

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

31 December 2010

Dear Mr Stawick,

Re: RIN 3038-AD00 “Process for Review of Swaps for Mandatory Clearing”

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.

One of the primary goals of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was to lower risk by requiring over-the-counter (“OTC”) derivatives to be centrally cleared. LCH.Clearnet strongly supports both the Dodd-Frank Act, and the policy goals underpinned by the Commission’s Proposing Release and the statutory provisions contained in Sections 723(a)(3) and 745(b) of the Dodd-Frank Act.

Section 723(a)(3) of the Dodd-Frank Act requires the Commission to adopt rules for the review of a swap, or group, category, type, or class of Swaps (collectively, “Swaps”) to make a determination as to whether the Swaps should be required to be cleared. Section 745(b) directs the Commission to prescribe criteria, conditions, or rules under which the Commission will determine the initial eligibility or the continuing qualification of a derivatives clearing organization (“DCO”) to clear Swaps.

The Group believes it is critically important that the Commission establishes a process for the review and designation of Swaps for mandatory clearing and, equally, that it subjects market infrastructures to strict requirements to ensure their safety and robustness.

LCH.Clearnet believes that the process set out in the Proposing Release is consistent with the Congressional requirement that a DCO be eligible to clear Swaps, and that before a Swap becomes subject to mandatory clearing, the public get to provide input on the contract or class of contracts. The Group is therefore fully supportive of the proposals set forth by the Commission 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.

The Group commends the Commission for its careful consideration of the issues raised by the provisions outlined overleaf, but has a number of comments on this important rule and welcomes this opportunity to share these with the Commission.

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

A Eligibility of a DCO To Clear Swaps

The proposed rules set out under 39.5(a) require that the Commission must determine the initial eligibility and continuing qualification of a DCO to clear a Swap that it plans to accept for clearing. To receive a determination of eligibility or continuing qualification, a DCO would have to demonstrate compliance with the core principles for DCOs set out under Section 5b(c)(2) of the Commodities Exchange Act ("CEA"), specifically, the sufficiency of its financial resources and its ability to manage the risks associated with clearing the Swap.

As more Swaps are submitted for clearing and some Swaps become subject to a mandatory clearing requirement, it is essential that the DCOs that clear these instruments should be subject to rigorous financial, organizational and prudential requirements.

The Group is fully supportive of the Commission's proposed rules under 39.5(a) and believes these will help establish a comprehensive regulatory framework to reduce risk, increase transparency and promote market integrity within the financial system.

B Submission of Swaps to the Commission for Review

Commission Review

The Dodd Frank Act requires a DCO that plans to accept a Swap for clearing to submit the Swap to the Commission for review. Under Proposed Regulation 39.5(b), the Commission sets out the process for a DCO to follow, outlining the information that a DCO must include in its submission to assist the Commission in its review.

In its Proposing Release, the Commission has identified the considerations that should form the basis both for its determination that a DCO may clear a Swap, and its determination that a Swap should be subject to a mandatory clearing obligation. LCH.Clearnet believes that the Commission has correctly identified the matters specified that need to be considered as laid out under 39.5(b), however it would strongly urge the Commission to de-couple the determination that a DCO may clear a Swap from the determination that a Swap should be subject to a mandatory clearing obligation.

Whilst strongly supportive of the introduction of mandatory clearing obligations for certain classes of Swaps, the Group does not believe that it is appropriate to tie the process by which a DCO is determined to be eligible to clear a given Swap, to the process by which the Commission will make a determination that a Swap mandatory clearing obligation should apply.

The Group's supporting explanation for this separation are set out below:

1. Just because a Swap is eligible to be cleared and a DCO is eligible to clear it, it will not necessarily follow that the Swap should be cleared on a mandatory basis.

2. By tying the Swap approval and mandatory clearing decision-making processes together, the Commission may inadvertently discourage a DCO from seeking approval to clear a Swap that is suitable for clearing, but unsuitable for a mandatory clearing obligation.
3. Tying the Swap approval and mandatory clearing decision-making processes together may have a perverse effect on innovation in clearing, since it will encourage DCOs to develop clearing facilities for those Swaps that are most likely to qualify for a mandatory clearing obligation, and discourage DCOs from developing clearing services for Swaps unlikely to qualify for a mandatory clearing obligation.

Information Requirements

The Group would also encourage the Commission to amend the supporting information requirements under 39.5(b)(3), such that a DCO is required to include in its submission only that information which is necessary for determining the *suitability* of a Swap for clearing and the *eligibility* of a DCO to clear that Swap (but not the information required to support the determination of whether a Swap should be subject to a mandatory clearing obligation).

The Group does not believe that a DCO should be required to include the information required to support the determination of whether a Swap should be subject to a mandatory clearing obligation, firstly because we believe that the determination that a DCO may clear a Swap should be separate from and independent of any determination that a Swap should be subject to a mandatory clearing obligation.

Secondly, it is the Group's view that a DCO will not always have access to the information required to support the determination of a mandatory obligation for a Swap, particularly the information requirements set out under subparagraphs 39.5(b)(3)(ii)(A), (ii)(C), ii(D) and (viii).

Finally, we believe that requiring that a DCO provide the information set out under subparagraphs 39.5(b)(3)(ii)(A), (ii)(C), ii(D) and (viii) may have a detrimental effect on competition, since to the extent that this information is available, larger DCOs may be better equipped to source it than smaller DCOs.

The information requirements that a DCO would be required to submit would remain substantially the same as those laid out by the Commission in its Proposing Release under 39.5(b)(3), with the exception of subparagraphs (ii)(A), (ii)(C), ii(D) and (viii), which the Group would recommend striking as marked below:

39.5(b)(3)

- (ii) A statement that includes, but is not limited to, information regarding the swap, or group, category, type, or class of swaps that is sufficient to provide the Commission a reasonable basis to make a quantitative and qualitative assessment of the following factors:
 - (A) The existence of ~~significant outstanding notional exposures, trading liquidity, and~~ adequate pricing data;
 - (B) The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded;
 - (C) The effect on the mitigation of systemic risk, taking into account ~~the size of the market for such contract and~~ the resources of the DCO available to clear the contract;
 - (D) ~~The effect on competition, including appropriate fees and charges applied to clearing; and~~
 - (E) The existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty

- positions, funds, and property;
- (iii) Product specifications, including copies of any standardized legal documentation, generally accepted contract terms, standard practices for managing any life cycle events associated with the swap, and the extent to which the swap is electronically confirmable;
 - (iv) Participant eligibility standards, if different from the derivatives clearing organization's general participant eligibility standards;
 - (v) Pricing sources, models, and procedures, demonstrating an ability to obtain sufficient price data to measure credit exposures in a timely and accurate manner, including any agreements with clearing members to provide price data and copies of executed agreements with third-party price vendors, and information about any price reference index used, such as the name of the index, the source that calculates it, the methodology used to calculate the price reference index and how often it is calculated, and when and where it is published publicly;
 - (vi) Risk management procedures, including measurement and monitoring of credit exposures, initial and variation margin methodology, methodologies for stress testing and back testing, settlement procedures, default management procedures, and an independent validation of the scalability of the derivatives clearing organization's risk management policies, systems, and procedures, including the margin methodology, settlement procedures, and default management procedures;
 - (vii) Measures of market liquidity and trading activity, including information on the sources of such measures;
 - ~~(viii) An analysis of the effect of a clearing requirement on the market for the group, category, type, or class of swaps, both domestically and globally, including the potential effect on market liquidity, trading activity, use of swaps by direct and indirect market participants, and any potential market disruption;~~
 - (ix) Applicable rules, manuals, policies, or procedures;
 - (x) Terms and trading conventions on which the swap is currently traded;
 - (xi) A description of the manner in which the derivatives clearing organization has provided notice of the submission to its members and a summary of any opposition to the submission expressed by the members. A copy of the notice to members shall be included with the submission.

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. It believes that, subject to the above amendments, the Proposing Release will help establish a comprehensive regulatory framework to reduce risk, increase transparency and promote market integrity within the financial system.

The Group would, however, urge the Commission to ensure – to the greatest extent possible – that where DCOs are subject to supervision elsewhere, the required consultation, notification and approval periods in the different jurisdictions do not lead to undue delays, limiting the ability of such organizations to extend their clearing safeguards deeper into the Swaps marketplace.

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. The Group 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 on the matters raised in this letter. 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,

A handwritten signature in blue ink, appearing to read 'R Liddell'.

Roger Liddell

Chief Executive