

LCH.CLEARNET GROUP LIMITED

BASEL III PILLAR 3 DISCLOSURES REPORT

For the year ended 31 December 2014

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INTRODUCTION

1.1. LCH.Clearnet Group Limited

LCH.Clearnet Group Limited is the holding company of the LCH.Clearnet Group comprising three clearing houses: LCH.Clearnet Limited based in London, LCH.Clearnet LLC based in New York and LCH.Clearnet SA based in Paris.

LCH.Clearnet Group Limited is a compagnie financière regulated by the Autorité de Contrôle Prudentiel et de Résolution (ACPR). 57.8% of its shares are owned by the London Stock Exchange Group plc (LSEG).

Both LCH.Clearnet SA and LCH.Clearnet Group Limited are subject to Basel III requirements on a standalone and consolidated basis respectively. This Pillar 3 disclosure document covers the disclosures of LCH.Clearnet Group Limited.

1.2. Basel III Overview

On 26 June 2013 the European Parliament and Council approved the Capital Requirements Regulation (“CRR”) and Capital Requirements Directive (“CRD”), together known as “CRD IV”, and which transposed the new global standards on bank capital (the Basel III agreement) into EU law. The new rules entered into force on 1 January 2014 with the CRR directly binding in all EU Member States while the CRD needed to be implemented into national law. CRD IV replaces the existing capital requirements for credit institutions and investment firms, and is applicable at an entity, sub-consolidated and consolidated basis.

CRD IV introduced a number of changes, including stricter definition of capital resources, increased capital requirements, increased reporting obligations (COREP), binding liquidity ratios and new requirements on remuneration.

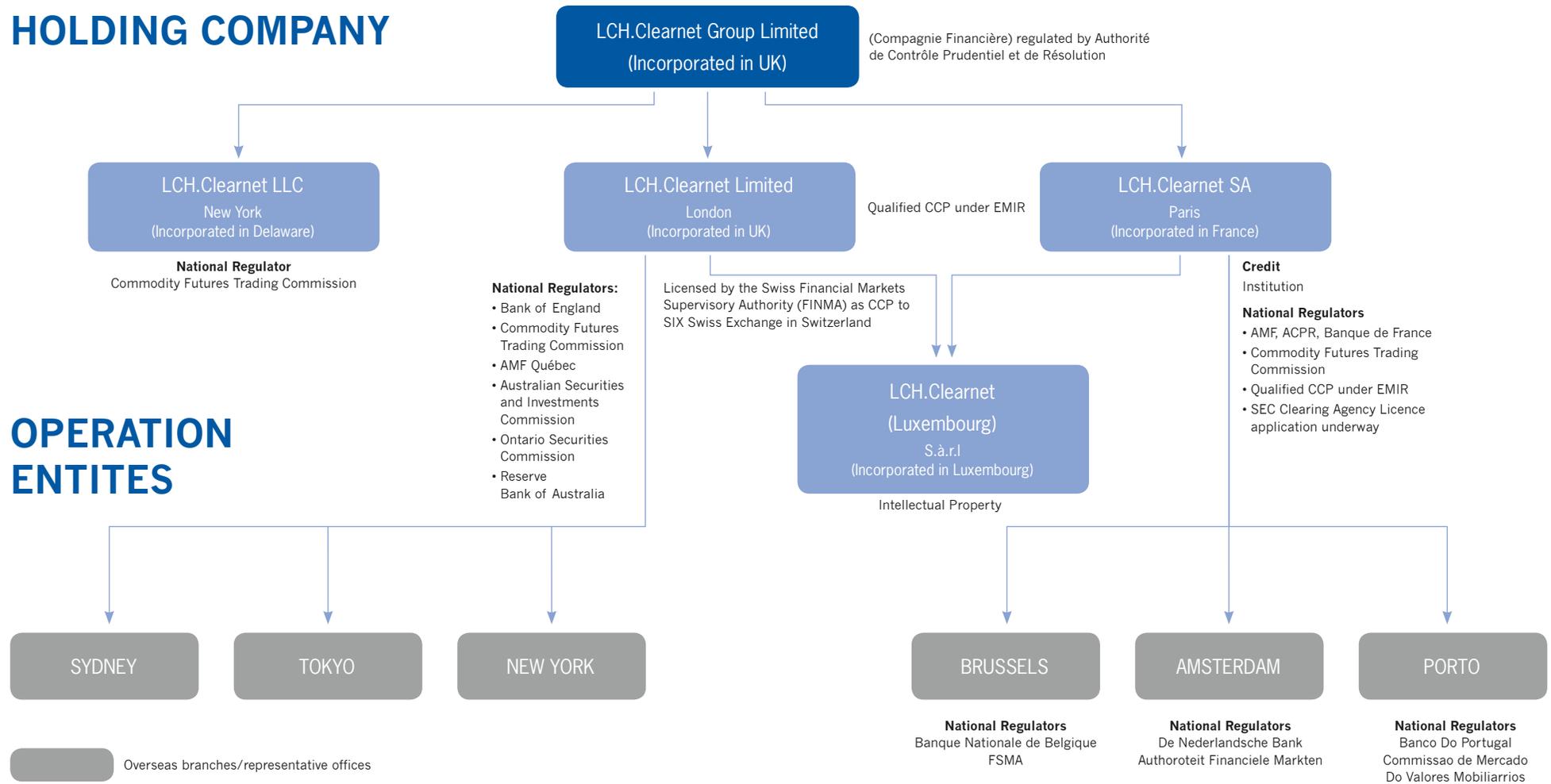
The Basel framework consists of three pillars:

- Pillar 1 defines the minimum capital requirements to cover credit, market and operational risks, the eligible capital instruments, and the rules for calculating RWA (Risk Weighted Assets)
- Pillar 2 states that the credit institutions and investment firms must have an internal capital adequacy assessment process (ICAAP) and that national competent authorities must evaluate each credit institution’s and investment firm’s overall risk profile as well as its risk management and internal control processes
- Pillar 3 encourages market discipline through disclosure requirements which allow market participants to assess the risk and capital profile of credit institutions and investment firms banks. This document is designed to meet LCH.Clearnet SA’s Pillar 3 disclosure obligations

1.3. Scope of Application

The scope of application is to LCH.Clearnet Group Limited on a consolidated basis. A simplified Group structure that includes the Group's principal operating entities is as follows:

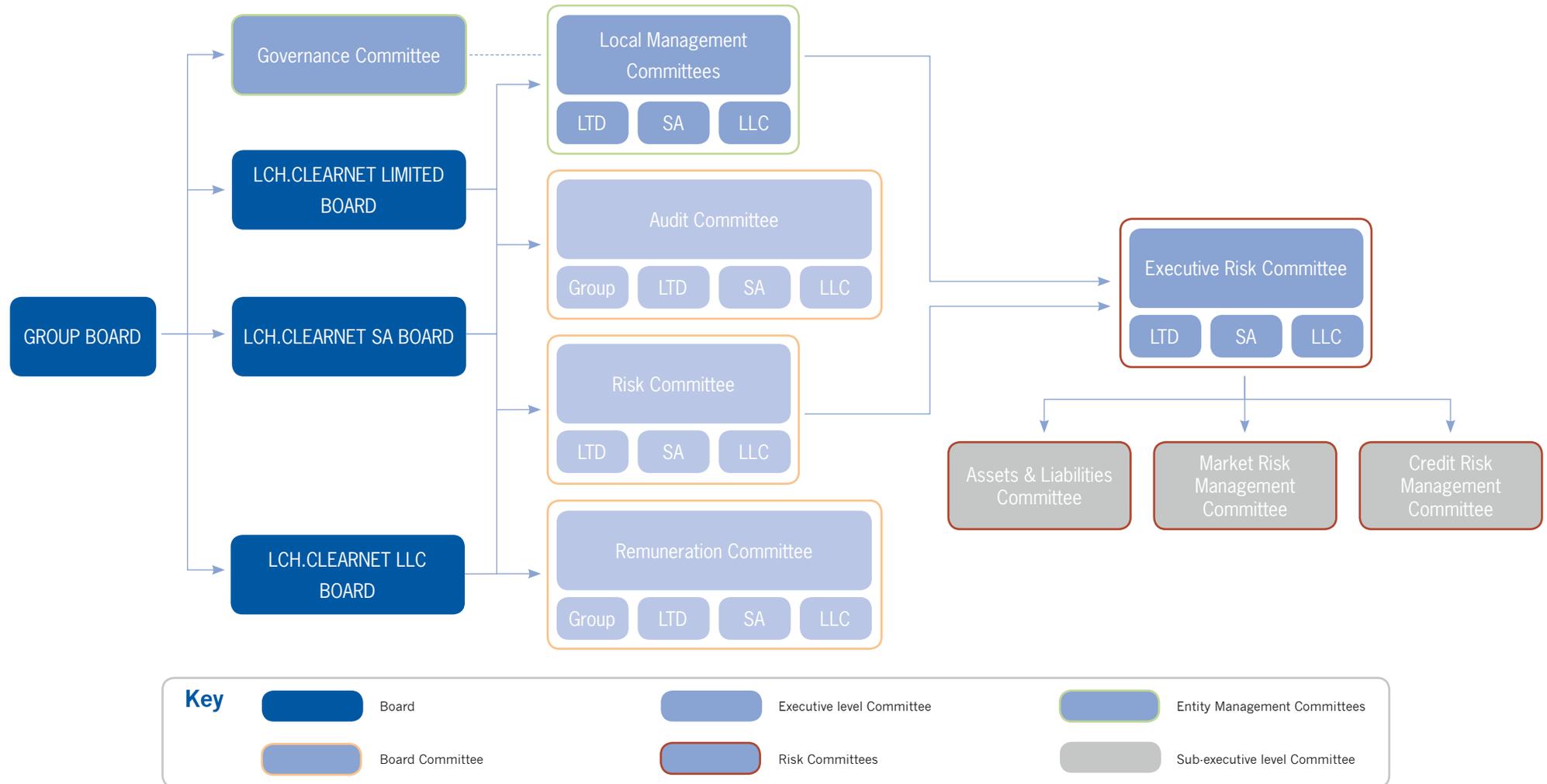
HOLDING COMPANY



1.4. Risk governance

The governance of LCH.Clearnet reflects the Group's history and structure and consequently includes a number of Board and Executive committees, the coordination of which is ensured through common members or chairmen.

Each subsidiary is legally responsible for its decisions, therefore Group Board decisions are, when necessary, ratified by subsidiary Boards to ensure they are compliant with any specific legal or regulatory requirements.



1.4.1. Risk management

The Chief Risk Officer for each entity of LCH.Clearnet Group (“CRO”) is responsible for the day-to-day management and control of all risks. The CRO has the overall responsibility for all risk decisions within the framework of agreed risk policies, including:

- General authority over all functional reports (not superseding the authority of the relevant subsidiary CEO)
- Responsibility for developing and implementing LCH.Clearnet’s strategic risk management program and risk framework
- The responsibility for monitoring and measuring risk according to LCH.Clearnet Group standards

The Group Chief Risk Officer is responsible for:

- Developing and proposing to the Board, the Group Risk Governance Framework
- Setting the risk standards applicable for each entity, which are laid down in risk policies

1.4.2. Executive committees dedicated to risk management

The Local Management Committee (LMC) of each LCH.Clearnet entity is chaired by the CEO and is responsible for monitoring entity-level risk management practices it reviews and to approve proposals that impact that entity’s risk profile.

The LMCs are advised by the Executive Risk Committee (ERCo). This combined risk committee for each of the operating entities is chaired by the Group Chief Risk Officer, and comprises the heads of each clearing business, the entity Chief Risk Officers (CROs), and senior group risk management and compliance executives. Its responsibilities are to oversee, monitor, review and challenge the management of all risks arising in pursuit of the stated business objectives and risk appetite. Any new business containing new risk or changes to risk policy must be reviewed by the ERCo and referred to the appropriate Board Risk Committee for review and applicable Board for approval.

There are three sub-committees of the ERCo which meet on regular basis to monitor specific risk areas:

- The Asset & Liability Management Committee is in charge of the monitoring of investment, liquidity and risk funding
- The Market Risk Management Committee is in charge of the monitoring and reviewing of the latent market risk framework, including margin levels and models, stress testing, default fund adequacy and default management arrangements
- The Credit Risk Management Committee is in charge of the monitoring the effectiveness of the group’s credit risk management framework and performance of credit review and exposures

1.4.3. Board and Committees of the Board

In broad terms, the LCH.Clearnet Board is responsible for setting strategy, objectives and policies, and approving budgets and significant business decisions, this includes the risk appetite statement and relevant risk policies. The Board reviews on an annual basis the system of internal control.

There are three sub-committees of the LCH.Clearnet Boards:

- LCH.Clearnet Audit Committees represent the interests of the Boards of LCH.Clearnet in the sound financial management, operational risk control and internal risk control discipline of LCH.Clearnet. These Committees review and discuss with LCH.Clearnet management and the external auditors of LCH.Clearnet the audited financial statements of their respective company, before their approval by the Boards

The Audit Committees of the Group and of its three main operating entities have the same independent chairman. The Audit Committees met eight times in 2014.

- LCH.Clearnet Risk Committees address matters concerning significant risks faced by LCH.Clearnet. It includes the regular review of the risk appetite framework and all risk policies. They are chaired by an Independent Non-Executive Director identical for all three operating entities of the Group and its membership comprises representatives of the CCP's users and their clients, and other INEDs

The Risk Committees of the three subsidiaries met eight times in 2014.

- LCH.Clearnet Remuneration Committees oversee the remuneration policy and principles for operating entities and Management. They recommend the remuneration packages to the Boards for approval. The Group Remuneration Committee met eleven times in 2014
- LCH.Clearnet Group Nomination Committee of the Board of Directors makes recommendations to the respective Boards of the LCH.Clearnet group for nominations of candidates as directors of the Boards. The Group Nomination Committee met five times in 2014

1.4.4. Risk governance framework (RGF)

LCH.Clearnet has in place a risk governance framework approved by the LCH.Clearnet Boards which:

- Defines a risk appetite for LCH.Clearnet
- Lists the universe of risks to which the LCH.Clearnet can potentially be exposed, together with a working definition of each risk type
- Lists the minimum standards/tolerance for each risk which the Board expects to be met, both on a current basis and on a forward looking basis
- Designates the individuals/groups/committees who are responsible for measuring and monitoring risk

Due to considerations of systemic risk and the public nature of the LCH.Clearnet mission, the Risk Appetite of the group can broadly be described as low. LCH.Clearnet adheres to high risk management standards. Risks should be managed at business unit level but escalated if the impact or probability of occurrence is increasing.

The universe of risks includes 21 risks which are tailored to the specific type risk which may be faced by LCH.Clearnet in the performance of its specific function within the market place. The risks in Risk Governance Framework (RGF) are not equal to the risk types as per Basel III but a translation is made to these risk types for the purposes of this report.

For each identified risk there are:

- An individual who is designated as being responsible for measuring and monitoring such risk
- Minimum tolerance which the Board expects to be met or exceeded
- A specific risk policy approved by the Board or other relevant risk management documentation

An holistic enterprise risk management framework is in place for the measurement and monitoring of all the risks within the risk universe of LCH.Clearnet Group Limited and an operational risk dashboard is in place which is regularly reviewed by Senior Management, the Audit Committees and LCH.Clearnet Boards.

Any risks which are outside the risk appetite will immediately be reported and an action plan will be put in place as to bring back the relevant risks within appetite.

1.4.5. Basel risk types & coverage

The below Basel risks are relevant for LCH.Clearnet.

Credit risk

Credit risk is the risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the institution or its failure to perform as agreed.

LCH.Clearnet has the following main credit exposures:

- Investment counterparties
- Clearing members (subject to the default waterfall)
- Interoperating CCPs
- Occasional overnight exposure as a result of settlement and payment activities (see settlement, payment and custodian risk)

All Counterparties, including sovereigns and interoperating CCPs, are subject to a formal and documented Internal Credit Score assessment (Credit Review), before on-boarding and then at least once a year.

The credit risk on the investment portfolio is minimised in the following manner:

- Setting criteria so that only good quality counterparties are used
- Setting limits to minimise concentration risk to these counterparties
- Securing as much of the cash portfolio as possible or undertaking “high quality” investments
- Setting haircuts appropriate to the type of collateral received

Market risk

It is the role of each operating entity as a central counterparty to interpose itself between the counterparties to a trade. As such, each subsidiary has a balanced book in which, for every long position it has with a counterparty, there is an opposing short position. Consequently, the CCPs are exposed to market risk only in case of a clearing member default.

However, each operating entity must invest the cash deposited by clearing members in order to pay them an interest to deposited cash. As a consequence of these investment activities LCH.Clearnet may have an exposure on interest rate changes. In line with EMIR rules the investment portfolio of LCH.Clearnet is qualified as a trading book. Consequently the resulting exposure is qualified as a market risk in Pillar 1.

Market risk exposures as a result of interest rate changes are subject to stringent limits as set out in the investment risk policy approved by the LCH.Clearnet Board.

The LCH.Clearnet group also generates costs and revenues in other currencies than the reporting currency (EUR); as such it is exposed to a market risk as a consequence of FX movements.

A process is in place to forecast cash flows in non-reporting currencies and these exposures are managed through spot buying and selling of currency as recommended by the Asset and Liability Committee.

Operational risk

This is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Operational risks are identified, assessed, controlled and managed in a proactive manner to minimise the impact on LCH.Clearnet.

The following processes are in place to manage operational risk:

- Risk and control self-assessment
- Permanent controls reporting
- Loss data collection
- Project analysis

Liquidity risk

This is the risk that LCH.Clearnet will, at any time, have insufficient liquid resources available to meet its obligations towards its clearing members or any other creditors and in particular in managing a member default.

There are two main sources of liquidity needs: operational liquidity and liquidity risk generated by a default event.

On a daily basis, assessments are performed of the liquidity buffer and available liquidity resources considering all relevant scenarios and an extended time period.

Concentration risk

This risk includes (i) large (connected) individual exposures and (ii) significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors, e.g. sector, economy, geographical location, instrument type.

The management of concentration risk is included within the overall credit risk monitoring and specific indicators are in place for this purpose.

Settlement, payment and custodian risks

- Settlement risk: is the risk of making a payment or delivery without receiving, at the same time, the delivery or payment from the counterparty
- Settlement bank risk: is the risk of loss of funds held with a settlement bank should it become insolvent
- Custody risk: is the risk of loss on securities in safekeeping (custody) as a result of the custodian's insolvency, negligence, misuse of assets, fraud, poor administration or inadequate record keeping

LCH.Clearnet has the following generic tools in place to reduce these exposures:

- Direct access to the Banque de France and (I)CSDs
- Strict capital and quality requirements for other intermediaries
- The performance of DVP settlement and finality of payments
- Risk monitoring & control of the exposures

Business risk

This risk can be defined as the risk arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment.

Business risk is managed and monitored in accordance with EMIR and a scenario analysis is performed considering reasonably foreseeable scenarios.

Pension Risk

Pension risk exists within the Group, predominantly due to the defined benefit section of the LCH.Clearnet Limited Pension Scheme (“the Scheme”) in the UK. This was closed to new entrants from September 2009 and future accrual for existing members from April 2013. The Scheme is administered by a Trustee Board.

Pension risk can occur as a result of adverse changes (which arise from a number of factors some of which are outside the control of the Trustee Board e.g. low levels of prevailing interest rates which give rise to increased pension liabilities) to the funding level of the Scheme, which may ultimately lead to additional cost to the firm in meeting the Scheme’s obligations to pay members’ benefits.

The Trustee Board has appointed external advisors who advise the Trustee Board regarding any funding or investment strategy decisions. The Trustee Board consults with LCH.Clearnet in setting investment strategy. In addition to the triennial actuarial valuation, the funded status of the Scheme is also monitored and reported on (at least) a quarterly basis, with the reports made available to LCH.Clearnet.

2. OWN FUNDS: COMPOSITION OF REGULATORY CAPITAL

LCH.Clearnet Group's total regulatory capital is composed of Tier 1 capital which consists primarily of share capital, additional paid-in capital and retained earnings.

Group regulatory capital and shareholders' funds at 31 December 2014

	€'m
Share capital	74.2
Share premium	316.1
Capital reserves	15.3
Other reserves	62.2
Retained earnings	368.9
Shareholders' equity	836.7
Dedicated own resources (skin in the game) and other deductions	(396.3)
Common equity after deductions	440.4
Grandfathered preferred securities	143.1
Tier 1 capital	583.5
Other capital	-
Total regulatory capital	583.5

The prudent valuation is calculated with the standard method (Art 105 CRR)

- As per the default waterfall process, in case of a clearing member default, LCH.Clearnet CCPs would first use the defaulting member's initial, variation and additional margins as well as the defaulter contribution to the default fund. Should the loss be greater, they will use a share of their capital. As per EMIR, this share of capital, referred to as "skin in the game" (SIG), is calculated as 25% of minimum capital including retained earnings and reserves as defined in Article 35 of regulation EU N°153/2013 of 19 December 2012 (latent market risk)

3. CAPITAL REQUIREMENTS

LCH.Clearnet capital exceeds its requirements minimum capital ratios. Its Pillar I requirements at 31 December 2014 were as follows:

	€'m
Credit risk	12.9
Market risk	44.4
Operational risk	64.3
Total Pillar I capital requirement	121.6
Risk weighted assets	1,520.0
Common equity capital ratio (minimum 4.0%)	29.0%
Tier 1 capital ratio (minimum 5.5%)	38.4%
Total capital ratio (minimum 8.0%)	38.4%

An Internal Capital Adequacy Assessment Process (ICAAP) process has been performed using Basel III rules which are applicable from 1 January 2014. The ICAAP has been approved by the Audit Committees and Boards. As an outcome of this process, LCH.Clearnet has concluded that it holds sufficient capital for the relevant risks.

4. CREDIT RISK

Credit risk is the risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the institution or its failure to perform as agreed.

LCH.Clearnet has the following main credit exposures:

- Investment activities
- Occasional overnight exposure as a result of settlement and payment activities (see settlement, payment and custodian risk)

The LCH.Clearnet Group capital requirement for credit risk is calculated as follows:

€'m	Risk-weighted exposure	Capital requirement
Institutions	132.8	10.6
Corporates	28.0	2.2
	160.8	12.9

The capital is assigned on the basis of the regulatory capital under the standard method. The External Credit Assessment Institutions (ECAIs) used are Moody's, S&P and Fitch. The overall credit risk exposures are related to the steps 1 or 2 under the standard method.

The counterparty credit risk exposures are related to the investment portfolio (cash margins invested). It is mainly composed of high quality assets as required by EMIR such as Eurozone/US/UK/Supranational securities, Money Market Funds (only for LCH.Clearnet LLC) and reverse repo transactions/cash deposits with highly rated credit institutions. LCH.Clearnet operating entities are collateral taker (cash provider) and the reverse repo agreements are not subject to any downgrade clause.

LCH.Clearnet operating entities do not book any derivatives contract as of 31 December 2014 as required by EMIR.

All counterparties, including sovereigns and interoperating CCPs, are subject to a formal and documented Internal Credit Score (ICS) assessment, before on-boarding and then at least annually. The ICS models are models driven by a quantitative assessment based on a set of ratios (e.g. equity ratio, return on assets), external ratings (market implied ratings and credit risk ratings) and qualitative assessments (e.g. parental support).

The limits and the eligibility criteria are set in LCH.Clearnet Group investment policy. Each review is submitted to the Risk Governance for review and approval of the Internal Credit Score.

The credit risk on the investment portfolio is minimised in the following manner:

- Setting criteria so that only good quality counterparties are used
- Setting limits to minimise concentration risk to these counterparties
- Securing as much of the cash portfolio as possible or undertaking “high quality” investments
- Setting haircuts appropriate to the type of collateral received

The LCH.Clearnet Group investment policy does not authorise to bear any wrong way risk in the investment portfolio.

As of 31 December 2014, the counterparty credit risk exposures (Exposure At Default under Standard Method) are set out below:

- Reverse repurchase transactions for €353.9 million
- Securities purchases for €17,928.5 million
- Banque de France deposit for €1,169.0 million

As of 31 December 2014 the geographical breakdown regarding reverse repurchase transactions with credit institutions counterparties is set out below:

- Australia: 2%
- Denmark: 4%
- France: 21%
- Germany: 15%
- UK: 49%
- US: 9%

As of 31 December 2014, the geographical breakdown regarding the securities purchases sovereign exposures is set out below:

- Belgium: 7%
- BEI: 4%
- Germany: 12%
- France: 30%
- UK: 4%
- Netherlands: 2%
- US: 41%

5. MARKET RISK

LCH.Clearnet is exposed to interest rate risk on the investment portfolio as a consequence of changes in applicable interest rates (including credit spreads) of long term sovereign investments and secured lending transactions.

The exposure to the interest rate risk is measured and monitored daily by currency and maturity, this exposure is determined with the PV01 metric (sensitivity to 1 bp parallel shift of the OIS Curve).

The LCH.Clearnet Board determines the risk appetite for Interest Rate Risk (IRR) not exceeding 10% of LCH.Clearnet capital. Stress scenarios are set with reference to the capital position, and are will be updated monthly or upon material downward movement.

ERCo uses its discretion to adjust interest rate limits at or below maximum levels allowed by the risk policy, to suit the prevailing market conditions.

In addition, the LCH.Clearnet Group is exposed to changes in foreign exchange (FX) rates as it generates costs and revenues in other currencies than the reporting currency (EUR) as such it is exposed the market risk as consequence of FX movements.

6. OPERATIONAL RISK

Operational risk is the risk of loss arising through failures associated with personnel, processes, systems or from external events. It is inherent in every business organisation and covers a wide spectrum of issues.

Operational risks are identified, assessed, controlled and managed in a proactive manner to minimise the impact on LCH.Clearnet under the Group's Operational Risk Framework (ORF).

The objectives of the ORF are to identify measure, control and/or reduce operational risk and to provide an accurate, usable picture of the risk profile of LCH.Clearnet. The ORF organises the qualitative management of operational risk. It is supplementary to loss protection by regulatory capital. For the operational risk capital requirement applicable since 1 January 2008, LCH.Clearnet uses the Basic Indicator Approach (BIA).

This framework covers all types of operational risks proposed under Basel III, namely internal fraud, external fraud, employment practices and workplace safety, client, product and business practices, damage to physical assets, business disruption and system failures, execution, delivery and process management.

7. UNENCUMBERED ASSETS

In the below table, the securities portfolio are reported as unencumbered assets and reverse repurchases on both trading book and clearing business are reported as encumbered assets.

€'m	Encumbered assets		Unencumbered assets	
	Carrying amount	Fair value	Carrying amount	Fair value
Equity instruments	-	-	-	-
Debt instruments	232,354.2	232,354.2	13,053.5	13,053.5
Other assets	-	-	859.4	-
	232,354.2		13,912.9	

€'m	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
Carrying amount of selected financial liabilities	208,262.6	-

8. REMUNERATION POLICY

Decision making process for determining remuneration policy

The Remuneration Committees oversee LCH.Clearnet group's remuneration policies. The Committees are appointed by the Board of LCH.Clearnet and are made up of a majority of independent Non Executive Directors.

The Committees' terms of reference, which are reviewed regularly by the Boards, are available on the Governance section of LCH.Clearnet's website (<http://www.lchclearnet.com/about-us/governance>) and detail, inter alia, the duties and powers of the Committee.

Under its remuneration policy, LCH.Clearnet undertakes to reward all employees fairly and to comply with any and all regulatory frameworks which apply to the remuneration of any employees of LCH.Clearnet.

External consultants

New Bridge Street, an Aon Hewitt company, are the appointed advisors to the Committees. The Committees are satisfied that the advice provided by New Bridge Street is independent.

In determining its remuneration policies, the LCH.Clearnet monitors developments in the wider market place and continues to consult and work with key stakeholders (including, but not limited to the LCH.Clearnet regulators and London Stock Exchange Group Remuneration Committee) on any key decisions taken.

Link between pay and performance

It is the policy of the LCH.Clearnet to operate competitive remuneration policies so as to attract, retain and motivate an appropriate workforce for the ongoing success of LCH.Clearnet.

Remuneration arrangements may include a mix of base salary, annual discretionary bonus awards and share based incentives (payable in shares of the London Stock Exchange Group plc), in addition to other country specific benefits. The remuneration of the LCH.Clearnet's senior management typically includes a greater proportion of performance related pay than applied to other employees of the LCH.Clearnet.

Basic salaries are set at an appropriate level to allow a fully flexible policy to be operated in respect of the award of any variable remuneration. LCH.Clearnet is committed to ensuring that total variable remuneration does not limit its ability to strengthen its capital base.

Variable remuneration is used to reward individual performance in line with a number of factors including risk appetite, departmental and LCH.Clearnet performance and corporate strategy. Employees engaged in risk management, compliance and internal audit are rewarded in a manner that is independent of the business performance of LCH.Clearnet.

Bonus awards to Group Executive Committee members are typically subject to 50% cash deferral for a three year period. Deferrals may also be applied to other employees depending on their role and the total bonus amount at LCH.Clearnet's discretion.

A new Long Term Incentive Plan (LTIP) was introduced in 2014 for selected employees of the LCH.Clearnet Group. The construct, both in terms of performance conditions and delivery vehicle, of the LTIP was endorsed by the Group's regulators. Vesting occurs over a three year period subject to the achievement of a risk management gateway and one or more of the following performance measures dependent upon the role undertaken by the participant: regulatory management, cost management and EBIT performance. LTIP awards are granted in the form of a nil cost option to acquire London Stock Exchange Group plc shares.

LTIP awards as well as deferred bonus awards made to Group Executive Committee members may be subject to performance adjustment (including adherence to the risk framework) prior to vesting. Furthermore, LCH.Clearnet may in certain circumstances exercise clawback, pursuant to which LCH.Clearnet may require deferred variable remuneration to be repaid (or deducted from future payments) for up to three years following the date of payment.