

David A. Stawick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

3 October 2011

Dear Mr. Stawick:

### **International Swap Regulation Study**

LCH.Clearnet Group Limited ("LCH.Clearnet" or the "Group") is pleased to respond to the Commodity Futures Trading Commission (the "CFTC") and the Securities Exchange Commission ("SEC") and, together with the CFTC, (the "Commissions") consultation on international swaps regulation.<sup>1</sup> The Group commends the Commissions for determining that public comment will provide an effective and transparent means of gathering information for the Study on International Swap Regulation mandated by Section 719(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), and applauds the Commissions for undertaking this important work.

As the world's leading independent clearing house group, and the most global and most established provider of over the counter ("OTC") derivatives clearing services, LCH.Clearnet is expertly positioned to give input to this study.<sup>2</sup> The Group clears more asset classes than any other clearing operators globally, and has provided OTC clearing for over 10 years to members and markets across the world. We are subject to stringent regulation in the US, the UK and France as well as through cooperation agreements between French, Belgian, Dutch, English, and Portuguese regulatory authorities.

From this unique vantage point, we are acutely aware of the paramount importance of the need to harmonize regulations across borders to the fullest extent possible. We believe that it is of critical importance that standards are agreed globally and harmonised at the highest level. The failure to do so increases the danger that global markets will become fragmented and costs needlessly

<sup>1</sup> 76 Fed. Reg. 44508 (July 26, 2011).

<sup>2</sup> The Group was formed out of the merger of the London Clearing House Limited and Clearnet SA and operates two central counterparty clearing houses or CCPs, LCH.Clearnet Limited in London ("LCH LTD") and LCH.Clearnet SA ("LCH SA") in Paris. It serves major international exchanges and platforms, as well as a range of OTC markets and clears a broad range of asset classes, including cash equities, exchange-traded derivatives, metals, energy, freight, interest rate swaps and euro- and sterling-denominated bonds and repos. LCH LTD currently clears more than 50% of the OTC interest rate swap market representing trades with a total notional principal of over \$307 trillion in 17 currencies. LCH SA cleared more than €42 billion notional value in OTC credit default swaps over the last year. LCH.Clearnet works closely with market participants and exchanges to identify and develop services for new asset classes, particularly in support of OTC derivatives market reforms in a variety of jurisdictions.

increased. A lack of harmonization also increases the danger of regulatory arbitrage that could have a negative impact on the global financial markets as a whole.

For this reason, LCH.Clearnet supports efforts, such as those of CPSS-IOSCO, to develop high, globally agreed standards for clearing houses that are applicable on a consistent basis across the world and we would urge the Commissions to ensure the greatest adherence possible to these standards.

As the attached annex demonstrates, the regulatory regimes to which LCH LTD and LCH SA are currently subject are extremely robust, and both entities are well-regulated today. LCH LTD is both a registered Derivatives Clearing Organization ("DCO") regulated by the Commodity Futures Trading Commission ("CFTC") in the US and a Recognised Clearing House ("RCH") regulated by the Financial Services Authority ("FSA") in the UK. Due to its regulated status as a bank, a clearing house and operator of a securities settlement system, LCH SA is supervised in France by the French Financial Markets Authority *Autorité des Marchés Financiers* ("AMF"), the *Banque de France* ("BdF"), the *Autorité de contrôle prudentiel* ("ACP"), and cooperation agreements among other European regulatory authorities. Finalization of the pending European Market Infrastructure Regulation ("EMIR") will raise the regulatory standards for both LCH LTD and LCH SA even further.

The attached annex provides detailed answers to the questions posed by the Commissions in sections D and F of their request for comment. In addition, the annex contains a brief overview of the differences between the European Commission's proposed regulation on OTC derivative transactions, central counterparties and trade repositories, known as EMIR, and current UK law and regulation. We hope that the Commissions find these comments helpful and constructive.

LCH.Clearnet, as the world's pioneering OTC derivatives CCP group, fully shares the G20's and the Commissions' goals in ensuring a stable, safe and efficient global financial system and looks forward to continuing its participation in the policymaking debate.

We appreciate the opportunity to share our views on these important matters and would welcome the opportunity to discuss any of the matters raised in the consultation in greater detail. Please do not hesitate to contact Simon Wheatley at +44 (0)207 426 7622 regarding any questions raised by this letter or to discuss these comments in greater detail.

Yours sincerely,



Ian Axe  
Chief Executive Officer

## ANNEX

### D. Regulatory requirements for central counterparties

1. Does the regulatory framework include requirements for central counterparties that provide clearing and settlement services for swaps?

#### United Kingdom

In the UK there are recognition requirements set out in Part XVIII of the Financial Services and Markets Act 2000 ("FSMA") as supplemented by the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (SI 2001/995) (the "FSMA Recognition Requirements Regulation"). These are supplemented by rules adopted by the FSA under FSMA which can be found in the FSA's Sourcebook on Recognised Investment Exchanges and Recognised Clearing Houses ("REC") which forms part of the FSA's Handbook of Rules and Guidance ("FSA Rules").

Broadly, under FSMA, a firm is prohibited from undertaking certain regulated activities in the UK unless it is authorised by the FSA, the so-called "general prohibition"<sup>3</sup>. An RCH is, however, exempt from the general prohibition with respect to a regulated activity which is carried out for the purposes of, or in connection with, the provision of clearing services by the CCP. [Section 285(3), FSMA] The qualifications for recognition (the "Recognition Requirements") are set out in the FSMA Recognition Requirements. If a CCP satisfies the Recognition Requirements Regulation, the FSA will make a recognition order under Section 290 of FSMA declaring that it recognises the CCP thus exempting the CCP from the general prohibition. Section 307 of FSMA requires HM's Treasury's approval for the making of a recognition order. As such, the CCP is subject to a specific regulatory regime for recognised investment exchanges and RCHs, rather than the general regulation regime that FSA authorised firms are subject to.

The UK regulatory supervisory framework for CCPs is in the process of being reorganised and from 2012 onwards CCPs will be supervised by the Bank of England. At this stage however, and subject to our comments below in relation to European legislative developments, we have no reason to believe that the UK regulatory framework for the supervision of CCPs will materially change, following the transfer of supervisory responsibility from the FSA to the Bank of England.

#### France

LCH SA currently provides clearing services for credit default swaps ("CDS"). The regulatory requirements which apply to the clearing by LCH SA of CDS are set out below.

Due to its regulated status as a bank, a clearing house and operator of a securities settlement system, LCH SA is supervised by various French and international regulatory authorities, as described below. In addition, the supervision and oversight of LCH SA is also carried out through cooperation agreements between French, Belgian, Dutch, English, and Portuguese regulatory

<sup>3</sup> The general prohibition is contained in Section 19 of FSMA. The regulated activities for which a firm must be authorised to carry out are set out in the FSMA 2000 (Regulated Activities) Order 2001.

authorities, due to the presence of LCH SA in these jurisdictions and the structure of its corporate group, also as described below.

**AMF:** LCH SA is authorised by the French Financial Markets Authority *Autorité des Marchés Financiers* (“AMF”) as a clearing organisation. As a clearing house, LCH SA is subject to detailed rules set out by the AMF including conduct of business rules applicable to clearing houses and their staff members, rules applicable to the membership of clearing houses, and rules governing the recording of trades and positions by clearing houses, the relationship between clearing members and their clients, the consequences of a default of a clearing member and the collateral which may be called by clearing houses. In addition, the AMF supervises LCH SA to ensure that it complies with rules of conduct and professional duties (including insider trading rules and dissemination of information relating to directors’ dealings).

**BdF:** as a financial instruments clearing and settlement system, LCH SA is overseen by the *Banque de France* (“BdF”). As part of its duties within the European System of Central Banks, the BdF oversees the security of the systems used to clear, settle and deliver financial instruments.

**ACP:** LCH SA is authorised by the *Autorité de contrôle prudentiel* (“ACP”) (the French Prudential Control Authority) to execute client orders and carry out own account trading activities in respect of any of the financial instruments referred to in Article L 211-1 of the Financial and Monetary Code. The ACP, which is chaired by the Governor of the BdF, is vested with carrying out the prudential supervision of LCH SA as such investment service provider, and monitors the way in which LCH SA operates and the soundness of its financial condition.

## 2. What are the registration or licensing requirements for such central counterparties?

### United Kingdom

The Recognition Requirements are set out in Section 5 and Part III of the Schedule of the FSMA Recognition Requirements Regulation as supplemented by the FSA Rules. The Recognition Requirements broadly include:

- **financial resources**, a CCP must have financial resources sufficient for the proper performance of its functions as an RCH. [Paragraph 16, Schedule to the FSMA Recognition Requirements Regulation] The FSA will, in determining whether the CCP’s financial resources are sufficient or not, consider the CCP’s:
  - *counterparty and market risks*, including the amount and liquidity of its financial assets and the likely availability of liquid financial resources during periods of major market turbulence as well as the nature and scale of the CCP’s exposures to counterparty and market risks and, where relevant, the counterparties to which it is exposed;
  - *operational and other risks*;
  - the amount and composition of the *CCP’s capital and liquid financial assets*; and

- the financial benefits, liabilities, risks and exposures arising out of *the CCP's connection with other persons* (including, for example, a person in the same group as the CCP, a significant shareholder or investor, or any person with whom it has a significant contractual relationship); [REC 2.3]
- **suitability**, the CCP must be a fit and proper person to perform the function of an RCH. In reaching a determination the FSA will consider: (i) the CCP's governing body's commitment to satisfying the Recognition Requirements; (ii) the arrangements, policies and resources put in place to satisfy its obligations under FSMA in relation to its activities; (iii) the extent to which its constitution and organisation provide for effective governance; (iv) the arrangements in place to ensure that the governing body has effective oversight of the CCP's functions; (v) the regulatory department's access to the governing body; (vi) the size and composition of the governing body (including the number of independent members of the governing body); (vii) the structure and organisation of the governing body, including the distribution of responsibilities amongst members and committees; (viii) the integrity and competence of the governing body and key individuals; (ix) any breaches of law, regulation or codes of practice by the CCP or key individuals; (x) the arrangements in place to ensure that the CCP employs individuals who are honest and demonstrate high standards of integrity; (xi) the effectiveness of the CCP's arrangements to control conflicts of interest (see the separate conflicts of interest requirement below); and (xii) the independence of the regulatory department from the commercial and marketing departments. The FSA will also have regard to, amongst other things, the CCP's connections with any other undertakings in the same group, any owner or part-owner of the CCP and any person who has the right, or is in practice able, to appoint or remove members of the governing body or other key individuals; [Paragraph 17, Schedule to the FSMA Recognition Requirements Regulation]
- **systems and controls**, the CCP must ensure that its systems and controls are adequate and appropriate for the scale and nature of its business. In determining whether the systems and controls are adequate and appropriate, the FSA will have regard to a number of factors, including, in particular:
  - the CCP's *risk management function*, particularly the frequency with which all exposures and risks incurred by the CCP are monitored against risk or exposure limits; the frequency with which risk or exposure limits or other control parameters are reviewed; the reliability of the arrangements for monitoring and assessing intra-day movements in exposure and risks; the robustness of the arrangements for calculating, collecting and holding margin payments and the allocation of losses; and, the arrangements for stress testing the adequacy of the CCP's financial resources to cover its exposures including in times of substantial movements in market values or counterparty defaults;
  - the CCP's systems and controls for the *safeguarding and administration of assets* belonging to users of the CCP;
  - the CCP's systems and controls for *managing conflicts of interest*;
  - the CCP's arrangements in relation to *internal and external audits*; and

- the *adequacy of the information technology* used by the CCP to perform or support its functions; [Paragraph 18, Schedule to the FSMA Recognition Requirements Regulation]
- **participation requirements**, a CCP must make transparent and non-discriminatory rules governing access to the CCP. A CCP may, however, refuse access on legitimate commercial grounds; [Paragraph 21A, Schedule to the FSMA Recognition Requirements Regulation and REC 2.7.2A]
- **safeguards for investors**, a CCP must ensure that investors are afforded appropriate protections, including, for example: (i) satisfactory arrangements for the recording of transactions that the CCP clears which includes maintaining a record of the transaction for at least 3 years [REC 2.9.3(1)] and (2) safeguarding and administering assets belonging to the users of the CCP. [REC 2.11.2] The FSA will, in determining whether satisfactory arrangements are in place will, *inter alia*, consider whether adequate arrangements to ensure the proper segregation of assets belonging to the CCP from those of the users of its facilities are in place; [REC 2.11.3(5)]
- **promotion and maintenance of standards**, a CCP is expected to promote and maintain high standards of integrity and fair dealing and is expected to cooperate, by the sharing of information with the FSA or any other relevant authority; [Paragraph 20, Schedule to the FSMA Recognition Requirements Regulation]
- **rules**, a CCP must ensure that it has appropriate procedures in place to make rules, for keeping the rules under review and for amending them; [Paragraph 21, Schedule to the FSMA Recognition Requirements Regulation]
- **discipline**, a CCP must have effective arrangements in place for monitoring and enforcing compliance with its rules; [Paragraph 22(1), Schedule to the FSMA Recognition Requirements Regulation]
- **complaints**, a CCP must have effective arrangements for the investigation and resolution of complaints arising in connection with the performance of, or failure to perform, any of its regulatory functions; [Paragraph 23, Schedule to the FSMA Recognition Requirements Regulation]
- **default Rules**, a CCP must have default rules in place which, in the event of a clearing member being or appearing to be unable to meet its obligations in respect of one or more market contracts, enable actions to be taken to close out that clearing member's positions in relation to all unsettled market contracts to which they are a party. [Paragraph 24, Schedule to the FSMA Recognition Requirements Regulation]. Broadly, the default rules must provide for the close-out and netting of the defaulter's unsettled market contracts. To the extent that the net sum is payable by the defaulter to the CCP, the CCP may set that amount off the following amounts in this order (the default waterfall): (i) any property provided by or on behalf of the defaulter as cover for margin; (ii) any default fund contributions provided by the defaulter; and (iii) any other funds, including the default fund, under the CCP's default rules; and [Paragraph 25, Schedule to the FSMA Recognition Requirements Regulation].

- **margin**, the rules of the CCP must provide that in the event of a default, margin provided by the defaulter on his own account is not to be applied to meet a shortfall on a client account (other than a client account of the defaulter). [Paragraph 28, Schedule to the FSMA Recognition Requirements Regulation]

## France

LCH SA has been designated by the French authorities to the European Commission as a securities settlement system (a "System") for the purposes of the European Directive no. 98/26/EC dated 19 May 1998 on settlement finality in payment and securities settlement systems (the "Finality Directive"). Systems within the meaning of the Finality Directive are regulated in detail by the AMF, which determines the general principles of organisation and operation of securities settlement systems and must approve the operating rules of such systems as well as any amendments thereto. Entities wishing to operate a securities settlement system are required to provide the AMF with detailed information about their constitutional documents, their shareholding structure, the human and technical resources dedicated to their activities and the CVs of their principal managers. Changes in such information must be notified to the AMF.

The AMF is also responsible for granting professional licences to certain staff members of LCH SA, in particular the person responsible for the supervision of clearing activities, the person responsible for the supervision of clearing members and the head of compliance. A report on the conditions under which these persons perform their supervisory and monitoring duties must be transmitted by LCH SA to the AMF on a yearly basis.

French clearing houses are required under French law to be licensed as a credit institution. Accordingly, LCH SA is licensed as a bank within the meaning of the European Directive no. 2006/48/EC dated 14 June 2006 ("Banking Directive") relating to the taking up and pursuit of the business of credit institutions. Such licence has been granted by the French Credit Institutions and Investment Firms Committee ("*Comité des établissements de crédit et des entreprises d'investissement*", or CECEI, which is now part of the ACP). The ACP grants banking and investment firm licenses and specific exemptions as provided in applicable banking regulations. The licence granted to LCH SA also covers the provision by LCH SA of investment services (execution of orders for third parties, and trading for own account).

Entities wishing to obtain a banking licence are required to provide the ACP with detailed information about their constitutional documents, their shareholding structure, the human and technical resources dedicated to their activities and the resumes of their principal managers. Changes in such information must be notified to, and may be subject to prior approval of the ACP.

### 3. Who is excluded or exempted from such registration or licensing requirements?

#### United Kingdom

There are no specific exclusions or exemptions. The recognition order regime for clearing houses is in and of itself an exemption from the general prohibition as discussed in greater detail above. It

is however, worth noting the regime in place for overseas clearing houses which is discussed in greater detail below in response to question 7.

#### France

N/A

#### **4. What is the process for updating, withdrawing, or terminating such registration or exempting from such registration?**

##### United Kingdom

The FSA can revoke a recognition order:

- at the request or with the consent of the CCP; or
- if it appears to the FSA that the CCP is failing or has failed to satisfy the Recognition Requirements or any other obligations under FSMA.

In order to revoke a recognition order, the FSA must notify the CCP of its intentions. The CCP then has a two month period from the date the notice is served on the CCP to make representations to the FSA. The FSA must have regard to the representations in deciding whether to make a revocation order. The FSA must then notify the CCP of its decision. In any event, the revocation cannot take effect earlier than the end of a period of three months beginning with the day on which the order is made. [Section 297, FSMA]

##### France

The Clearing Rules applicable to the clearing activities of LCH SA, and any amendments thereto, must be approved and published by the AMF, which must ensure that LCH SA performs its obligations and conducts its activities in accordance with French law.

Where its regulations have been breached, the ACP may act as an administrative court and impose sanctions, which may include warnings, financial sanctions and deregistration of a bank resulting in its winding-up. The ACP also has the power to appoint a temporary administrator to provisionally manage a bank that it deems to be mismanaged. Insolvency proceedings may be initiated against banks such as LCH SA only after a formal consultation with the ACP.

#### **5. What are the ongoing regulatory responsibilities of such central counterparties (e.g., financial resources, risk management, safeguards against member or participant default, authority in the event of a default, recordkeeping)?**

##### United Kingdom

Please refer to the response to question 2 above.

##### France



The AMF publishes regulations which detail regulatory duties of financial markets, issuers of financial instruments offered to the public in France and investment service providers, including credit institutions authorised to provide investment services such as LCH SA. The AMF may impose sanctions against any person breaching its regulations.

In addition, as a bank, LCH SA is fully subject to French laws and regulations applicable to French banks. Such laws and regulations are detailed in the Monetary and Financial Code, in the General Regulations (*"Règlement général"*) of the AMF and in regulations published by the Banking and Financial Regulations Committee (*Comité de la Réglementation Bancaire et Financière*, or CRBF), or implemented in the form of collective decisions (*"Arrêtés"*) issued by the French Minister of the Economy.

In particular, LCH SA must comply with minimum capital and ratio requirements, including the solvency ratio based on the standards published by the Basel Committee on Banking Supervision as such standards have been adopted in France and the rest of the European Union to implement Capital Adequacy Directive 2006/48/EC and 2006/49/EC (CAD III) aimed at limiting systemic risk of an institution large enough to trigger further defaults and a crisis of the whole banking system. However, currently LCH SA is not categorised as a systemically important financial institution (SIFI). Its business model does not create generic systemic risk but instead monitors and administers the credit and market risks of its clearing members, even if it assumes counterparty risk through novation.

In addition, LCH SA is subject to regulations of the ACP concerning credit and market risk diversification and liquidity, monetary policy, restrictions on equity investments, money laundering, internal control, compliance and reporting requirements.

Specifically with respect to internal control, LCH SA is required to establish appropriate internal control systems which must include a system for controlling operations and internal procedures (including compliance monitoring systems), an organisation of accounting and information processing systems, systems for measuring risks including (but not limited to) CAD III-related credit, market and operational risks and results, systems for supervising and monitoring risks (including in particular cases where LCH SA uses outsourcing facilities), a documentation and information system and a system for monitoring flows of cash and securities.

Periodic reports, collectively referred to as *"états périodiques"*, and comprising principally a statement of its activities during the relevant period (with exhibits providing detailed information), as well as reports regarding its internal procedures and the measurement and monitoring of the operational risks to which it is exposed, are to be made by LCH SA to the ACP (previously, the *"Commission Bancaire"*).

In addition to the periodic reports that LCH.Clearnet SA is required to submit to it, the ACP may also request additional information that it deems necessary and may carry out off-site audits and on-site inspections including to allow for other competent foreign regulators for individual specific markets subject to their competence to execute their supervisory powers on an extraterritorial basis based on either Cooperation Agreements and/or Memoranda of Understandings on Information Sharing (see response 6. below).

Finally, rules issued by the AMF govern the relationship of a System with its participants, and provide that each such securities settlement system must have appropriate risk management procedures to safeguard the rights of participants in the event of a (cross) default by one or more participant(s). As an operator of the clearing system recognised as a securities settlement system, LCH SA is subject to these detailed rules designed to ensure the proper clearing and settlement of transactions in financial instruments.

**6. Do such central counterparties have the ability to share information with domestic and/or foreign regulatory authorities?**

**United Kingdom**

A CCP is obliged to share information with the FSA or any other person having responsibility in the UK for the supervision or regulation of the CCP. [Paragraph 20(2), Schedule to the FSMA Recognition Requirements Regulation.] In addition, there are a number of notification obligations under which a CCP must share information with the FSA. These relate to a wide number of matters including: key individuals and internal organisation; the constitution and governance of the CCP; fees and incentive schemes; complaints; insolvency events relating to the CCP; legal proceedings instituted against the CCP; a suspension of services or inability to operate facilities; investigations and disciplinary actions relating to members; the restriction of an institution to close-out positions; the default of a member; and, a proposal to make regulatory provisions.

**France**

LCH SA has branches located in The Netherlands and Belgium and has opened a representative office in Portugal. Because of its presence in those jurisdictions, LCH SA is subject to the supervision of the Dutch, Belgian and Portuguese regulatory authorities.

The French, Belgian, Dutch and Portuguese authorities are parties to a memorandum of understanding to ensure coordinated supervision and oversight of the clearing activities of LCH SA. Under the memorandum of understanding, these authorities have agreed to cooperate and coordinate among themselves to promote effective supervision and oversight of LCH SA and its affiliates, and in particular, to provide each other with relevant information about any significant matters concerning LCH SA and its affiliates. The authorities have agreed to share, among other things, information concerning risks to and posed by LCH SA, its affiliates and its clearing members, any significant regulatory changes affecting LCH SA, and any incidents or developments that might impair the ability of LCH SA to operate effectively and efficiently.

In 2010, the FSA granted LCH SA the status of Recognised Overseas Clearing House (ROCH) in the UK, and as such LCH SA is subject to the supervision of the FSA with respect to LCH SA's clearing activities on UK-based trading platforms such as SecFinex.

As part of the consolidated supervision of LCH SA is "lead-regulated" by the ACP. A memorandum of understanding was signed in February 2005 between the French, Dutch, Belgian and Portuguese authorities responsible for the oversight, regulation and supervision of LCH SA, and the FSA and the Bank of England. This memorandum of understanding describes the basis

on which the different authorities aim to cooperate insofar as the LCH.Clearnet are concerned to promote an efficient regulation, supervision and oversight of the various entities within LCH SA and LCH.Clearnet.

The French and Italian regulatory authorities have signed a memorandum of understanding in February 2003 on activities covered by the agreement between MTS S.p.A., Cassa di Compensazione e Garanzia S.p.A. and LCH SA.

With respect to CDS clearing services, the formal regulatory competence is undertaken by French regulators whilst information is provided to the Coordination Committee on Clearing (CCC), created pursuant to the memorandum of understanding, mentioned above, between the French, Belgian, Dutch and authorities.

The AMF is also a signatory to (i) the IOSCO "Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information" (May 2002), and (iii) the "Memorandum of Understanding Concerning Cooperation and the Exchange of Information Related to the Supervision of Cross-Border Clearing Organizations" (September 2009).

Pursuant to an "Administrative Agreement" dated 6 June 1990, the CFTC and the *Commission des Opérations de Bourse* (the predecessor to the AMF) (the "COB") established a system of mutual assistance in order to facilitate monitoring and compliance matters related to the mutual recognition of intermediaries and products. The CFTC and the COB agreed to provide access to information in their files and, using all their powers and means according to procedures provided under the law of the respective entity, to gather the evidence and obtain documents from individuals, associations, partnerships, corporations, trusts, or other legal entities. This includes any request for assistance relating to customers or professionals operating in the futures markets, as well as other persons likely to have information.

More recently, in January 2011 the AMF and ACP signed a memorandum of understanding with the CFTC, setting out the parties' mutual understanding concerning consultation, cooperation, and the exchange of information, in connection with LCH SA's anticipated application for DCO status.

**7. How are foreign central counterparties treated? (e.g. a special recognition category, an exclusion or an exemption from registration).**

**United Kingdom**

A foreign CCP can apply for a recognition order under Section 288 of FSMA in the same way as a UK CCP. There is however an alternative method of applying to become a RCH. The FSA may make a recognition order declaring an overseas applicant to be an RCH if it satisfies the following requirements:

- (a) investors are afforded protection equivalent to that which they would be afforded if the CCP were required to comply with Recognition Requirements;

- (b) there are adequate procedures for dealing with a person who is unable, or likely to become unable, to meet his obligations in respect of one or more market contracts connected with the CCP;
- (c) the CCP is able and willing to co-operate with the FSA by the sharing of information and in other ways; and
- (d) adequate arrangements exist for co-operation between the FSA and those responsible for the supervision of the CCP in the country or territory in which the CCP's head office is situated. [Section 292, FSMA]

#### France

N/A

### F. Regulatory comparison

#### 1. Across jurisdictions, for any and or all of the items listed above, which areas of regulation are similar and which areas are different?

- There are two areas in particular that stand out as being materially different between the US and UK [and France]:
- **ownership interests**, under both the present UK [and French] regime and the proposed regime under EMIR there are no strict ownership limits indeed, the imposition of such limits would likely run counter to the provisions on the freedom of establishment and freedom of movement under the Treaty for the functioning of the European Union. The US takes a different approach and has proposed rules regarding limitations on the ownership of CCPs by certain entities; and
- **membership requirements**, under the present UK [and French] regimes a CCP is obliged to make transparent and non-disciplinary rules governing access to the CCP. Beyond that there are no specific criteria set out in the relevant law and regulation, although as noted above, in determining whether the CCP's access criteria protect the orderly functioning of the facilities, the FSA will have regard to whether the CCP limits access as a member to persons who have adequate financial resources in relation to their exposure to the CCP. [REC 2.7.3G(1)(d)] The US again takes a different approach and has proposed a minimum capital requirement for clearing members that wish to clear swaps through a DCO.

#### 2. In viewing the existing laws, institutions and enforcement mechanisms of each respective jurisdiction as a whole, are such similarities and differences appropriate and desirable for regulatory purposes, or do certain aspects of a particular jurisdiction's swap market warrant a different regulatory approach?

N/A

- 3. What are the potential costs and benefits (in terms of investor protection, market efficiency, competition, or other factors) that may arise from further consistency/harmonization or regulations across borders?**

We think that it is more appropriate to respond to this question in the inverse, that is to say, what is the likely result of a failure to harmonize regulations across borders. We think that the response to this question is that there is a danger that the market becomes fragmented and costs to the wider market are increased. There is also a danger of regulatory arbitrage that could also have a negative impact on the global market as a whole.

- 4. How should consistency in regulation across jurisdictions be measured and are there factors other than the harmonized text of a regulation that should be taken into consideration when assessing the degree to which cross-border regulatory harmonization has been implemented in practice?**

We support the creation of the technical working group set up in June 2011 constituted of members of US market regulators, the European Commission and the European Securities and Markets Authority ("ESMA") aimed at fostering alignment between Europe and the US. The sometimes differing regulatory philosophies across jurisdictions merit closer discussions with the aim of identifying and addressing necessary regulatory overlaps.

- 5. Assuming that a theoretically "optimal" set of regulations for a particular jurisdiction might take into consideration elements unique to a specific market in ways that might make cross-border harmonization difficult, to what extent do the benefits of greater regulatory harmonization across borders outweigh the costs associated with having regulations tailored to a particular market's circumstances? In what areas do you believe the benefits of harmonization most outweigh any potential downsides? Are there any areas where you believe the likely benefits of "optimal" market-specific regulation outweigh the likely benefits of harmonization?**

N/A

- 6. In the United States, what steps should or could be taken to better harmonize statutory requirements under the Dodd-Frank act with statutory requirements implemented in other jurisdictions?**

Please refer to the response to question 4 above.

- 7. In the United States, what steps could be taken to harmonize CFTC or SEC regulations with regulations promulgated by authorities in other jurisdictions?**

Please refer to the response to question 4 above.

## The proposed European Union regulatory regime

The legislative process in Europe to implement the September 2009 G20 Pittsburgh commitment to clear standardised OTC derivatives is still underway. On 15 September 2010, the European Commission released the first version of EMIR (which is directly applicable in member states and consequently does not require implementing legislation at the national level). There are currently two competing drafts, the latest Presidency compromise proposal was submitted by the Polish Presidency on 23 September 2011 and the text adopted by the ECON Committee<sup>4</sup> on 24 May 2011. Once a final text has been adopted, ESMA will be charged with producing the level 2 implementing measures, known as technical standards, by 30 June 2012. Please note that our comments below in relation to EMIR are based on the latest draft dated **23 September 2011** and are subject to any subsequent drafts and any technical standards produced by ESMA.

It is worth noting that many of the provisions in EMIR relating to the licensing requirements effectively replicate existing regulatory requirements for CCPs under the current UK law and regulation. There are however, some areas in which the present draft of EMIR is different from the UK regime. These include:

- **Pan-European authorisation:** under EMIR, once a CCP has been authorised by the competent authority of the member state of the European Union in which it is established that authorisation is effective for the entire territory of the EU. [Article 10(2), EMIR]
- **Individual client segregation:** the draft segregation requirements under EMIR oblige a CCP to offer individual client segregation whereby the CCP must maintain separate records and accounts enabling each clearing member to distinguish in account held by the CCP, the assets and positions held for the account of a client from those held for the accounts of other clients. Clearing members are then obliged to offer individual client segregation in accounts with the CCP to their clients. [Article 37, EMIR] Whilst this level of segregation is not currently mandated under UK law and regulation, it is worth noting that the effect of Basel III and the current proposed draft Regulation on prudential requirements for credit institutions and investment firms ("draft CRD IV Regulation") is to encourage clearing members and CCPs to offer to segregate the positions and assets of the clearing member, other clients and the CCP at both the clearing member and CCP levels by granting favourable capital treatment of CCP related transaction to those clients whose positions and assets are so segregated. [Article CCR 30, draft CRD IV Regulation]
- **Portability:** broadly, EMIR provides that a CCP is obliged in certain circumstances to contractually commit itself to transfer the assets and positions held by a defaulting clearing member for the account of its clients to another clearing member (so-called portability). [Article 45, EMIR] Whilst there is no corresponding obligation under UK law and regulation, it is worth noting that LCH.Clearnet has introduced portability in respect of some of its product streams.

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<sup>4</sup> The Committee on Economic and Monetary Affairs of the European Parliament.

- **Board representation:** EMIR mandates that at least one third but not less than two board members should be independent. [Article 25(2), EMIR].
- **Risk Committee:** a CCP is obliged to establish a risk committee composed of representatives of its clearing members and independent members of the board. The risk committee may invite employees of the CCP and external experts to attend risk committee meetings in a non-voting capacity. The advice of the risk committee is to be independent from any direct influence by management of the CCP. [Article 26, EMIR]

**ENDS**