

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

13 December 2010

Dear Mr Stawick,

Re: RIN 3038-AC98, 3038-AD02 “Financial Resources Requirements for Derivatives Clearing Organizations”

The LCH.Clearnet Group (“LCH.Clearnet”) is pleased to add further comment to the letters it has already submitted to the Commodity Futures Trading Commission (“Commission”). We continue to appreciate the careful thought and consideration that the Commission has given to the rulemaking process and the open manner in which it has consulted with market participants and other interested parties.

LCH.Clearnet strongly supports the policy goals underpinned by the Commission’s Proposing Release and the statutory provisions contained in Sections 725 and 805(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

Section 725 of the Dodd-Frank Act sets forth the core principles with which a Derivatives Clearing Organization (“DCO”) must comply to be registered and to maintain registration as a DCO and, further, authorizes the Commission to adopt rules prescribing the manner in which a DCO must meet each core principle, including core principle B, Minimum Amount of Financial Resources. Section 805(a) specifically empowers the Commission, following consultation with the Financial Stability Oversight Council and the Federal Reserve Board, to prescribe enhanced risk management standards for systemically important DCOs (“SIDCOs”).

LCH.Clearnet believes it is of the utmost importance that market infrastructures are subject to strict requirements to ensure their safety and robustness. LCH.Clearnet is therefore fully supportive of the proposals set forth by the Commission under RIN 3038-AC98, 3038-AD02 and believes that these proposed rules will help establish a comprehensive regulatory framework to reduce risk, increase transparency and promote market integrity within the financial system.

In order to minimize the divergence between US regulated Central Counterparties (“CCPs”) and other CCPs around the world, and to ensure a global level playing field for all CCPs globally, LCH.Clearnet would urge the Commission to do its utmost to ensure there is maximum

convergence between its final rules and the global standards for financial market infrastructures that will be laid down by CPSS-IOSCO¹ in early 2011.

LCH.Clearnet sets forth its more detailed comments on the Commission's proposals below.

A DCOs

1 Amount of Financial Resources Required

The proposed rules set out under 39.11 require that the DCO must have sufficient financial resources to be able to withstand a potential default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions. Similarly, the provisions require that the DCO must have sufficient resources to cover its operating costs for a period of at least one year, calculated on a rolling basis.

LCH.Clearnet concurs with all the provisions set forth by the Commission under 39.11(a) and agrees with the Commission's proposed requirement that the DCO must treat any clearing member, either controlled by another clearing member or under common control with another clearing member, as a single clearing member for the purposes of provision 39.11(a)(1).

2 Types of Financial Resources

LCH.Clearnet generally concurs with all the provisions set forth by the Commission under 39.11(b). We would, however, recommend that the "potential assessments" currently included under 39.11(b)(v) are disallowed to satisfy the requirements of paragraph 39.11(a)(1).

It is LCH.Clearnet's view that financial resources in the form of "assessments for additional guaranty fund contributions" should not be allowed in order to meet the requirement that the DCO is able to meet the obligations notwithstanding the default of the clearing member creating the largest exposure to the DCO in extreme but plausible market conditions.

We believe it is of the utmost importance that the CCP's resources following a member default – especially if the default is of such a magnitude as to exhaust the margin provided by that member – be immediately and unconditionally available. Such resources should therefore be pre-funded and under the control of the CCP. We believe that assessments should be allowed as part of the DCO's "waterfall" of protections, but should not be taken into account to meet the specific test outlined under 39.11(a)(1).

3 Computation of the Financial Resources Requirement

Under 39.11(c) the Commission outlines the parameters for testing whether the DCO meets the requirements set out under 39.11(a). Generally LCH.Clearnet agrees with these parameters, however we are concerned by the requirement set out 39.11(c)(1) that the DCO perform stress testing only on a *monthly* basis to meet the requirements of paragraph

¹ The Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) set up a working group in July 2009 to review the application of the 2004 CPSS-IOSCO *Recommendations for Central Counterparties* to clearing arrangements for over-the-counter (OTC) derivatives. The recommendations, which were developed by the CPSS and the IOSCO Technical Committee, set out standards for risk management of a central counterparty. The new Recommendations are expected in early 2011.

39.11(a)(1). In our view stress testing should be carried out by the DCO on at least a *daily* basis, and we would strongly urge the Commission to amend its proposal accordingly. LCH.Clearnet does not believe that monthly stress-testing is adequate, as experience has shown that market conditions and member positions can change rapidly during periods of market turmoil.

4 Valuation of financial resources

As noted above in paragraph 2, LCH.Clearnet does not believe that financial resources in the form of “assessments for additional guaranty fund contributions” should be allowed in order to meet the required test outlined in 39.11(a)(1). Consequently, the question of haircutting assessments should not arise.

5 Liquidity of financial resources

LCH.Clearnet is unclear what the Commission intends to mean in paragraph 39.11(e)(1) by requiring that the DCO should allocate financial resources to meet the requirements of paragraph 39.11(a)(1) and fulfil its arising obligations during a “one-day settlement cycle”. The Group believes that the requirement should be that the DCO should instead be obliged to fulfil its arising obligations “as they fall due”.

Additionally, we would suggest that the requirement that the DCO must have “sufficient capital in the form of cash to meet the average daily settlement variation pay per clearing members over the last fiscal quarter” is insufficient. We believe this requirement should be replaced by a test that the DCO can meet its liquidity requirements “following the default of the clearing member(s) creating the largest liquidity requirement under stressed market conditions over the quarter”.

B SIDCOs

Subject to the comments above *mutatis mutandis*, LCH.Clearnet supports the proposal to introduce enhanced requirements for Systemically Important DCOs (SIDCOs) and agrees with the parameters set out by the Commission under 39.29. LCH.Clearnet would, however, like to draw the Commission’s attention to the need to ensure that the status of DCOs not designated as SIDCOs is regularly monitored, so as to ensure that there is no “avoidance” of this designation by DCOs seeking to operate subject to a lower degree of oversight and or to lower financial requirements.

Similarly, LCH.Clearnet would encourage the Commission to ensure a level playing field between such DCOs that are nominated as SIDCOs and other large CCPs around the world that are of similar systemic importance, but which are not subject to the Commission’s oversight. In this connection, we note the comments made by the Bank for International Settlements’ Committee on Payment and Settlement Systems in its September 2010 report entitled “*Market Structure Developments in the Clearing Industry: Implications for Financial Stability*”², p. 47:

² <http://www.bis.org/publ/cpss92.pdf>

“ ... regulatory complexity, and with it the potential for regulatory arbitrage, may increase, especially when competing CCPs are regulated by different authorities and/or are located in different jurisdictions. Regulators may also be concerned by level playing field issues. Typically, the incumbent is subject to onerous regulatory requirements as it is likely to be of systemic importance, while the new entrants may (at least initially) be too small to warrant the same degree of scrutiny (e.g. the regulator/overseer may assign fewer staff to them). This would give the former a disadvantage, while the latter may have fewer/lower incentives to invest in risk management processes.”

In this connection we would like to emphasise that all DCOs, whether designated as systemically important or not, must be subject to the same standards in respect of initial margin requirements (i.e. percentage of observed price movements, number of days' coverage), even though the requirements for financial resources overall will be higher for SIDCOs.

LCH.Clearnet recognizes the hard work undertaken by the Commission in order to develop these proposed rules and values its open and thoughtful approach in this task. LCH.Clearnet looks forward to extending its clearing services further into the US marketplace, thereby offering the safeguards of its proven structures to a wider audience. We appreciate 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 do not hesitate to contact Simon Wheatley at (+44) 20 7426 7622 regarding any questions raised by this letter, or to discuss these comments in greater detail.

Yours sincerely,



Roger Liddell

Chief Executive