

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

10 September 2012

Dear Mr. Stawick:

**Re: RIN No. 3038-AD86, Clearing Determination under Section 2(h) of the Commodity Exchange Act**

LCH.Clearnet Group Limited (“LCH.Clearnet” or “The Group”) is pleased to respond to the request for comment on the Commodity Futures Trading Commission’s (“the CFTC” or “Commission”) proposed Clearing Determination under Section 2(h) of the Commodity Exchange Act (“proposed mandatory clearing determination”).<sup>1</sup>

The Group strongly supports the policy goals underpinned by the proposed mandatory clearing determination and the statutory provisions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).

The Commission proposes regulations to establish a clearing requirement under section 2(h)(1)(A) of the Act. The proposed regulations would require that certain classes of credit default swaps (“CDS”) and interest rate swaps be cleared by a derivatives clearing organization (“DCO”) registered with the Commission. The Group strongly supports the Commission’s proposed mandatory clearing determination for interest rate swaps. The Group also agrees with the Commission that the proposed mandatory clearing determination for interest rate swaps is consistent with the five factors outlined in Section 2(h)(2)(D) of the Act. LCH.Clearnet concurs in the Commission’s decision to limit its initial mandatory clearing determinations to swaps that are already cleared by a DCO.<sup>2</sup>

**LCH.Clearnet Overview**

LCH.Clearnet is the leading independent clearing house group, serving major international exchanges and platforms, as well as a range of OTC markets. It clears a broad range of asset classes including: securities, exchange traded derivatives, commodities, energy, freight, foreign exchange, interest rate swaps, credit default swaps, and euro and sterling denominated bonds

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<sup>1</sup> 77 FR 47169 (August 7, 2012).

<sup>2</sup> *Id.* at 47173.

and repos. LCH.Clearnet works closely with market participants and exchanges to identify and develop clearing services for new asset classes.

The Group consists of three operating subsidiaries: LCH.Clearnet Limited, LCH.Clearnet LLC, and LCH.Clearnet SA. LCH.Clearnet Limited is registered with the Commission as a DCO and is regulated as a Recognised Clearing House by the UK Financial Services Authority. Several of LCH.Clearnet Limited's business lines, SwapClear, ForexClear, and EnClear, clear swaps. LCH.Clearnet LLC, formerly International Derivatives Clearinghouse, LLC ("IDCH") was recently acquired by the Group and is registered with the Commission as a DCO. LCH.Clearnet LLC is domiciled in the US.<sup>3</sup> LCH.Clearnet SA has filed an application with the Commission for a DCO license<sup>4</sup>, is regulated as a credit institution by a regulatory college of the market regulators and central banks of France, the Netherlands, Belgium and Portugal, and is regulated as a Recognised Overseas Clearing House by the UK Financial Services Authority. LCH.Clearnet SA's CDSClear service clears swaps and security-based swaps. LCH.Clearnet Limited and LCH.Clearnet SA are subject to the European Markets Infrastructure Regulation ("EMIR") and will have to apply for reauthorisation in 2013 under EMIR.

Both LCH.Clearnet Limited and LCH.Clearnet SA operate global swap clearing services in multiple jurisdictions. Our clearing members for these services include global banks as well as banks that limit their swap activities to their domestic markets. The clients of these clearing members include a wide variety of US and non-US participants in the swaps market including banks, asset managers, hedge funds, insurance companies, and corporations. LCH.Clearnet Limited is well-placed to assist our clearing members and their clients in discharging clearing mandates under both Dodd-Frank and EMIR because it is registered and conducts business in both the United States and European Union. We are also committed to seeking appropriate recognition to allow counterparties in other G-20 countries to discharge their clearing mandates by clearing on LCH.Clearnet Limited. LCH.Clearnet SA is following a similar approach by seeking a DCO license. Our approach allows counterparties in two different jurisdictions to discharge the clearing mandate in their respective jurisdictions at the same CCP, and is consistent with the global nature of the swaps industry.

#### Proposed Mandatory Clearing Determination for Interest Rate Swaps

LCH.Clearnet's SwapClear service currently clears more than 50% of the interest rate swap market, measured by notional principal.<sup>5</sup> The over one million trades in SwapClear have an aggregate notional principal amount equivalent to over USD 331 trillion, with a further USD equivalent of 138.9 trillion of cleared transactions removed through multilateral trade

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<sup>3</sup> On August 14, 2012, the Group acquired IDCG, and its subsidiary IDCH, from The NASDAQ OMX Group, Inc. LCH.Clearnet changed the name of IDCH to LCH.Clearnet LLC. After regulatory approval of conforming rule changes, LCH.Clearnet LLC will clear all of the interest rate swaps currently cleared by LCH.Clearnet Limited using existing LCH.Clearnet technology and procedures. LCH.Clearnet LLC is expected to launch in the fourth quarter of 2012. Prior to that launch, LCH.Clearnet LLC is not accepting interest rate swaps for clearing.

<sup>4</sup> The comment period on LCH.Clearnet SA's DCO application recently closed.  
<http://www.cftc.gov/PressRoom/PressReleases/pr6319-12>.

<sup>5</sup> Market share percentage based upon BIS statistics and SwapClear volumes as of August 31, 2012.

compression.<sup>6</sup> Launched in 1999, SwapClear clears interest rate swaps in 17 currencies: USD, EUR, and GBP out to 50 years, AUD, CAD, CHF, SEK and JPY out to 30 years and the remaining nine currencies out to 10 years. The SwapClear service also clears overnight index swaps out to two years in USD, EUR, GBP, and CHF. Additionally, the SwapClear service clears forward rate agreements (“FRAs”) for dealers in USD, EUR, and JPY out to three years and on CHF, CZK, DKK, HUF, NOK, PLN, and SEK out to two years. We expect to begin offering these FRAs to clients within weeks as well as to offer GBP FRAs out to three years for dealers and clients. Over the last 10 years, we have worked closely with market participants to build SwapClear into a leading and successful inter-dealer OTC clearing service providing a range of benefits to the inter-bank market. SwapClear successfully closed out the Lehman Bros International Europe OTC interest rate swap portfolio that comprised USD 9 trillion of notional in five currencies out to 30 years maturity; this is testament to SwapClear’s deep expertise, provenance and risk management practices in clearing OTC derivatives markets. More recently, SwapClear implemented end-user client clearing in both Europe and the U.S. and has cleared an aggregate notional principal amount equivalent to over USD 2.9 trillion in 11 of the 17 available currencies for clients.<sup>7</sup>

On February 24, LCH.Clearnet Limited submitted all of the interest rate swaps cleared through the SwapClear service to the Commission for a mandatory clearing determination.<sup>8</sup> Our submission recommended that the Commission mandate clearing of all interest rate swaps cleared by LCH.Clearnet phased by the underlying currency of the swap and consistent with the Commission’s phasing by participant type.<sup>9</sup> We are pleased that the Commission’s proposed mandatory clearing determination is closely aligned with LCH.Clearnet’s recommendation. Based on our extensive experience in clearing interest rate swaps, LCH.Clearnet strongly agrees with the classification criteria selected by the Commission as well as the scope of the proposed mandatory clearing determination.

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<sup>6</sup> As of August 31, 2012.

<sup>7</sup> As of August 31, 2012.

<sup>8</sup> LCH.Clearnet’s submission is available at <http://www.cftc.gov/stellent/groups/public/@otherif/documents/ifdocs/swapsubmission022412lchltd.pdf>.

<sup>9</sup> A key consideration undergirding LCH.Clearnet’s recommendation is an analysis of the first of the five statutory factors under Section 2(h)(2)(D)(ii) of the CEA that the Commission must consider in making a mandatory clearing determination. That factor requires the Commission to take into account the existence of outstanding notional exposures, trading liquidity, and adequate pricing data. LCH.Clearnet’s analysis focused on liquidity in the context of interest rate swaps. Our submission noted that for interest rate swaps, “volume in isolation is a not a reliable indicator of liquidity” because “only a very small percentage of even the most standardized interest rate swaps executed today are fungible with those executed as recently as yesterday. Therefore it is not appropriate for a DCO to rely on the traditional listed futures measures of liquidity when considering IR swaps.” Instead, “LCH.Clearnet’s evaluation of interest rate swap liquidity respects and responds to the product’s idiosyncrasies and is primarily contemplated through the prism of default management.” The submission lists the factors relevant for the determination, which enable recognition of the operative fungibility for risk purposes between “on-the-run” and “off-the-run” contracts and need to be considered in both “normal” and “stressed” market conditions.”

The Commission's decision to classify interest rate swaps based on six principle swap specifications—currency, floating rate index, stated termination date rate, optionality, dual currencies, and conditional notional amounts—is sound. The LCH.Clearnet submission letter noted that it would be “counterproductive to define every single attribute and combination that could be found in an IR swap, and furthermore it would always be possible to create additional attributes that would move a swap outside of the mandate.”<sup>10</sup> As a result, LCH.Clearnet recommended “defining a subset of easily identifiable features that determine” whether a swap is subject to mandatory clearing.<sup>11</sup> The Commission's six principle swap specifications meet that standard in a simple and straightforward way.

We also agree with the Commission's decision to limit the initial proposed mandatory clearing determination to swaps that are currently cleared.<sup>12</sup> This decision properly precludes mandatory clearing at this time of swaps with embedded optionality, cross-currency swaps, and swaps that lack notional amount certainty.<sup>13</sup> Given the very substantial volumes of interest rate swaps currently cleared by LCH.Clearnet, we are confident that the Commission's mandatory clearing proposal would not compromise our continued ability to comply with the DCO Core Principles.

LCH.Clearnet also supports the Commission's decision to initially limit its proposed mandatory clearing determination to swaps with USD, EUR, GBP, and JPY as the underlying currency. Approximately 95% of the notional amount of the swaps cleared by LCH.Clearnet's SwapClear service is denominated in one of these four currencies.<sup>14</sup> LCH.Clearnet recommends that the Commission propose mandatory clearing of swaps denominated in the other 13 currencies cleared by LCH.Clearnet once the initial phase of mandatory clearing is well-established. There is ample volume and liquidity in swaps denominated in these currencies to support mandatory clearing. It would be helpful to the market for the Commission to clarify whether it plans to propose mandatory clearing of swaps denominated in the other currencies that LCH.Clearnet clears and, if it does plan to do so, when that this likely to occur.

The Commission seeks comment on whether the swap that is created by the exercise of a non-cash settled interest rate swaption should be subject to the clearing requirement if the swap meets the specifications in the proposed mandatory clearing determination.<sup>15</sup> LCH.Clearnet strongly believes that mandatory clearing should not apply to swaps created *after* the

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<sup>10</sup>LCH.Clearnet submission at 6.

<sup>11</sup> *Id.*

<sup>12</sup> In its capacity as successor to IDCG, LCH.Clearnet requests clarification that the Commission intended to include basis swaps when it identified the swaps then being cleared by IDCG in its mandatory clearing determination proposal.

<sup>13</sup> LCH.Clearnet understands that the Commission is mandating clearing of interest rate swaps with a defined upfront notional schedule, for example, amortizer and roller coaster interest rate swaps, but is not mandating the clearing of interest rate swaps with an undefined upfront notional schedule. We request that the Commission confirm our understanding in its final mandatory clearing determination.

<sup>14</sup> As of August 31, 2012.

<sup>15</sup> 77 FR at 47202.

commencement of mandatory clearing by the exercise or expiry of swaptions<sup>16</sup> entered *prior* to the commencement of mandatory clearing. These swaptions were not priced with any expectation that a swap created on exercise would be cleared. However, if a swaption entered after the commencement of mandatory clearing results in a swap that meets the specifications in the proposed mandatory clearing determination (whether through exercise or expiry), LCH.Clearnet believes that this swap should be subject to mandatory clearing.

### Proposed Part 50 Rules

The Commission proposes new Part 50 rules related to mandatory clearing. LCH.Clearnet supports the Proposed Part 50 rules but believes that they could be improved by minor changes and clarifications.

Proposed Rule 50.2 provides swap counterparties with flexibility on the timing of submission to clearing of swaps that are executed late in the business day. LCH.Clearnet commends the Commission for including this flexibility in the proposed rules. LCH.Clearnet currently clears swaps that are executed late in the day. We read proposed Rule 50.2 as permitting LCH.Clearnet to continue to clear late day swaps. We request that the Commission confirm our understanding.

Proposed Rule 50.3(a) requires a DCO to post on its website a list of all swaps that it will accept for clearing and that identifies which of the swaps on the list are required to be cleared. LCH.Clearnet supports this requirement. The information currently posted on the LCH.Clearnet website identifying the swaps cleared by LCH.Clearnet was designed for dealer use. LCH.Clearnet is committed to revising the information on its website so that it is provided in a format that will be easily understandable by all swaps counterparties, including swaps customers.

Proposed Rule 50.5 implements Section 2(h)(6) of the Act which exempts from mandatory clearing swaps entered before the enactment of Dodd-Frank and those entered after the enactment of Dodd-Frank but prior to the application date of a mandatory clearing determination. LCH.Clearnet suggests changing the reference in proposed Rule 50.5(a) from Rule 44.02 to Rule 46.3. LCH.Clearnet suggests changing the reference in proposed Rule 50.5(b) from Rule 44.03 to Rule 46.3 for swaps entered after the enactment of Dodd-Frank but prior to the compliance date for reporting to a swap data repository ("SDR") and to Rule 45.3 for swaps entered after the compliance date for SDR reporting but prior to the application date of a mandatory clearing determination.

Proposed Rule 50.6 provides delegated authority to the Director of the Division of Clearing and Risk, with the consultation of the General Counsel, to determine whether a new swap submitted by a DCO under Rule 39.5 for a mandatory clearing determination is covered by an existing mandatory clearing determination. LCH.Clearnet supports this approach to addressing technical changes to swaps that are already covered by a mandatory clearing determination. However, we understand that if a DCO makes material changes to an existing type of swap already accepted

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<sup>16</sup> In LCH.Clearnet's view, swaps that result from swaptions, extendable swaps and callable swaps should be treated in the same way. Extendable swaps are swaps with an embedded swaption that grants the right to extend the maturity of the swap. Callable swaps are swaps with an embedded swaption that grants the right to cancel the swap.

for clearing and subject to mandatory clearing, for example by extending the tenor of that type of swap that is accepted for clearing, the Commission plans to follow the full mandatory clearing determination process. We request that the Commission confirm our understanding.

Conclusion

LCH.Clearnet appreciates the opportunity to share our views on the Commission's proposed mandatory clearing determination. We look forward to working with the Commission as it continues to implement the Dodd-Frank Act. Please do not hesitate to contact Lisa Rosen at +44 (0)207 426 7541 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 'Ian Axe', written in a cursive style.

Ian Axe  
Chief Executive Officer