

November 5, 2010

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: RIN 3038 AD01, “Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest”

Dear Mr Stawick,

The LCH.Clearnet Group (“LCH.Clearnet”) is pleased to respond to the request for comment by the Commodity Futures Trading Commission (the “CFTC” or “Commission”) on RIN 3038 AD01, “Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest.”¹

LCH.Clearnet appreciates the careful thought and consideration that the Commission has given to the rulemaking process and the open way in which it has consulted with market participants and other interested parties. LCH.Clearnet strongly supports the policy goals underpinned both by the Proposing Release and the statutory provisions contained in Section 726 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

Section 726(a) of the Dodd-Frank Act specifically empowers the Commission to adopt rules mitigating conflicts of interest with respect to any Derivatives Clearing Organization (“DCO”) that clears Swaps. These rules may include numerical limits on the control of, or the voting rights with respect to, such a DCO by one of several specified market participants. These participants include a Swap dealer, a major Swap participant, and a large bank holding company or non-bank financial company regulated by the Federal Reserve.

LCH.Clearnet has long recognized that potential conflicts of interest may arise from such firms’ ownership stakes in clearinghouses. DCO shareholders who deal in over-the-counter (“OTC”) derivatives may have an interest in seeing that the clearinghouse does not clear the instruments in which they deal – although LCH.Clearnet’s substantial OTC derivatives clearing book plainly evidences the contrary. Such conflicts of interest are not limited to derivatives dealer

¹ RIN 3038 AD01, “Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest” (the “Proposing Release”).

shareholders: exchanges may also have an interest in seeing that a clearinghouse in which they are shareholders does not clear instruments traded on competing exchanges or in the OTC market, while end users may have an interest in seeing that a clearinghouse in which they are shareholders keeps margin requirements and other associated costs artificially low.

LCH.Clearnet has adopted a number of corporate governance safeguards that ensure that such conflicts of interest do not affect the safety and soundness of its clearinghouses. These safeguards ensure that the Group is able to serve markets, innovate and develop clearing services for new asset classes, sometimes for competing exchange partners. The Group's safeguards include limitations on voting rights by individual shareholders; independent board membership requirements; and objective and transparent clearinghouse membership criteria.

The effectiveness of the governance safeguards adopted by LCH.Clearnet has been demonstrably proven. Since 1999 when it first rolled out its innovative interest rate swap and repurchase agreement clearing services, the Group has consistently strived to expand its range of cleared OTC products, pioneering a large range of successful and proven OTC services. As well as offering a range of OTC cleared services to the European repo, and global energy, commodity, freight and emissions markets, LCH.Clearnet currently clears more than 40 percent of the global interest rate swap market through its SwapClear service, representing trades with a total notional principal of over \$220 trillion in 14 currencies.² Of that amount, approximately \$85 trillion is in U.S. dollars. There are currently 33 members of LCH.Clearnet's SwapClear service. In December 2009 the service was extended to facilitate client clearing and since then a wide range of end customers have used the service, ahead of an explicit regulatory obligation to do so.

LCH.Clearnet's application of transparent but onerous membership criteria promotes the operation of its clearinghouses in a manner that is free from conflicts of interest. To ensure the safe and sound operation of its clearinghouses, LCH.Clearnet employs membership eligibility criteria for each market that it clears. The criteria are approved by the Risk Committees and Board of Directors and include transparent and objective minimum capital requirements, operational standards, and in some cases credit ratings. Members must separately satisfy the criteria for each different clearing service they wish to join. A clearing member may provide access to the clearing service for all of its clients; LCH.Clearnet does not set any criteria regarding the access to clearing by clients of clearing members or otherwise discriminate among clients or third-parties.

For OTC derivative markets, LCH.Clearnet Limited has additional objective criteria to establish whether a clearing member is able to participate in the default management arrangements that are critical to the stability of the service and the clearinghouse. All of these criteria are completely transparent and available on the clearinghouse's website. The resilience of

² From Q1 2011 the range of currencies cleared will be extended from 14 to 20, to include IRS denominated in HUF, CZK, KRW, MXN, BRL and SGD. This extension will enable over 95 percent of the global IRS market to be cleared through SwapClear.

SwapClear's default management process was demonstrated in September 2008 when it successfully handled Lehman Brothers' \$9 trillion interest rate swap default. The highly effective default management process ensured that over 60,000 trades were hedged and auctioned off to other clearing members in a timely fashion and that the default was managed well within the margin held and with no recourse to the default fund.

Following are LCH.Clearnet's comments with respect to certain specific proposed rule provisions contained in the Proposing Release.

17 CFR Part 39 Registered Clearing Organization, Conflict of Interest, Membership, Access, Voting, Ownership

39.13 Risk Management

(g) Risk Management Committee

LCH.Clearnet is fully supportive of the Commission's proposed requirement that a DCO has a Risk Management Committee responsible for advising the Board on significant changes to the DCO's risk model and default procedures. Equally, the Risk Management Committee should be responsible for determining standards and requirements for initial and continuing clearing membership eligibility; for approving or denying (or reviewing) approvals or denials of clearing membership applications; and for determining products eligible for clearing. The LCH.Clearnet Group's subsidiary clearinghouses have long had Risk Management Committees chaired by independent directors responsible for undertaking these tasks, and the Group believes that the contribution of such Committees to the prudent management of DCO operations is critical.

Currently, LCH.Clearnet's clearinghouses' Risk Management Committees are not responsible for reviewing the performance of the Chief Compliance Officer. We are concerned that tasking the Committees with reviewing the Officers' performance may not be wholly appropriate. Whilst LCH.Clearnet understands the policy goals sought by this provision, it nonetheless believes that the Senior Executive of the DCO is better placed to review the Officer's performance than such a Committee. We would therefore recommend either (a) that the Commission amend this proposal such that the Officer's performance may be reviewed by the DCO's Senior Executive, or (b) that it may be reviewed by the Senior Executive jointly with the Board.

LCH.Clearnet believes that the Risk Management Committee should report to the Board of the DCO, as under proposed Rule 39.13(g)2. However, we have certain reservations about the Risk Management Committee composition requirements laid out under proposed Rule 39.13(g)3. Whilst LCH.Clearnet agrees that clearing members and customers (end users) should be represented on the Risk Management Committee, and

that a 10 percent representation requirement would be appropriate for customers, we are less certain that the Committee should be composed of at least 35 percent Public Directors.

The LCH.Clearnet Risk Management Committees currently enjoy broad representation, being chaired by Public Directors and having both exchange and clearing member representation. In expectation of the imminent expansion in end-customer OTC clearing, and in recognition of the valuable new perspectives this sector will bring to the risk management debate, LCH.Clearnet also recently amended its Risk Management Committee composition requirements, such that customers (end users) may also sit on the committee.

LCH.Clearnet is fully supportive of any rule from the Commission that ensures broad Risk Management Committee representation such as that outlined above, however we would urge the Commission to give due consideration to the importance of the expertise required on the Committee. A deep, detailed and current knowledge of the market in which the clearinghouse operates is crucial, and thus whilst LCH.Clearnet believes that it is important that there is input from independent representatives on the Committee, and that such Committees be chaired by Public Directors, we are not convinced that a hard-wired composition component of 35 percent Public Directors is appropriate in this instance.

The area of greatest concern for LCH.Clearnet under proposed Rule 39.13, however, lies in the provision at 39.13(g)3(C)(ii), wherein the Commission proposes that employees of DCOs should be disallowed from being Risk Management Committee members. LCH.Clearnet Group believes that it is of paramount importance that the Senior Executive of DCOs be responsible and accountable for risk decisions. We would therefore strongly urge the Commission to amend this provision to allow DCO employees to attend Risk Management Committee meetings as equal members, with full voting rights.

39.25 Conflicts of Interest

(a) **General**

LCH.Clearnet supports the Commission's efforts to ensure that DCOs establish and enforce rules to address conflicts of interest in their decision-making processes. The Group has long been aware of the conflicts arising within clearing and believes that rules and regulations can do much to mitigate the conflicts as well as to ensure that management is able to balance the interests of all different constituencies.

LCH.Clearnet has hardwired rules into its own articles of association and, like the Commission, believes that such governance arrangements should be clear and transparent. Above all, the governance arrangements should be designed to promote the safety and efficiency of the DCO, to support the stability of the broader financial system and other relevant public interest considerations, and to support the objectives of all relevant stakeholders.

(b) Limits on Voting Equity Ownership and the Exercise of Voting Power

2 Limits

LCH.Clearnet agrees with the policy concern underlying proposed Rule 39.25(b)2(i). This provision seeks to limit the influence any DCO member, either alone or together with its related persons, from directly voting or causing the vote of any interest in a DCO that exceeds 20 percent of the voting power of such clearinghouse. Ensuring that no individual entity is able to unduly influence the management and or operation of a DCO is an important policy goal that is upheld by LCH.Clearnet. In fact, the clearinghouse would go further and suggest that such voting power be limited to a 5 percent limit, as proposed by the Commission under proposed Rule 39.25(b)2(ii).

LCH.Clearnet is nonetheless concerned by proposed Rule 39.25(b)2(i), in which the Commission provides that participants should not collectively own or vote on more than 40 percent of any class of securities or other ownership interest. LCH.Clearnet believes that Congress correctly rejected any collective or aggregate limits on the ownership of clearing and trade execution facilities in the Dodd-Frank Act. As enacted, Section 726 of the Dodd-Frank Act gives the CFTC discretionary authority to limit the control of, or the voting rights with respect to, a DCO by an individual bank holding company or other specified entity. It does not authorize the CFTC to limit aggregate ownership of a DCO by bank holding companies or other specified entities.

- (ii) As noted above, LCH.Clearnet agrees with the policy concern reflected in proposed Rule 39.25(b)2(ii), that seeks to limit the influence any DCO member, either alone or together with its related persons, from directly voting or causing the vote of any interest in the DCO that exceeds five percent of the voting power of such DCO. LCH.Clearnet commends the Commission for proposing five percent as an appropriate threshold at which to set a limitation on voting interests, and appreciates its efforts in recognizing the efficacy of similar measures in existence today. LCH.Clearnet would nonetheless observe that a voting limitation such as that proposed by the Commission and outlined above might more appropriately be applied to all kinds of shareholders, rather than solely to DCO members since all kinds of DCO stakeholders may, on occasion, seek to unduly influence decisions.

LCH.Clearnet’s corporate charter already prohibits any shareholder from exercising votes representing more than five percent of the shares in issue, even if a shareholder actually holds a number of shares amounting to more than five percent of the total number of shares in issue. This measure has effectively ensured that neither a single shareholder nor a small group of shareholders – whatever their origin or collective interests - has been able to dominate management of LCH.Clearnet’s clearinghouses and determine their policies, such as which asset classes will be cleared. Instead, the management and policies of the clearinghouses must respect the broad interests of all shareholders, including exchanges, financial intermediary users, and end users.

LCH.Clearnet also believes that the Commission is correct in recommending that a limitation on voting interests is itself sufficient to ensure that conflicts of interests can be sensibly addressed. An “ownership limitation” proposal, such as that put forward by the Securities Exchange Commission,³ would be unnecessary and unduly restrictive. Hardwiring ownership limitations into the Commission’s rules would restrict the ability and incentive of participants to invest in new DCOs and may thereby inadvertently hamper the development of OTC derivatives clearing.

Restrictive ownership limits may also impede the ability of existing clearinghouses to grow and provide clearing services effectively in the global financial markets. LCH.Clearnet believes that restrictions on voting rights by individual shareholders, a fair representation requirement for Board composition and objective and transparent membership criteria would strike a better balance between mitigating conflicts of interest and ensuring a competitive market for clearing services and therefore applauds the Commission’s efforts in this regard.

17 CFR Part 40 Governance, Directors, Committees, Conflict of Interest

40.9 Governance

(b) The Board of Directors

LCH.Clearnet believes that the Boards of DCOs should include Public Directors. The LCH.Clearnet Board currently has four independent members (representing approximately 25 percent of the Board). Additionally, the LCH.Clearnet Board is composed of a balanced mix of exchange representatives and financial intermediaries. This wide spectrum of representation ensures that the Board is balanced, is well-

³ See SEC Rel. No. 34-63107, File No. S7-27-10, “Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC.”

positioned to serve the interest of LCH.Clearnet's entire shareholder and user community and to operate our clearinghouses accordingly.

LCH.Clearnet believes that it is of key importance to ensure that the members who have capital at stake in the clearinghouse group are fully involved in all Board decisions, avoiding any incentives by other stakeholders to erode risk management standards in order to increase profitability or gain market share. It is also critical that DCO Boards be furnished with a sufficiency of the necessary risk and market expertise to ensure that their operations be managed in accordance with the responsibilities and in support of the objectives laid out under the Dodd-Frank Act.

Former Swap dealers who are no longer actively engaged in the business, and who qualify as Public Directors under the Commission's definition, will be able to bring a wealth of useful knowledge and experience to the table. LCH.Clearnet would nonetheless observe that it is critical in these fast-changing markets that the balance of expertise comes from the active Swap dealer community. For that reason, LCH.Clearnet suggests the Commission consider whether a 25 percent Public Director requirement might not be more appropriate for DCOs than the 35 percent requirement contained in proposed Rule 40.9(b)(1)(i).

LCH.Clearnet fully supports the remainder of the provisions laid out by the Commission under proposed Rule 40.9(b) and commends the Commission for its thoughtfulness in this area.

(c) Committees and Panels

(1) Nominating Committee

The Commission has proposed that DCO's should have Nominating Committees tasked with identifying qualifying individuals to serve on the Board and administer the process for nominations. LCH.Clearnet believes this requirement is entirely appropriate, and indeed already has such a committee in place. LCH.Clearnet also supports the proposed requirement that the Nominating Committee be chaired by a Public Director.

LCH.Clearnet is concerned, however, by the requirement laid out under proposed Rule 40.9(c)(1)(iii) that stipulates that "a majority" of Public Directors sit on the Nominating Committee. LCH.Clearnet does not believe that this onerous requirement supports the underlying policy concerns, nor that it would have a sufficiently positive effect on mitigating conflicts of interest to justify its imposition. Indeed, LCH.Clearnet believes that it is important that those serving on a Nominating Committee have a detailed knowledge of the markets in which the clearinghouse operates, the technologies it uses, and its legal and regulatory environments.

LCH.Clearnet believes that it is important that there is input from Public Directors on the Nominating Committee and would therefore instead recommend that the Commission consider whether the Nominating Committee might better have a threshold of 25 percent Public Directors.

(2) Executive Committee

LCH.Clearnet agrees that any Executive Committee of the Board with delegated authorities should be subject to the composition rules – again, however, we would recommend that the Commission consider whether a 25 percent Public Director requirement might not be more appropriate for DCO Executive Committees than the 35 percent requirement laid out under proposed Rule 40.9(c)(2).

(3) Disciplinary Panels

The Commission has proposed under proposed Rule 40.9(c)(3) that each DCO should have a Disciplinary Panel responsible for conducting hearings, rendering decisions and imposing sanctions with respect to disciplinary matters.

LCH.Clearnet broadly agrees with the composition requirements laid out by the Commission under 40.9(c)(3)(ii). However as LCH.Clearnet has no such Disciplinary Panel in place today and instead delegates such responsibilities as laid out under proposed Rule 40.9(c)(3)(i) to its Board, we would welcome greater detail from the Commission about this Committee's exact roles and responsibilities.

LCH.Clearnet looks forward to extending its clearing services into the US marketplace, thereby introducing the safeguards of its proven structures deeper into the US customer base.

We recognize the hard work undertaken by the Commission in order to develop these proposed rules and value its open and thoughtful approach in this task. LCH.Clearnet appreciates the opportunity to comment on these important issues and would be pleased to enter into a further dialogue with the Commission and its staff. Please contact Simon Wheatley at (+44) 207 426 7622 regarding any questions raised by this letter or to discuss these comments in greater detail.

Sincerely yours,

A handwritten signature in blue ink that reads 'Roger Liddell'.

Roger Liddell
Chief Executive