



**Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001
Australia**

19 October 2012

Dear sirs,

Consultation on New Financial Stability Standards

This paper provides the response of the LCH.Clearnet Group ("LCH.Clearnet") to the Bank's consultation on "New Financial Stability Standards" ("FSSs").

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.

We welcome the proposed FSSs for central counterparties (CCPs) and the aim to align the Australian regime for regulation of licensed clearing and settlement ("CS") facilities with CPSS-IOSCO standards. This is a positive move. We would however like to draw attention to some specific issues contained in the Consultation.

We support the approach of graduated requirements and in particular the principle that arrangements should be commensurate with the nature and scale of a central counterparty's operations and service to the Australian market as set out in FSS standard 16.11. However we seek clarification that the three categories of facilities outlined in section 4.3 (p. 16) "Regulatory Influence over Cross-border Clearing and Settlement Facilities" also include the scenario of a CS facility that may not be systemically important but does have a strong domestic connection. Such a facility is referred to in section 3 (p. 7) as outlined in s3 "Graduated Approach to Additional Requirements" in the July 2012 Council of Financial Regulators' Supplementary Paper on "Ensuring Appropriate Influence for Australian Regulators over Cross-Border Clearing and Settlement Facilities". As that paper suggests, only the Foundational Requirements should apply to such an entity.

We also seek confirmation of our understanding that the differentiation of settlement of large trades as opposed to small trades provided on FSS 11.2 "Exchange-of-value Settlements" was not intended to include settlement of cash equities.

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Our answers to the specific questions follow.

1. Are there potential conflicts between the requirement for licensed CS facilities to explicitly support financial system stability and other relevant public policy objectives (proposed CCP and SSF Standard 2.1), and other obligations or duties of facilities and their directors?

We agree that a CCP should place a high priority on ensuring its own safety and do not see that this presents unmanageable conflicts. However CCPs will typically be organised as commercial entities and it is important that supervisory practices acknowledge this and the competitive environment in which CCPs operate.

2. Should the requirement for non-executive members of a CS facility's board (proposed CCP and SSF Standard 2.4) be extended to specify the number of non-executive directors and their degree of independence from management or related entities?

We recommend that the provision regarding the proportion of non-executive directors be brought in line with the similar provisions in proposed rules to implement the US Dodd-Frank Act (35%) and the EU's Regulation on OTC derivatives, central counterparties and trade repositories ("EMIR") (33%).

3. Are there any potential obstacles to CCPs taking the proposed steps to monitor the credit standing of participants and impose additional risk controls where a participant's credit standing is called into question (proposed CCP Standard 4.3)?

We do not see any obstacles.

4. In balancing the system-wide impact of restricting collateral eligibility to high-quality liquid assets against the risk that lower-quality or less-liquid collateral assets may not hold their value in a stressed market, should any other collateral eligibility criteria be considered (proposed CCP and SSF Standard 5)?

We agree with the proposed criteria.

7. Should settlement arrangements utilised by CCPs, or offered by SSFs, be allowed to settle using DvP model 2 where trade values are small and operational requirements dictate its use, or should all facilities be required to settle according to DvP model 1 or 3 (proposed CCP Standard 11, SSF Standard 10)?

We seek confirmation of our understanding that the terminology of "trade-by-trade" used to describe the DvP models was meant to encompass net lines of settlement ("line by line") rather than requiring settlement of individual trades separately. LCH.CleARNET's preference is for DvP models 1 and 3.

8. Would a change from a principal-to-principal model to an agency model for indirect participants of a CCP allow for effective portability arrangements in the case of a clearing

participant default (proposed CCP Standard 13)? What would be the costs and consequences of such a change?

We do not see that a change to an agency model would necessarily make portability arrangements more effective than in a principal-to-principal model.

9. Should the required level of segregation for any collateral posted on behalf of participants' customers differ between CCPs clearing securities and derivatives markets, having regard to the much shorter duration of pre-settlement risk exposure in securities transactions and the reduced likelihood that customer positions would be ported in such circumstances (proposed CCP Standard 13)?

We do not see any reason to prevent customers who are trading securities from seeking the same levels of protection as those trading derivatives.

10. Should a CS facility licensee be subject to more prescriptive controls regarding their investment policies than envisaged in the proposed FSSs, such as a minimum proportion of funds invested in risk-free assets or limits on the concentration of exposures to investment counterparties (proposed CCP Standard 15, SSF Standard 13)?

We believe it would be prudent to require a CCP to secure a minimum proportion of its cash deposits and refer the Bank to the EMIR regulation that requires CCPs to collateralise 95% of its cash deposits calculated as an average over a month.

11. It is proposed that CS facility licensees be required to achieve resumption of operations within two hours following a disruption to critical information technology systems (proposed CCP Standard 16.7, SSF Standard 14.7). What would be the benefits and costs of reducing the window for resumption of operations for systemically important CS facility licensees in respect of their critical systems?

We are unable to quantify the costs of such a reduction but note that other jurisdictions have enacted legislation that applies the two-hour rule to all CCPs and believe this to be sufficient.

12. Should the proposed FSSs include specific requirements for licensed CS facilities to manage cyber security risks? If so, what sorts of risk controls would be appropriate?

Yes, we believe that licensed CS facilities should be required to manage cyber security risks. The controls that should be considered should address perimeter-based mitigation, internal-based mitigation and proactive measures.

- *Perimeter-based mitigation should include an Intrusion Detection System that has the capability to track attack floods and notify of alerts, maintenance of firewalls, independent assessments of potential network vulnerabilities, contact to network service provider emergency management teams in order to reduce any potential*

attack from reaching the networks, and the availability of a “Clean Pipe” service to redirect legitimate traffic in the event of a targeted Distributed Denial of Service attack.

- *Internal-based mitigation should include continuous patching and hardening of systems to reduce the risk of exploitation via newly discovered vulnerabilities; maintenance of anti-virus and other security updates, application penetration testing and incident response procedures.*
- *Proactive measures should include a requirement to maintain an understanding of the current threat “landscape”.*

13. Following the release of the CPSS-IOSCO consultative report on *Recovery and Resolution of Financial Market Infrastructures*, is there sufficient clarity within the proposed FSSs to capture all necessary measures to ensure an effective recovery regime (including loss allocation arrangements)?

This is a particularly complex area and we believe that the FSSs are at a high level adequate at this stage, although as the Bank notes this matter is currently progressed at the global level and doubtless the FSSs may evolve in conjunction with this initiative.

14. Requirements under proposed CCP Standards 3.5, 16.4 and 16.10, and SSF Standards 3.5, 14.7 and 14.10 have been designed to ensure arrangements are in place to assist any statutory manager when stepping into a CS facility following a shock to the CS facility. Are these standards sufficiently comprehensive to ensure any such action would be effective?

We believe these are sufficient.

15. Are there any further requirements placed on CS facilities in other jurisdictions that could be applied in Australia to enhance the systemic risk controls of licensed CS facilities, without imposing disproportionate costs?

We have not identified any additional requirements.

17. Is the assessment approach articulated in Attachment 5 consistent with the objective to deliver a framework for regulation of overseas licensees that does not impose an unnecessary regulatory burden, while ensuring competitive neutrality in the Australian regulatory environment?

We believe that this approach is satisfactory.

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We are grateful for the open and constructive dialogue which we are able to have with the Bank and other Australian authorities and look forward to continuing in the same way.



Should you have any questions or issues arising from this response please contact Rory Cunningham, Director of Public Affairs at rory.cunningham@lchclearnet.com.

Yours faithfully

A handwritten signature in blue ink, appearing to read 'Ian Axe', written over a faint blue circular stamp.

Ian Axe
Chief Executive Officer