LCH.CLEARNET

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

18 January 2011

Dear Mr Stawick,

Re: RIN 3038-AD99 "Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies".

The LCH.Clearnet Group ("The Group") is pleased to add further comment to the letters it has already submitted to the Commodity Futures Trading Commission ("Commission").

The Group had urged for passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") because of the new law's provisions in Title VII designed to reduce risk and increase transparency in the over-the-counter ("OTC") derivatives market through mandated clearing. The Group believes this mandate is a major step in preventing another financial crisis from occurring.

The Group supports the policy goals underpinned by the Commission's Advanced Notice of Proposed Rulemaking on "Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies" and is grateful for the opportunity to provide notice on the appropriate model for protecting the margin collateral posted by customers clearing Swaps transactions. The Group believes this is an important matter that requires careful consideration in the light of the Congressional requirement that standardized Swaps must be cleared.

Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies

The amendment of Section 5b(c) of the Commodity Exchange Act of 1936 (the "Exchange Act"), enacted by Section 725 of the Dodd-Frank Act, requires that the rules of a derivatives clearing organization ("DCO") prescribe that "nondefaulting members or participants would not be exposed to losses that nondefaulting members or participants cannot anticipate or control".

Section 4d(f)(2) of the Exchange Act, as amended, provides that property of a swaps customer "shall not be commingled" with the funds of the futures commission merchant ("FCM") or be used to margin, secure or guarantee any trades or contracts of any swaps customer or person other than the person for whom the same are held.

Section 4d(f)(6) of the Exchange Act, as amended, makes it unlawful for a depository, including a DCO that has received such swaps customer property to "hold, dispose of or use any such... property as belonging to... any person other than the swaps customer of the futures commission merchant".

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The Group welcomes these provisions and believes the Commission has identified the optimal model for delivering the client-level protections that were sought by Congress in the ANPR under Option 2: "*Legal Segregation With Commingling" ("LSOC")*. We believe that in discharging its duty in this regard, the CFTC should therefore prescribe rules that would allow a DCO to offer client clearing under Option 2: "*Legal Segregation With Commingling"*. The Group's letter and answers set forth in the attached annex relate to Option 2, however the Group would also recommend that the Commission allow for a DCO to offer Option 1 ("*Full Physical Segregation*")[1] when required by customers seeking further levels of collateral protection.[2]

Option 2: Cost of set up for clearing and default management provision for Swaps

The Group suggests that it is important to distinguish between the one-off set up costs that an FCM or DCO would face when establishing a capability for clearing and default managing Swaps client risk, and the costs that an FCM or DCO would face when subsequently implementing Option 2.

It is the Group's view that, regardless of whether they are offering Swap clearing services under CFTC Options 1, 2, 3 or 4, it is imperative that both a DCO and an FCM have the daily capability to view the position and risk of each counterparty that they may have ultimately have exposure to in a default event, in order to accurately hedge and close out that risk.

The reasons for this are twofold. Firstly, an FCM's risk exposure is always to each of its clients individually. Secondly, whilst a DCO's daily risk exposure is only to its FCMs, in the event of an FCM's default the DCO's risk exposure is to each of the defaulting FCM's individual clients. The DCO must therefore always have daily (and intraday) visibility on risk and positions at both FCM *and* at individual client level.

Option 2: Cost of margin for Swaps

The Group believes there should be no economic difference in terms of margin called for implementing Option 1, 2, 3 or 4. The Group's clearinghouses' models do not take account of the client Initial Margin mutualization layers when calculating risk waterfall provisions. This is because, from a prudential risk management perspective, we believe that there is no certainty of availability of funds in the client Initial Margin mutualization layer. As a result of this risk management assumption, the risk exposure calculated for each client and clearing member's account in our models is funded up-front via initial margin per account and the clearing member's contribution to the mutualized guaranty fund, thus removing any reliance on Initial Margin provided by non-defaulting clients.

To further illustrate this, we outline two possible scenarios overleaf:

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[1] **Option 1 -** Whilst cognisant of some clients' desire for Option 1 given the additional collateral protections it offers, the Group would observe that the implementation of the operational infrastructure to support Option 1 would not be trivial as it requires multiple DCOs, clients, FCMs and custodians to build appropriate infrastructure, connectivity and legal frameworks to support such a model. Whilst the Group believes this option may be achievable in the medium-to-long term, the cost, complexity and timeframes of such an implementation would be sizeable (although not quantifiable at this stage). Notwithstanding these complexities and potential costs, the Group believes that should customers require such a service, and should a DCO be able to offer it, Option 1 should be permissable under CFTC rules.

[2] Concerns that the LSOC model may expose clients to "collateral risk" (if the commingled collateral account has insufficient assets due to adverse movements in the value of the collateral) have been overblown. The Group acknowledges there is a risk in this regard, but believes it is mitigated in the first instance by its clearinghouses' stringent rules which limit collateral acceptability to only the most highly liquid and highly rated assets and require prudent haircuts and daily marking to market of collateral.
The Group believes the collateral risk should also be considered in context: Under the LSOC model, if the client ports, the total value of the margin collateral called by the DCO to cover its risk is protected. If the client is ported it is thus isolated from any losses incurred due to loss in value of collateral held, since any losses are instead borne by the defaulting FCM and the DCO via the usual risk waterfall, as it is the DCO's responsibility to value and haircut collateral prudently and appropriately.
If the client's positions were not ported, the DCO would instead liquidate that client's portfolio and deduct any monies related to close out losses and any reduction in collateral value. If more than one client was liquidated, the DCO would attribute any losses in collateral value to the clients on a pro rata basis. In such a manner, the two clients' market risk remains individually segregated, and the only "fellow client" losses that might accrue would therefore stem from a fall in the value of the commingled client collateral. Given that the DCO should only accept the highest quality, most liquid collateral, the likelihood is that the collateral posted would have benefitted from a "flight to quality" in the wake of the market disruption, further mitigating the likelihood of a fall in its value.

Scenario 1 - an FCM defaults due to a large client default - i.e. a shock event, as a result of fraud, or an unexpected large client default. In such a scenario it is unlikely that other fellow clients will have moved their business and margin to an alternate FCM given the 'shock' nature of the default event. Under this scenario the assumption of access to non-defaulting client Initial Margin might hold.

Scenario 2 - an FCM defaults following a gradual decline. In this scenario it is likely that other fellow clients will have moved their business and margin to an alternate FCM. Under this scenario the assumption of access to non-defaulting client Initial Margin does not hold.

For the reasons explained above, from the Group's standpoint introducing Option 2 would result in the same level of Initial Margin as Options 1, 3 or 4 as outlined by the Commission.

The Group believes it is of the utmost importance that DCOs are managed prudently. Accordingly, their risk waterfalls must cater for all events, not just 'shock' events. This requires that DCOs clearing Swaps must always assume that no client Initial Margin is available at the point of a default, as this is the most conservative assumption from a risk management standpoint. The Group also believes that this is the most consistent interpretation of Sections 5b(c) and 4d(f)(2) of the Exchange Act as amended by Section 725 and Section 724, respectively, of the Dodd-Frank Act.

Option 2: General Benefits

The Group believes the LSOC model is both the optimal and most achievable model for providing the client collateral protection levels sought by Congress. LSOC offers a greater level of client protections than either Option 3 or 4, without wholly altering the DCO and FCM infrastructure that is already in place for clearing, risk managing and default managing Swaps. The LSOC model facilitates broader client participation in Swaps clearing, as it allows an FCM to exchange client collateral for alternative higher quality collateral that is eligible for submission to the DCO. Were Option 1 the only choice, the extent of Swaps clearing would either be constrained to the availability of eligible collateral, or the DCO would have to contemplate extending its collateral appetite.

Introducing the choice of such customer-level safeguards as outlined under Option 2 should help increase the overall safety and soundness of the financial markets, and help ensure that the protections and safeguards afforded to the US clientbase are as strong as those that will be offered to European Swaps customers in Europe, as required under the European Commission's proposal for a European Market Infrastructure Regulation ("EMIR")[3].

In our view, the model that the Commission has outlined under Option 2 is very similar to the client clearing model which the Group's London-based clearinghouse, LCH.Clearnet Limited ("LCH.Clearnet") has implemented for Swaps client clearing in Europe. Indeed, the Group believes that the Individual Segregated Account ("ISA") clearing model developed for SwapClear delivers the individual customer-level protections for Swaps that was sought by Congress.

Although developed before enactment of the Dodd-Frank Act, the ISA model is, in the Group's view, consistent with the provisions of the Exchange Act, as amended by the Dodd-Frank Act, which directs DCOs "through margin requirements and other risk control mechanisms [to] limit the exposure of the DCO to potential losses from defaults by members and participants of the DCO to ensure that… non-defaulting… participants would not be exposed to losses that non-defaulting members or participants cannot anticipate or control" (Section 5b(c)(2)(D)(iii).

By way of further background, the Group summarizes the ISA client clearing structure overleaf.

[3] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0484:FIN:EN:PDF

LCH.Clearnet's ISA model

LCH.Clearnet's client clearing model was specifically designed to address the challenges presented by clearing long-dated Swaps and, in particular, to ensure maximum protection and probability of client portability in the event of a clearing member's default. During the design phase the Group consulted with various stakeholders, including a range of Swaps clients, many of whom wished to preserve the collateral protections they are offered in the bilateral uncleared Swaps business, whilst also wanting to enhance the protection of their market risk position. It is important to note that current bilateral Swap market provisions give no protection from a market risk position standpoint: i.e. in a bilateral Swap, the client would receive back its collateral from the defaulting counterparty but its market risk position with that defaulting counterparty would no longer exist. The client would therefore need to replace that market risk position in the market at its own cost which could be significant dependent on the client, its position and the then prevailing market environment.

Under current Swaps market practise, some clients are able to negotiate for individual segregation of collateral that they post for uncleared Swaps. The collateral posted by clients that have made such arrangements, although subject to other risks, is not subject to the risk of the default of other market participants that have entered into transactions with their Swaps counterparts. These clients – many of them pensions providers, long-term savings institutions, Government and related fiscal authorities and other real money investors – believe it is inappropriate that they should be subject to an additional risk (that of fellow-customers) when clearing their Swaps positions. The Group also believes that this is the most consistent interpretation of Sections 5b(c) and 4d(f)(2) of the Exchange Act as amended by Section 725 and Section 724, respectively, of the Dodd-Frank Act.

As specifically requested by customers, the SwapClear ISA model ensures that non-defaulting clients can be protected from the risks of other defaulting clients – so-called "fellow-customer risk". The model also improves on the protections afforded in the bilateral Swaps marketplace, by enabling the clearinghouse to offer clients portability of Swaps margin-related collateral *and* market risk positions in the event of a clearing member's default.

The ISA model is structured so as to enable the clearinghouse to identify and cover the risks associated with an individual customer's portfolio as if the clearinghouse were required to take on its management in isolation, as could happen in the event of a FCM member default. This construct enables the clearinghouse to: (i) monitor client profiles individually ahead of FCM member default so as to apply concentration multipliers to large positions where appropriate; (ii) upon FCM member default, present a full set of information on each client and its cleared profile to potential replacement clearing members; (iii) maximize the likelihood of portfolio transfer to replacement clearing members which they have individually nominated; and (iv) where a client did not transfer, allocate to each client only those losses specific to its own post-default performance.

Having implemented the above-outlined ISA model – analogous to Option 1 - in Europe, the Group is confident that it gives rise to no further costs than the "Baseline Model" either at the DCO or at the clearing member level. Further, LCH.Clearnet can confirm that the implementation of this clearing model has caused no change to its "waterfall" structure, has not required an increase in margin collateral levels, nor has it led the clearinghouse to raise clearing member contributions to the default fund.

LCH.Clearnet looks forward to working with the Commission to extend its existing SwapClear client clearing service to US customers under the well-proven FCM structure. At the same time, the clearinghouse believes that its Swaps clearing ISA model outlined above would complement the Commission's important client protection mechanisms offered under CFTC Regulation 190. The Group would therefore suggest that the Commission's rules for DCOs allow them to satisfy the "limitation of exposure" requirement by permitting them to provide individual customer accounts for Swaps similar to those outlined above.

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The Group's answers to the specific questions raised in the ANPR issued under RIN 3038-AD99 are set forth in the attached annex.

The Group appreciates 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. We are grateful for 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 (0)207 426 7622 regarding any questions raised by this letter or the attached annex, or to discuss any of the comments in greater detail.

Sincerely yours,

Roger Liddell

Chief Executive Officer

Questions for DCOs

a. Compliance (internal):

i. What compliance activities (including gathering of information) would you need to perform as a result of that model that you do not perform now (i.e., as part of the baseline model)?

The Group does not believe that any other compliance, nor information gathering activities, are necessary in order to deliver a service under option 2 "Legal Segregation with Commingling" for Swaps.
In the Group's view, trying to identify and segregate individual Client positions at the point of default introduces a new layer of risk that is likely to lead to losses. For this reason, a clearinghouse offering any form of Swaps clearing service (whether under Option 1, 2, 3 or 4) needs daily visibility of all clearing member and individual client risk positions.
Furthermore, a clearinghouse offering Swaps client clearing services under any of the models outlined by the Commission in the ANPR must be able to see the risk (delta, valuations, hedge equivalents, margin contributions) at every account and sub-account level that it may inherit at some point in the future and have to close out through a default management process. A clearinghouse needs to be able see this information daily, and on an intraday basis, to be able to effectively manage the risk of both clearing members and their clients in order to have certainty of its own risk position, should a default event occur. Any costs incurred for setting up these capabilities are essential costs for clearing Swaps, and do not arise from the implementation of the different models outlined by the Commission.

ii. What is a reasonable estimate of the initial and annualized ongoing cost of such incremental activities (relative to the baseline model) for your DCO? Please provide a detailed basis for that estimate.

The Group does not believe that there would be either any initial or annual ongoing costs involved in order to deliver a service under Option 2 "Legal Segregation with Commingling" that would not be involved under Options 1, 3, or 4. Option 1 would have additional cost from connectivity, infrastructure and legal framework perspectives. We do not have an estimate for this however we believe that the costs involved in implementing such a model across multiple Clients, FCMs, Custodians and DCOs would not be trivial. The implementation timeframe for such a model could also be substantial.

b. Compliance (members):

i. What compliance activities (including gathering of information) would you expect each of your members to perform as a result of that model that they do not perform now (i.e., as part of the baseline model).

The Group does not believe that its members would need to perform any additional compliance, nor information gathering activities in order to deliver a service under Option 2 "Legal Segregation with Commingling".
In the Group's view an FCM offering any form of Swaps clearing services (whether under Option 1,2,3, or 4) will need daily visibility of all its individual client risk positions.
Because the FCM is the counterparty to the Swaps Client in the first instance, the FCM should constantly monitor each Client's (and their sub-accounts') risk positions and charge appropriate margin for them. This is the case, regardless of whether the FCM is clearing under Option 1,2,3 or 4, since in all these models the FCM would, in the first instance, inherit that individual Client (and or its sub-accounts') risk positions in the event of that Client's default. In all cases, the FCM must therefore be able to see the risk (delta, valuations, hedge equivalents, margin contributions) at every account and sub-account level that it may inherit at some point in the future. The FCM needs to be able see this information daily, and on an intraday basis, to be able to effectively manage the risk of its clients and its clients' sub-accounts in order to have certainty of its own risk position, should a client default event occur. The costs an FCM may incur in setting up these capabilities are essential costs of clearing Swaps, and are not related to the different account class options.

ii. What is a reasonable estimate of the initial and annualized ongoing cost of such incremental activities (relative

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to the baseline model) for each such member? Do these costs vary with the member's level of activity? How? Please provide a detailed basis for your estimates.

The Group does not believe that its members, irrespective of their size or activity, would incur either any initial or annual ongoing costs in order to deliver a Swaps clearing service under Option 2 "Legal Segregation with Commingling" that would not be involved under Options 1,3, or 4.

iii. What is a reasonable estimate of the initial and ongoing costs of such activities across your membership? May there be some members who do not incur these costs? Please provide a detailed basis for these estimates.

As explained in answer to (ii) above, the Group does not believe that its members, irrespective of their size or activity, would incur either any initial or annual ongoing costs in order to deliver or continue offering a service under option 2 "Legal Segregation with Commingling" for Swaps.

c. Changes to default management structure:

i. What changes to your default management structure (relative to the baseline model) would the model require?

The Group would need to make no changes to its default management structure (relative to the baseline model) in order to implement Option 2 "Legal Segregation with Commingling" for Swaps.

ii. Costs to the DCO

1. What types of costs would these changes impose on the DCO if the industry adapts to that model in the most efficient manner feasible? How are these costs different from the costs the DCO would incur under the baseline model?

   The Group does not anticipate that its clearing houses would incur any incremental costs for supporting Option 2 for Swaps.

2. What is a reasonable estimate of the initial and annualized ongoing incremental cost to the DCO? Please provide a detailed basis for that estimate.

   As above, the Group does not anticipate that its clearing houses would incur any incremental costs for supporting Option 2 for Swaps.

iii. Costs to members

1. What types of costs would these changes to the DCO's default management impose on members if the industry adapts to that model in the most efficient manner feasible? How are these costs different from the costs the members would incur under the baseline model?

   The Group does not anticipate that its clearing houses' members would incur any incremental costs for supporting Option 2 for Swaps.

2. What is a reasonable estimate of the initial and annualized ongoing incremental cost to each member? Are these costs the same for each member, or are they a function of activity level? Please provide a detailed basis for that estimate.

   The Group does not anticipate that its clearing houses' members would incur any incremental costs for supporting Option 2 for Swaps.

3. What is a reasonable estimate of the initial and ongoing costs of such activities across your membership? May there be some members who do not incur these costs? Please provide a detailed basis for these

estimates.

The Group does not anticipate that its clearing houses' members would incur any incremental costs for implementing and supporting Option 2 for Swaps that they would not incur for supporting Option 1,3 and 4 for Swaps.

iv. To what extent do the costs identified above represent increased costs to the system as a whole (i.e., customers, FCMs, and DCOs considered together) and to what extent do they represent a shift of risk and/or cost between those groups?

There are general costs that the industry would incur for implementing Swaps client clearing, however the Group does not anticipate that its clearing houses, their members or their customers would incur any costs for supporting or using Option 2 for Swaps that they would not incur for supporting Option 1,3 and 4 for Swaps.

b. What benefits does the model present relative to the baseline model, and relative to other models?

The Group believes that the model outlined by the Commission under Option 2 is the optimal model for ensuring that non-defaulting clients can be protected from the risks of other defaulting clients or insulated from "fellow-customer risk" for Swaps. Under the Baseline and Option 3 models, the assets deposited by non-defaulting clients are potentially at risk in the event of default of another client. Moreover, since the DCO may liquidate all customer positions, the DCO may liquidate positions of non-defaulting clients. As observed by Bliss and Papanthanassiou[4], the aggregation of client assets and risks within an omnibus account, in combination with the distribution powers of the bankruptcy trustee, potentially results in clients guaranteeing each others' positions across all DCOs with the consequence that each client carries to some extent the credit and liquidity risk of the other (unknown) clients of the same clearing member.
Importantly, the Option 2 model as outlined by the Commission also enables the clearinghouse to offer clients portability of Swaps related margins and positions in the event of a clearing member's default, whilst in the Group's view, neither Option 3: "Moving Customers to the Back of the Waterfall" nor Option 4: "Baseline Model", offer these safeguards to customers.
The model outlined by the Commission under Option 1: "Full Physical Segregation" does afford similar customer-level protections to those in Option 2, whilst also ensuring full physical protection of customer margin collateral and its reinvestment. Implementation of the operational infrastructure to support this model would not be trivial as it requires multiple DCOs, clients, FCMs and custodians to build appropriate infrastructure, connectivity and legal. Whilst the Group is aware of some strong client interest in this model and believes that it would be achievable in the medium-to-long term, the cost, complexity and timeframes of such an implementation would be sizeable. Should a DCO be able to offer such a service, however, the Group believes it should not be prohibited by CFTC rules from doing so.

For all commenters:

2. Optional Models

A point frequently raised is that individual customer protection should be made available on an optional basis. There are questions as to how such a model could be implemented, and how the costs imposed by a customer obtaining individual protection could be attributed to—and charged to—that customer. For example, in the ''Full Physical Segregation'' and ''Legal Segregation with Commingling'' models discussed above, a significant portion of the marginal costs may arise from the fact that the collateral posted by the opting-out customer would not be available in the event of a default caused by other customers of the same FCM.

How could a payment by the opting-out customer be used to address the changes to the DCO's default management structure that would be attributable to that opting out?

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[4] "*Derivatives clearing, central counterparties and novation: the economic implications*", R Bliss, C Papathanassiou, 8 March 2006.

The Group does not believe that any changes to its default management structure are necessary in order to deliver Option 2, nor does it believe that a DCO should ever rely on the availability of collateral posted by any Swaps customer to cover either a fellow-customer default or to cover the default of an FCM. This is because it is at least possible, if not highly probable, that a customer will seek to port it margins and positions to another FCM in advance of either that FCM defaulting, or one of its customers defaulting. For this reason, the Group does not believe that a DCO should ever compute customer collateral in its coverage calculations (for anything other than that customer's own default) for Swaps; nor should a DCO ever assume that it will use one customer's collateral to cover another customer's default, nor any customer's collateral to cover an FCM's default for Swaps.

Considered from another perspective, how much cost would be avoided from an optional as contrasted to a mandatory implementation of each of the models above?

For the reasons outlined above, the Group does not believe that there would be (or should be) any difference in the cost of implementing Option 2 for Swaps whether on a mandatory basis or an optional basis.

If a marketplace in which varying models were in use was otherwise desirable, what changes to the Regulation Part 190 rules regarding bankruptcy account classes could or should be made to accommodate such variety?

The Group believes that it is of the utmost importance that the goals of the Dodd-Frank Act are met, and that DCOs are able to deliver the important client-level protections that were sought by Congress. We would therefore urge the Commission to effect any changes to its rules necessary in order to ensure the most consistent interpretation of Sections 5b(c) and 4d(f)(2) of the Exchange Act as amended by Section 725 and Section 724, respectively, of the Dodd-Frank Act. In this regard, the Group would point the Commission to the recent Financial Stability Board's comments in this regard in its recent report on OTC Derivatives[5].
The Group believes that it is vital that accounts are held on a per-DCO basis when considering the porting of positions and collateral. Shortfalls in the account at one DCO should not affect the ability to port positions and collateral at another DCO where there is no such shortfall.

3. **Moral Hazard: Customers risk- managing their FCMs:**

Another point frequently raised is that customers should risk-manage their FCMs, and provide market discipline by doing business with FCMs that pose less risk. DCOs already monitor the eligibility of their members, supervising the member's risk relative to collateral and capital, and considering members' risk management. The Commission is aware of concerns that, if the risk that customers will lose swaps collateral posted at an FCM is minimized, there will be less incentive for FCMs to maintain capital in excess of the minimum levels required by the Commission and the DCOs of which such FCMs are members. These concerns lead to a number of questions:

a. To what extent would each model lead to moral hazard concerns? How, if at all, could such concerns be addressed?

   The Group does not believe that the introduction of any of the models outlined by the Commission in its ANPR should give rise to any moral hazard concerns. An FCM's policies should be robust, under constant review and fully transparent and available to supervisors, DCOs and to the FCM's customers.

b. Are the capital requirements currently imposed by the Commission on FCMs and by DCOs on their clearing members sufficient? If not, what steps should DCOs or the Commission take to address this insufficiency?

[5] "Authorities should create a safe and sound environment for indirect access to clearing, and make any necessary proposals to change the legal framework and rules under which CCPs and market participants operate to achieve this. Authorities should monitor and, if detected, address unjustified impediments to indirect access. Authorities should require that CCPs and direct participants have effective arrangements in place that provide for the segregation and portability of customer positions and assets. In this context, authorities need to address the impact of insolvency laws and conflicts between insolvency laws that may arise in cross-border contexts." *Implementing OTC Derivatives Market Reforms Report of the OTC Derivatives Working Group*, Financial Stability Board, 10 October 2010.

It is the Group's understanding that the current requirements that the CFTC sets with regard to FCMs provide that each FCM is required to maintain adjusted net capital equal to or in excess of the greater of (a) US$1 million, (b) the FCM's risk-based capital requirement, computed as eight per cent of the total risk margin requirement for positions carried by the FCM in customer accounts and non-customer accounts.[6]
Due to the tenor or size of Swaps transactions, the Group believes that a higher capital threshold is more appropriate for members seeking to clear Swaps. Most importantly, however, it must be remembered that capital is only one dimension of risk that a DCO must consider when establishing eligibility criteria for Swaps clearing members. Given the nature of such transactions it is essential for DCOs to ensure that its' members can demonstrate the required technological, operational and market risk management expertise commensurate with their clearing aspirations.

c. Do the rules and procedures of DCOs currently provide adequate tools and incentives for DCOs to supervise their clearing members so as to mitigate the risk of default? If not, what steps should DCOs or the Commission take to address this inadequacy?

   The Group is confident that its clearing houses' current rules and procedures provide adequate tools and incentives to supervise their clearing members. However, the Group believes it is just as – if not more important – that clearing houses' rules and procedures ensure that a member's default can be managed without any knock-on impact on any other clearing members, their clients or on any of their cleared markets. The Group's clearing houses' current rules and procedures ensure these conditions are met and that the safeguards of the system are not put at risk.

[6] The Commission has recently issued a proposed rulemaking under RIN 3038-AC98: Risk Management Requirements for Derivatives Clearing Organizations, which include proposals on FCM net capital requirements. The Group is still in the process of examining these proposed rules.