



Melissa Jurgens  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

11 September 2013

Dear Ms. Jurgens:

**Re: RIN No. 3038-AE06, Derivatives Clearing Organizations and International Standards**

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 rules on Derivatives Clearing Organizations and International Standards ("proposed rules" or "proposal").<sup>1</sup>

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

The Commission proposes to amend its existing regulations to establish additional standards for compliance with the derivative clearing organization ("DCO") core principles set forth in Section 5b(c)(2) of the Commodity Exchange Act ("CEA" or "Act") for systemically important DCOs ("SIDCOs") and DCOs that elect to opt-in to the SIDCO regulatory requirements ("Subpart C DCOs"). The proposed rules are intended to address gaps between the Commission's Part 39 rules and the Principles for Financial Market Infrastructures ("PFMIs") adopted by the Committee on Payments and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions ("CPSS-IOSCO").<sup>2</sup> Adherence to the proposed rules would allow SIDCOs and Subpart C DCOs to be considered qualified central counterparties ("QCCPs") within the meaning of the Basel Committee on Bank Supervision ("BCBS") bank capital rules. In 2012, BCBS published interim rules governing capital changes arising from bank exposure to CCPs related to OTC derivatives, exchange traded derivatives, and securities financing transactions.<sup>3</sup> Under these interim rules, the capital treatment for bank clearing member exposures to QCCPs is significantly lower than the capital treatment for exposures to non-

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<sup>1</sup> 78 FR 67866 (August 16, 2013).

<sup>2</sup> Principles for Financial Market Infrastructures, (April 2012), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD377.pdf>.

<sup>3</sup> Capital Requirements for Bank Exposures to Central Counterparties (July 2012), available at [www.bis.org/publ/bcbs227.pdf](http://www.bis.org/publ/bcbs227.pdf).

qualified CCPs. Bank regulators in the US and Europe will begin to apply these interim rules on January 1, 2014.<sup>4</sup>

#### Summary of LCH.Clearnet Position

The Group strongly supports the Commission's proposal to adopt heightened regulatory standards that would allow both SIDCOs and non-SIDCOs to be QCCPs. However, the Group is very concerned that the proposed compliance schedule for Subpart C DCOs is unrealistic and will likely result in Subpart C DCOs not being able to achieve QCCP status prior to the end of 2013. Failure to become a QCCP by the end of 2013 will put Subpart C DCOs at a significant competitive disadvantage to non-US CCPs that are grandfathered as QCCPs and possibly US SIDCOs that would seem to benefit from a longer timeframe for complying with the heightened regulatory standards.

The Group therefore asks the Commission to adopt the heightened standards prior to the end of 2013 but to allow DCOs to file an application for additional time to comply with all of the substantive proposed Subpart C rules and not only the Subpart C systems safeguards. This approach would allow DCOs to achieve QCCP status by the end of 2013.

#### LCH.Clearnet Overview

LCH.Clearnet is the leading independent clearing house group, serving major international exchanges and platforms, as well as a range of derivative 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 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 supervised as a Recognised Clearing House by the Bank of England. Several of LCH.Clearnet Limited's business lines, SwapClear, ForexClear, and EnClear, clear swaps. LCH.Clearnet LLC, is registered with the Commission as a DCO, and clears for SwapClear. LCH.Clearnet LLC is domiciled in the US. LCH.Clearnet SA has filed an application with the Commission for a DCO license, 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 supervised as a Recognised Overseas Clearing House by the Bank of England. 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 have submitted

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<sup>4</sup> In July 2013, the Board of Governors of the Federal Reserve and the Office of the Comptroller of the Currency adopted final capital rules applicable to bank exposures to CCPs. The final rules are available at <http://www.occ.gov/news-issuances/news-releases/2013/2013-110a.pdf>.

In July 2013, the Capital Requirement Regulation that sets the capital rules applicable to bank exposures to CCPs entered into force and is available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0001:0337:EN:PDF>. The date of application of the Regulation is January 1, 2014.

applications for reauthorisation. Final action on these applications for re-authorization is expected in the first half of 2014.

### Proposed Rules and the PFMIs

Based on LCH.Clearnet's initial review of the proposed rules, we have not identified any significant differences between the proposed rules and the PFMI. However, LCH.Clearnet will need to undertake additional analysis of some of the more complex proposed rules. Such analysis is not immediately possible because of the extreme brevity of the comment period. That additional analysis may uncover areas of significant divergence between the proposed rules and the PFMI.

### Alternative Approach to Implementing the PFMIs

LCH.Clearnet believes that it is important for all CCPs which clear swaps and other derivatives, whether OTC or exchange traded, to adhere to the highest standards. The BCBS capital rules provide significant incentives for a CCP to meet the high standards embodied in the PFMI or face the real risk that bank clearing members will cease to clear through them. For this reason, LCH.Clearnet suggests that the Commission considers requiring that the rules implementing the PFMI apply to all DCOs. The Commission could have proposed a method for securing additional time to come into compliance with the more complex rules, such as those governing financial resources, system safeguards, risk management, and recovery and wind-down plans, and an option for DCOs to opt-out of the heightened standards if they believe that QCCP status is not important for their business. LCH.Clearnet urges the Commission to consider adopting such an approach in the final rules.

### Proposed Opt-In for Subpart C DCOs

If the Commission chooses not to apply the proposed rules to all DCOs, LCH.Clearnet LLC plans to take advantage of the Subpart C election process proposed for DCOs that are not SIDCOs. However, LCH.Clearnet believes that it will be extremely difficult for LCH.Clearnet LLC or any other non-SIDCO to use the Subpart C election process to become a QCCP prior to December 31, 2013. Even DCOs that are currently in compliance with most of the requirements of Subpart C will find it extremely challenging to complete the following tasks between the date of the Commission's proposal and December 31, 2013: (1) do a gap analysis between its current rules and procedures and the rules and procedures required under proposed Subpart C; (2) take the necessary steps to change any of its rules and implement any other changes indicated by the gap analysis; (3) gather the evidence necessary to support the filing of a Subpart C Election Form; (4) submit the Subpart C Election Form in draft to Commission staff in order to make sure that the evidence accompanying the form meets the staff's expectations since there will be little time prior to January 1, 2014 to make changes once the form is submitted in final; and (5) file a final Subpart C Election Form on or very shortly after the December 13, 2013 effective date of proposed rule 39.31, so that it can become effective prior to January 1, 2014. This challenge will be exacerbated by the fact that the gap analysis of any DCO considering applying as a Subpart C DCO will be affected by any changes that the Commission chooses to make when it adopts final rules. An additional complication is that the Commission has not previously proposed any requirements on recovery and wind-down plans so most DCOs will be putting these plans together from scratch on an extremely expedited schedule. For this reason, LCH.Clearnet urges the Commission to extend the flexibility provided by the proposed rule 39.34 to file an application

for additional time to comply with the proposed Subpart C systems safeguards requirements to all of the substantive proposed Subpart C rules. This approach would allow the Commission to adopt the PFMI rules prior to the end of 2013 and at the same time providing DCOs with a real ability to achieve QCCP status by the end of 2013.

As proposed, any DCO electing to become a Subpart C DCO is required to provide specific evidence that it is in compliance with all Subpart C rules at the time that it submits the Subpart C Election Form. The practical effect of this requirement is that Subpart C DCOs will have to come into compliance with all aspects of the PFMI rules prior to many non-US CCPs and, quite possibly, prior to many SIDCOs. This puts a significant burden on potential Subpart C DCOs that are seeing the proposed rules for the first time only four months before full compliance is required in order to secure QCCP status. By contrast, CCPs in the European Union will not be required to provide recovery plans to become and remain QCCPs as EMIR, which implements the PFMI rules in Europe, does not include such a requirement. EU legislation implementing the recovery and resolution aspects of the PFMI rules is not expected to be proposed by the European Commission until early next year. The proposal will need to go through the entire legislative and rulemaking process and implementation is therefore unlikely before 2016 at the earliest.<sup>5</sup> Despite the lack of recovery and resolution plans, EU CCPs are grandfathered into QCCP status until the earlier of June 15, 2014 or the date that they are reauthorized under EMIR. Requiring a DCO that desires to elect to be a Subpart C DCO to submit a recovery and wind-down plan at the time that it files a Subpart C Election Form will put that DCO at a competitive disadvantage to CCPs in the EU. The Commission could address this issue by providing a mechanism for DCOs submitting a Subpart C Election Form to seek additional time to comply with proposed rule 39.39.

#### Disclosure of Decisions of Board of Directors

Proposed Rule 39.32(a)(3) requires that major decisions of the board of directors should be clearly disclosed to clearing members, other relevant stakeholders, the Commission and – if the decision has broad market impact – the public. As the Commission will be aware, in connection with any new enterprise, there may be several board resolutions taken, and the initial one of these is typically taken at the commencement of the enterprise, when it is often uncertain that the matter will ultimately proceed to implementation. For instance, if a DCO intends to embark upon a corporate acquisition, or begin clearing in a new jurisdiction, the consent of the board is typically sought in order to commence exploratory negotiations, or jurisdictional due diligence. It is often only at a much later stage that one could say that a “decision” has been made by the Board that is determinative of the DCO actually embarking on the new initiative. The publication of board resolutions prior to such determinative decision would be confusing and potentially misleading or market-moving (especially for a DCO that is part of a listed group), and likely to serve as a deterrent to open discussions amongst Board members as to possible initiatives. Therefore, it seems to LCH.Clearnet that in interpreting Rule 39.32(a)(3), it would make sense that the disclosure requirement refers to the publication of the determinative decision of the Board, which in most instances is likely to be best served through a publication of the implementation details,

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<sup>5</sup> Laws in some EU jurisdictions will require CCPs to have recovery plans prior to the implementation of EU legislation. For example, legislation amending the Recognition Requirement Regulations of the Financial Services and Markets Act passed in the United Kingdom on July 30, 2013 requires CCPs to have a recovery plan in place by Feb 1, 2014. The final rules are available at [www.legislation.gov.uk/ukxi/2013/1908/regulation/3/made](http://www.legislation.gov.uk/ukxi/2013/1908/regulation/3/made)

though it may in some instances be useful to the market for the DCO to also publish a summary of the determinative Board resolution or the considerations relating to it.<sup>6</sup>

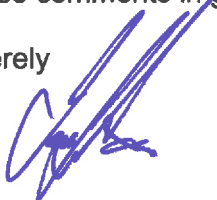
Maintenance of liquidity resources to satisfy obligations in all relevant currencies

LCH.Clearnet would like to provide a specific comment on Section E. The proposed paragraph (c) (2) in the preamble section on page 50275 on maintenance of liquidity resources can be read to suggest that a SIDCO or a Subpart C DCO needs to be able to meet an obligation in the correct currency or hold hedge instruments such as committed FX facility for all the currencies it clears. This approach overlooks the fact that the majority of the settlement obligations are likely to be in a few major currencies (e.g. the SwapClear service in LCH.Clearnet LLC clears in 17 currencies but settles obligations mainly in USD). Therefore, it is not necessarily the case that not having funds in the correct currency would lead to a disruption of the services of a SIDCO or Subpart C DCO. LCH.Clearnet would like to ensure that the intention of the CFTC is to limit the need for committed FX lines to material currencies only, which are indeed the ones likely to disrupt the SIDCO's services and impact financial stability.

Conclusion

LCH.Clearnet appreciates the opportunity to share our views on the Commission's proposed rules to establish additional standards for compliance with the DCO core principles for SIDCOs and DCOs that elect to opt-in to the SIDCO regulatory requirements. 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



Ian Axe  
Chief Executive Officer

cc: Commissioner Bart Chilton  
Commissioner Scott O'Malia  
Commissioner Mark Wetjen  
Ananda Radhakrishnan  
Bob Wasserman  
Phyllis Dietz  
Adam Cohen

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<sup>6</sup> This would also be consistent with the section of the PFMI relating to this requirement. Specifically, 3.2.18 of Principle 2 (*Governance*) states that "Without prejudice to local requirements on confidentiality and disclosure, the FMI should clearly and promptly inform its owners, participants, other users, and, where appropriate, the broader public, of the *outcome* of major decisions, and consider providing summary explanations for decisions to enhance transparency *where it would not endanger candid board debate or commercial confidentiality.*" [emphasis added]