

Via electronic submission

September 13, 2019

Mr. Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

**Re: Derivatives Clearing Organization General Provisions and Core Principles; RIN
3038-AE66**

Dear Mr. Kirkpatrick:

LCH Ltd and LCH SA (“LCH”) welcome the opportunity to respond to this request for comment from the Commodity Futures Trading Commission (“CFTC” or “Commission”) regarding the Derivatives Clearing Organization (“DCO”) General Provisions and Core Principles proposed rulemaking (“Proposal”).¹ We commend the CFTC on this initiative to enhance certain risk management and reporting obligations, clarify the meaning of certain provisions, simplify processes for registration and reporting, and codify existing relief and guidance.

LCH is an international, multi-asset class group of clearing houses, or central counterparties, that manage risk of many diverse portfolios of cleared derivatives.² LCH has supported regulatory reform enhancements to the global structure governing derivatives markets that have resulted in a comprehensive, stronger, and more robust risk management framework for CCPs, clearing members, and end-users of derivatives.

As discussed in further detail below, LCH is supportive of the Proposal to amend certain aspects of Part 39 to clarify and simplify CFTC regulations. However, as discussed below, LCH has concerns with two particular amendments under Part 39.13:

1. **Proposal to require monthly reviews of initial margin haircuts:** LCH encourages the CFTC to maintain the current requirement for DCOs to review haircuts on assets eligible for

¹ CFTC “Derivatives Clearing Organization General Provisions and Core Principles,” 84 FR 22226, available at <https://www.cftc.gov/sites/default/files/2019/05/2019-09025a.pdf>.

² LCH Ltd and LCH SA are registered Derivatives Clearing Organizations supervised by the CFTC under the Commodity Exchange Act and Commission Regulations. LCH SA is also registered with the Securities and Exchange Commission as a Clearing Agency. LCH Group is the leading multi-asset class and multi-national group of clearing houses, serving major international exchanges and platforms as well as a range of OTC markets. LCH Group clears a broad range of asset classes including securities, exchange-traded derivatives, foreign exchange derivatives, interest rate swaps, credit default swaps, and euro and sterling denominated bonds and repos. LCH Group Limited is majority owned by the London Stock Exchange Group (“LSEG”), a diversified international exchange group.

the initial margin requirement on a quarterly basis but suggest supplementing it with a new provision that would mandate DCOs to conduct more frequent reviews in specific cases.

2. **Proposal to impose risk limits on positions that may be difficult to liquidate:** LCH encourages the CFTC to address large positions that may be difficult to liquidate through means other than bright-line rules. This could avoid artificial limits unrelated to risk.

LCH provides the following comments to the CFTC's Proposal:

IV. Amendments to Part 39 – Subpart B – Compliance with Core Principles

A. Compliance with Core Principles - §39.10

The Proposal would require DCOs to have an enterprise risk management program and Enterprise Risk Officer.³ LCH has a framework in place for enterprise risk management and takes enterprise risk into account when making risk-based decisions. LCH recommends the role of the Enterprise Risk Officer be included in the role and responsibilities of the Chief Risk Officer to reduce duplication of responsibilities and benefit from efficiencies that can be derived from combining these related roles.

B. Financial Resources - §39.11

- i. LCH generally supports the Proposal to amend existing financial resources requirements and currently complies with most of these proposed changes. Specifically, LCH agrees DCOs must combine both customer and house account losses produced from stress tests.⁴
- ii. LCH supports the proposed use of IFRS rather than U.S. GAAP for non-U.S. DCOs' quarterly financial statement reports. LCH also recommends the CFTC allow non-U.S. DCOs to report in currencies other than U.S. dollar.⁵ This would allow the quarterly reports to align with the reporting currency of the entity's audited year-end financial statements. Further, this would simplify the reconciliation process proposed in §39.11(f)(2) of the Proposal.
- iii. The Proposal would require DCOs to annually report material differences between the audited year-end financial statements and the quarterly financial statements and inquires how "material" should be defined.⁶ LCH recommends "material" be defined as 10% of either the: (1) 6-month liquidity test; or (2) 12-month capital cost-based financial resources test.

D. Risk Management - §39.13

- i. LCH generally supports the CFTC's proposed amendments to its existing risk management requirements and currently complies with most of these proposed changes. In particular, LCH supports the CFTC's proposed changes to Margin

³ See Enterprise Risk Management - §39.10(d), at 22231.

⁴ See Calculation of Largest Financial Exposure and Stress Tests - §39.11(a)(1), (c)(1), and (2), at 22232.

⁵ See Financial Statements - §39.11(f)(1)(ii), at 22234.

⁶ See Annual Reporting - §39.11(f)(2), at 22234.

methodology and Coverage,⁷ Independent Validation,⁸ Spreads and Portfolio Margins,⁹ Back Tests,¹⁰ Clearing Members' Risk Management Policies and Procedures,¹¹ and currently complies with these requirements as proposed. LCH also supports the CFTC's proposal that customers' intraday initial margin be collected on a gross basis because it supports the risk management function of a DCO.¹²

- ii. LCH does not believe the review of haircut calculations on assets accepted to meet initial margin obligations should be made monthly and believes that quarterly reviews, as currently required, are sufficient.¹³ In normal market conditions, haircuts do not significantly change, or may not change at all, each month. LCH suggests that haircut reviews continue to be required on a quarterly basis, but the CFTC enhance 39.13(g)(12) by mandating DCOs review haircuts more frequently in the event of specific scenarios, such as breach of back testing or high market volatility, which would affect the valuation and liquidity of eligible collateral.
- iii. LCH agrees that DCOs should have procedures in place to address scenarios where clearing members clear large positions that may be difficult to liquidate in the event of a default. However, rather than setting bright-line limits on the maximum size of such positions, LCH suggests the CFTC require DCOs have measures in place, such as margin add-ons to address concentration risk.¹⁴ We believe that this would be an appropriate approach because the mitigants against concentration risk of certain positions in any one clearing member would be built into the DCO's risk model. Setting and maintaining such hard limits may result in market fragmentation or artificial limits that are not risk related and may inadvertently create disincentives to clearing.

E. Treatment of Customer Funds

- i. LCH supports the Proposal to amend Part 39.15(d)¹⁵ to require the "prompt," but not necessarily simultaneous, transfer of funds from the DCO to the customer. This change reflects how funds are transferred to customers, especially those where there is third-party involvement and the simultaneous transfer of funds may not be possible.
- ii. Further, LCH suggests the CFTC should allow DCOs to use its own money, securities, or other property to prevent a shortfall in the Cleared Swaps Customer Account pursuant to Part 22 of the CFTC's regulations.¹⁶ Part 22, in part, allows Futures Commission Merchants ("FCMs") to deposit additional collateral into these accounts, effectively creating a "buffer" to protect the account from becoming unsegregated. Allowing DCOs to deposit their own resources as a "buffer" would be consistent with the FCMs ability to make such deposits and further the CFTC's policy objectives to ensure customer accounts do not become unsegregated. Further, FCMs "buffer collateral" would not protect against operational risk or error that could occur at the DCO level. Thus, allowing

⁷ See Methodology and Coverage - §39.13(g)(2)(i), at 22235.

⁸ See Independent Validation - §39.13(g)(3), at 22235.

⁹ See Spreads and Portfolio Margins - §39.13(g)(4), at 22235.

¹⁰ See Back Tests - §39.13(g)(7), at 22235.

¹¹ See Clearing Members' Risk Management Policies and Procedures - §39.13(h)(5), at 22238.

¹² See Gross Customer Margin - §39.13(g)(8)(i), at 22235-36.

¹³ See Haircuts - §39.13(g)(12), at 22237.

¹⁴ See Risk Limits - §39.13(h)(1), at 22237-38.

¹⁵ See Transfer of Customer Positions - §39.15(d), at 22239.

¹⁶ See Final Rule, Protection of Cleared Swaps Customer Contracts and Collateral; Confirming Amendments to the Commodity Broker Bankruptcy Provisions, 77 Fed. Reg. 6636 (Feb. 7, 2012). 17 CFR §22.1.

DCOs to post “buffer collateral” would further protect against shortfalls in customer accounts and supports robust risk management.

H. Reporting

- i. The Proposal would require DCOs to report margin, cash flow, and position information by individual customer account.¹⁷ LCH requests the CFTC provide clarifications in the CFTC Guidebook related to the specific information of individual customer accounts be reported. Further, any clarifications made in the CFTC Guidebook should be finalized before the compliance date of these amendments.
- ii. The Proposal would also require DCOs to report model and margin model issues that affect the DCO’s ability to calculate or collect variation or initial margin.¹⁸ LCH recommends DCOs only be required to report margin model issues to the CFTC that *materially* affect the DCO’s ability to calculate or collect variation or initial margin. By only reporting margin model issues with an appreciable effect on FCMs and their clients, the amount of immaterial or non-significant information being reported is minimized. This ensures the CFTC focuses on those DCO’s issues that merit its attention, making the review process more efficient. Further, DCOs can detect margin model issues during the daily back testing process and resolve those issues before they pose an appreciable effect on FCMs and their clients.

General Comments on Implementation Periods

LCH recommends the CFTC provide a twelve-month implementation period for all the proposed amendments within this Proposal. Additionally, LCH recommends the CFTC allow for a six-month implementation gap between the Part 39.19 changes and the reporting requirement changes proposed (and to be proposed) under Parts 45 and 49.¹⁹ Allowing this amount of time to implement the proposed changes ensures DCOs and the wider industry have sufficient time to implement system changes in an orderly manner.

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LCH appreciates the opportunity to comment on this Proposal and looks forward to contributing further to this important initiative.

Sincerely,



Jonathan Jachym
Head of Regulatory Strategy & Government Relations, Americas
London Stock Exchange Group

¹⁷ See Daily reporting Information - §39.19(c)(1)(i), at 22240.

¹⁸ See Margin model Issues - §39.19(c)(4)(xxiv), at 22242.

¹⁹ See Certain Swap Data Repository and Data Reporting Requirements, RIN Number 3038-AE32, 84 FR 21044, May 13, 2019, available at <https://www.cftc.gov/sites/default/files/2019/05/2019-08788a.pdf>.