaction type; (ii) counterparty type; and (iii) collateral type? Which of the proposed options described above (or alternative options) do you think are more effective in reducing procyclicality risk associated with securities financing transactions, while preserving liquid and well-functioning markets?

Under (iii) Collateral type, we believe Sovereigns should be included. We also suggest collateral borrowing transactions should be included as well as cash borrowing transactions: 'jump to recovery' can produce systemic risk in the same way as 'jump to default'.

Q17. Are there specific transactions or instruments for which the application of the numerical haircut floor framework may cause practical difficulties? If so, please explain such transactions and suggest possible ways to overcome such difficulties.

As mentioned in the answer to question 14, it needs to be clear how the numerical haircut floor framework would apply to a portfolio of long and short positions (in the same security, same issuers but different maturity, and different but correlated issuers).

Q18. In your view, how should the framework be applied to transactions for which margins are set at the portfolio basis rather than an individual security basis?

In line with European practice, we believe that it would be better to define minimum model requirements rather than numerical haircuts.

Q19. Do you agree with the proposed minimum standards for the reinvestment of cash collateral by securities lenders, given the policy objective of limiting the liquidity and leverage risks? Are there any important considerations that the FSB should take into account?



In principle we agree with the standards and that they should apply across all jurisdictions in order to avoid regulatory arbitrage.

In the high level principle 1.3, we believe that "In developing and approving cash collateral reinvestment guidelines, securities lenders should take into account *at a minimum* the size of this activity relative to the firm overall". Also, a maximum remaining maturity as considered in the additional requirement 2.3 (a) should be supported by an appropriate methodology to manage interest rate risk.

Q21. Do you agree with the proposed minimum standards for valuation and management of collaterals by securities lending and repo market participants? Are there any additional recommendations the FSB should consider?

We agree with the proposed minimum standards. In standard 3.4.3 we believe that intraday mark to market of collateral and lent securities would also be appropriate; as the frequency of mark to market should be one component driving the holding period within the haircut calculation, a more frequent MTM would result in lower haircuts.

Q22. Do you agree with the policy recommendations on structural aspects of securities financing markets as described in sections 4.1 and 4.2 above?

We agree with the FSB's recommendation on the policy proposals laid out in section 4.2, because of the practical issues around changing bankruptcy law and defining risky and illiquid collateral.

We hope that the response will assist the FSB in its process of setting a policy framework for addressing risks in the securities lending and repo markets. Please contact Rory Cunningham at Rory.Cunningham@lchclearnet.com should you need any clarifications on the above response or wish to discuss the topic further.

Yours sincerely

A handwritten signature in black ink, appearing to read "Ian Axe", written over a light blue horizontal line.

Ian Axe
Chief Executive Officer