

## **CESAME**

### The position of LCH.Clearnet

LCH.Clearnet SA and LCH.Clearnet Ltd each act in two senses relevant to the account certainty project.

They take securities as collateral in relation to transactions in the markets (securities and derivatives) which are cleared.

They are each transferor and transferee of securities on the securities markets which are cleared.

LCH.Clearnet Ltd and LCH.Clearnet SA have been designated as Securities Settlement Systems in the UK and France respectively in accordance with Directive 98/26/EC on Settlement Finality.

It has been asked whether there are any special features of the work of a Clearing House which need to be taken into account in the work of the Account Certainty project. This paper is intended to set out those features.

#### **1 Collateral**

##### **A Settlement Finality Directive**

LCH.Clearnet Ltd takes securities collateral in England and Belgium. LCH.Clearnet SA takes securities collateral in France, Portugal, and Belgium.

Under Article 9 of Directive 98/26/EC on Settlement Finality:

1. The rights of: - a participant to collateral security provided to it in connection with a system, and - central banks of the Member States or the future European central bank to collateral security provided to them, shall not be affected by insolvency proceedings against the participant or counterparty to central banks of the Member States or the future European central bank which provided the collateral security. Such collateral security may be realised for the satisfaction of these rights.

2. Where securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Member States or the future European central bank as described in paragraph 1, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State.

Thus, under Article 9(1) each Clearing House may realise security provided to it, notwithstanding the insolvency of the provider, and under Article 9(2), the determination of rights of each of them to the collateral at each depository depends on the jurisdiction of the relevant depository.

## B LCH.Clearnet Ltd

LCH.Clearnet Ltd takes securities collateral in accordance with section 4 of its Procedures ([http://www.lch.com/Images/SECT\(4\)%20-%20Collateral%20Dec%202004%20JennyC\\_tcm3-372.pdf](http://www.lch.com/Images/SECT(4)%20-%20Collateral%20Dec%202004%20JennyC_tcm3-372.pdf))

UK gilts are transferred to the Clearing House's proprietary account in Crest. Other EU government bonds are transferred to its proprietary account at Euroclear Bank. The transfers are by way of legal mortgage documented by a form of charge and a collateral lodgment form (both English law) provided by the Clearing Member. The legal mortgage does not permit re-hypothecation of the collateral. If the work of the Account Certainty project enables the adoption in English law of a security interest which permits re-hypothecation (along the lines of the Swiss irregular pledge), such a result would be welcomed by LCH.Clearnet.

It might also be noted that as a Recognised Clearing House LCH.Clearnet Ltd is protected when acting under its default rules pursuant to Part VII of the Companies Act 1989. This is likely to be the only occasion when security is enforced, and although the legislation does not deal directly with certainty as to the enforcing of a security, it is likely that the protected status would be taken into account should there be any UK judicial review of the realisation of the collateral.

## C LCH.Clearnet SA

LCH.Clearnet SA takes securities collateral in accordance with Instruction 1.5-1 (<http://www.clearnetsa.com/member/files/Instructions/I%5B1%5D.5-1%20GB.pdf>):

Pursuant to Directive<sup>1</sup> on Settlement Finality the validity and enforceability of a guarantee (i.e a security interest) on book-entry Securities is assessed according to the law of the European member state where the account in which the rights with respect to the relevant Securities are recorded.

According to that :

- when a Clearing Member provides LCH.Clearnet SA with Collateral, directly or indirectly via an agent, by providing Securities, to an account belonging to CH.Clearnet SA held in France, by virtue of article L 442-6 of the French Monetary and Financial Code, ownership of the Collateral is transferred to LCH.Clearnet SA at the moment LCH.Clearnet SA's account is credited.
- when a Clearing Member provides LCH.Clearnet SA with Collateral, directly or indirectly via an agent, by providing Securities to an account belonging to LCH.Clearnet SA held in a centralised Securities system registered in Portugal, by virtue of articles 60.<sup>o</sup>, 81.<sup>o</sup>, 260.<sup>o</sup> and 273.<sup>o</sup> of the Portuguese Securities Code, the relevant articles of Comissao do Mercado de Valores Mobiliarios (CMVM) regulation<sup>2</sup> and of this Instruction, the Collateral is submitted to a pledge at the moment LCH.Clearnet SA's account is credited.
- when a Clearing Member provides LCH.Clearnet SA with Collateral, directly or indirectly via an agent, by providing Securities to an account belonging to LCH.Clearnet SA held in Belgium,

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<sup>1</sup> Article 9(2) : "Where securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Member State or the future European central bank as described in paragraph 1, and their rights (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State."

with Euroclear Bank or with National Bank of Belgium, by virtue of article 25 *bis* of the Belgian Act relative "au marché du titre de la dette publique et aux instruments de politique monétaire" dated January 2nd, 1991 the Collateral is transferred to LCH.Clearnet SA under a trust (*transfer of ownership for the purpose of collateral – transfert de propriété à titre de garantie*) at the moment LCH.Clearnet SA's account is credited.

- when a Clearing Member provides LCH.Clearnet SA with Collateral by holding Securities in accounts directly held by such Clearing Member with the Belgian branch of LCH.Clearnet SA, the Collateral is submitted to a legal privilege consisting in a first rank preferred right in favour of LCH.Clearnet SA, as provided in article 31 §2 of the Belgian Act of 2 August 2002 and Royal Decree of June 9th, 1995 relating to the realisation procedure. The Belgian branch of LCH.Clearnet SA in turns holds the relevant Securities accounts in CIK or NBB .

The underlying transactions and the requirement to provide collateral are governed by French law as provided in the Clearing Rule Book and Admission Agreement. The Instruction above provides that the validity and enforceability of the security interest is governed by the local law of the relevant depository.

## **2 Transfers of Securities**

As can be seen from the attached slide, settlement of transactions cleared through LCH.Clearnet is carried out in most of the major EU CSDs and ICSDs. Normally a direct account is held by the Clearing Houses, but for some CSDs LCH.Clearnet Ltd uses a local commercial bank custodian (In Scandinavia, and at NBB and Clearstream Frankfurt).

Where such custodians are used, the contract in question stipulates that the local law is to apply. The custodians are not designated under 98/26/EC.

## **3 Other Issues**

A LCH.Clearnet has consistently argued that Clearing Houses recognised in one EU state should be able to carry out their activities in other EU states on the basis of the recognition by its home state regulator. It takes this opportunity to repeat its request.

B LCH.Clearnet has reviewed the Euroclear paper Preparatory information regarding European Legal Harmonisation of 22 September 2004 and supports Proposals 2, 4 and 6 of the paper.

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