

VIA CFTC Portal

24 November 2021

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

RE: LCH Limited Submission Related to Mandatory Clearing Determination – Bloomberg Short-Term Bank Yield (“BSBY”) Index Interest Rate and Basis Swaps¹

Dear Mr. Kirkpatrick:

LCH Limited (“LCH”), a derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission (“CFTC”), is submitting (pursuant to CFTC regulation §39.5(b)), Interest Rate Swaps (“IRS”) and Basis Swaps referencing the USD BSBY index (together, “Submitted Swaps”) for a determination of whether mandatory clearing should apply.

§39.5 Review of swaps for Commission determination on clearing requirement.

(b) Swap submissions.

(2) A derivatives clearing organization shall submit swaps to the Commission, to the extent reasonable and practicable to do so, by group, category, type, or class of swaps.

LCH proposes to clear the Submitted Swaps to a maximum eligibility of 11 years initially. The eligible BSBY index tenors will be limited to one, three, and six months. The below table identifies the characteristics of the Submitted Swaps; specifically the instrument type, currency, legs of the swap, whether variable notional applies, maximum tenor, and notional amount.

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Instrument	Currency	Leg 1	Leg 2	Variable Notional	Maximum Tenor	Notional Amount (USD)
Interest Rate Swap	USD	Fixed	USD-BSBY	Yes	4,050 days	0.01-99,999,999,999.99
Basis Swap	USD	USD-BSBY	USD-SOFR-Compound ²	No	4,050 days	0.01-99,999,999,999.99
Basis Swap	USD	USD-BSBY	USD-SOFR-OIS Compound	No	4,050 days	0.01-99,999,999,999.99
Basis Swap	USD	USD-BSBY	USD-BSBY	No	4,050 days	0.01-99,999,999,999.99

§39.5(b)(3)(i) Statement of Eligibility

A statement that the DCO is eligible to accept the swap, or group, category, type, or class of swaps for clearing and describes the extent to which, if the CFTC were to determine that the swap, or group, category, type, or class of swaps is required to be cleared, the DCO will be able to maintain compliance with section 5b(c)(2) of the Act.

LCH is eligible to accept the Submitted Swaps for clearing and will be able to clear the Submitted Swaps in compliance with Section 5b(c)(2) of the United States Commodity Exchange Act (“Act”), including if the CFTC were to determine that such swaps are required to be cleared. LCH has a well-developed rule framework and support infrastructure for clearing interest rates swaps. LCH will leverage this existing operational capability to offer the clearing of the Submitted Swaps.

In order to prepare for the launch of these products, LCH will perform testing to ensure that it is able to clear these products in a manner which is consistent with the terms on which they are traded.

Further to this, LCH will notify its clearing members of a number of minor changes to the procedure documents which will be made in order to support the clearing of the Submitted Swaps in the above mentioned tenors. The procedural changes have been certified with the CFTC and are available on the LCH website.

§39.5(b)(3)(ii) Information Related to the Act’s Swap Submission Review Requirements

A statement that includes, but is not limited to, information that will assist the Commission in making a quantitative and qualitative assessment of the following factors:

(A) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data.

Pricing data for BSBY linked products, including SOFR/BSBY basis swaps and outright BSBY data is published by a number of large brokerage companies, with additional brokers preparing to provide

² All SwapClear contracts are governed by the 2021 ISDA interest rate derivatives definitions (the **2021 Definitions**). However, to accommodate member systems, LCH makes this basis swap eligible for clearing, even though “USD-SOFR-COMPOUND” is a floating rate option defined under the 2006 ISDA definitions, only. When the swap is cleared, LCH will apply the equivalent floating rate option under the 2021 Definitions, which is “USD-SOFR-OIS Compound”, for the purposes of the resulting SwapClear contract. Accordingly, a SwapClear contract resulting from a transaction referencing USD-SOFR-COMPOUND is equivalent to, and fungible with, a SwapClear contract resulting from a transaction referencing USD-SOFR-OIS Compound, and both will be governed by the 2021 Definitions.

quotations. Year-to-date volumes in the bilateral BSBY market are approximately USD 6 billion, with risk being weighted most heavily at the 5y and 10y tenors.

BSBY is calculated daily and published at 7:00am (ET) on each U.S. Business day on the Bloomberg Terminal, and is available through a Bloomberg Data Licence. The data is also published on www.bloomberg.com/bsby and includes historic values.

LCH publishes volume and outstanding notional data and will do so for BSBY swaps once launched. Please see Exhibit 1 – LCH Volumes (<https://www.lch.com/services/swapclear/volumes>).

(B) The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

LCH has a well-developed rule framework and support infrastructure for clearing interest rates swaps. LCH will leverage this existing operational capability to offer clearing of the Submitted Swaps.

(C) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract.

Central counterparty clearing of a product brings a number of well-established benefits to the market in that product, including to its oversight. Clearing imposes rigorous risk-management on all counterparties, including the collection of initial margin and the exchange of variation margin; it promotes standardization at all stages of trade management, which feeds back into improved market liquidity; and it introduces transparency, enabling more efficient market surveillance and monitoring of potential systemic risks. These benefits are especially important in the context of the ongoing global benchmark reform agenda, and to markets in new products such as BSBY swaps.

The introduction of the Submitted Swaps does not introduce any new or novel risks to the SwapClear service, and the policies, procedures and operational aspects of the service remain unchanged. BSBY is a credit linked term rate. LCH has experience clearing swaps referencing credit linked term rates and does not see BSBY as a new or novel risk factor.

SwapClear uses the Secured Overnight Financing Rate (“SOFR”) discounting for all USD cashflows, and this will apply to BSBY linked products.

As is the case for all cleared products, it is the view of LCH that clearing the Submitted Swaps is beneficial from a systemic risk perspective. Clearing avoids complex bilateral relationships and provides for default management of a failed institution to be handled centrally by the CCP. Additionally, since trades are centrally held by LCH, any implementation of fallbacks would be conducted under a single rule book, with LCH being the determining party. Furthermore, LCH provides a centralized view of risk for its cleared products and makes the visibility of risk positions more transparent.

(D) The effect on competition, including appropriate fees and charges applied to clearing.

LCH does not believe the clearing of the Submitted Swaps will have any negative impact on competition. Other CCPs are also proposing clearing BSBY-based swaps and 3-month BSBY futures contracts went live in the market in August 2021.

LCH's fees and charges for the above product are in line with those charged for existing SwapClear contracts. Please see Exhibit 2 – LCH Fees (<https://www.lch.com/services/swapclear/fees>).

(E) The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.

LCH believes that there is reasonable legal certainty in the event of the insolvency of LCH or a clearing member with regard to the treatment of house and customer positions, funds and property in connection with the clearing of the Submitted Swaps. Importantly, the level of legal certainty around the clearing of Submitted Swaps is in all material respects the same as that of the products already cleared in the LCH SwapClear service.

LCH's Default Rules, contained in its Rulebook, set out that it is entitled to place a clearing member in default if it appears to LCH that the clearing member is unable, or is likely to become unable, to meet its obligations in respect of one or more contracts. The Default Rules set out the steps that LCH may take in respect of a defaulter, including entering into contracts to hedge market risk, selling any security, porting customer accounts of that clearing member to another clearing member, auctioning the defaulter's proprietary portfolio to other clearing members (to include any customer accounts of that clearing member which could not be ported to another clearing member), otherwise closing out any open contracts, and generally taking such action as LCH may deem necessary for its protection. The sequence of actions will be determined by a number of factors, including size and characteristics of the defaulted clearing member's portfolio and the market environment.

Please see Exhibit 3 – LCH Rules (<https://www.lch.com/resources/rulebooks/lch-limited>).

Insofar as legal certainty in the event of the insolvency of the DCO is concerned, LCH would be wound up under English law.

§39.5(b)(3)(iii) Product Specifications

Product specifications, including copies of any standardized legal documentation, generally accepted contract terms, standard practices for managing any life cycle events associated with the swap, and the extent to which the swap is electronically confirmable.

Product terms for the Submitted Swaps are market standard and follow 2021 ISDA Definitions³ and are also part of the Financial products Markup Language (FpML) standard, which is a protocol for sharing information on derivatives and other products. The Floating Rate Option for BSBY under the 2021 ISDA definitions is USD-BSBY.

³ <https://www.isda.org/2021/10/04/2021-isda-interest-rate-derivatives-definitions/>

The Product Specific Contract Terms can be found in the LCH Product Contracts Terms and Eligibility Criteria Manual. Please see Exhibit 3 – LCH Rules (<https://www.lch.com/resources/rulebooks/lch-limited>) which includes links to the Product Specific Contract Terms and Eligibility Criteria Manuals although they are not part of the rulebook. A detailed specification of the product will be available to members and clients in line with those supplied for all existing products.

§39.5(b)(3)(iv) Participant Eligibility

Participant eligibility standards, if different from the derivatives clearing organization's general participant eligibility standards.

The participant eligibility standards for the Submitted Swaps are the same as those for existing SwapClear clearing members.

§39.5(b)(3)(v) Price Discovery

Pricing sources, models, and procedures, demonstrating an ability to obtain sufficient price data to measure credit exposures in a timely and accurate manner, including any agreements with clearing members to provide price data and copies of executed agreements with third-party price vendors, and information about any price reference index used, such as the name of the index, the source that calculates it, the methodology used to calculate the price reference index and how often it is calculated, and when and where it is published publicly.

Four brokers are currently quoting SOFR versus 3m BSBY basis swaps to 50y. One broker is quoting 1/3 and 3/6 BSBY Basis swaps to the same final maturity with another two in final preparations to begin publication soon. In addition to these Basis swap quotations, quotes are available for outright BSBY versus fixed swaps that are not being used by LCH, but could be used to imply the above spreads in conjunction with standard SOFR versus fixed quotations should a requirement arise.

Please see:

Exhibit 4 – LCH Settlement Prices (<https://www.lch.com/services/swapclear/essentials/settlement-prices>)

Confidential Exhibit 5 – Contract and Market Acceptability Policy

Confidential Exhibit 6 – SwapClear Zero Coupon Rate Curve Configuration

Confidential Exhibit 7 – SwapClear Zero Coupon Rate Curve Construction Methodology

§39.5(b)(3)(vi) Risk Management

Risk management procedures, including measurement and monitoring of credit exposures, initial and variation margin methodology, methodologies for stress testing and back testing, settlement procedures, and default management procedures.

The clearing of the Submitted Swaps and the use of SOFR for discounting has been entirely accommodated within the existing LCH framework for measurement and management of risk and for the process of default management. The introduction of a clearing mandate for the product would not necessitate any change to these processes.

Please see:

Confidential Exhibit 8 – SwapClear & Listed Rates Risk Management Framework
Confidential Exhibit 9 – Default Management Policy

§39.5(b)(3)(vii) Applicable Rules, Manuals, Policies, or Procedures

Please see Exhibit 3 – LCH Rules (<https://www.lch.com/resources/rulebooks/lch-limited>).

§39.5(b)(3)(viii) Communications to Members Regarding this Submission

A description of the manner in which the derivatives clearing organization has provided notice of the submission to its members and a summary of any views on the submission expressed by the members (a copy of the notice to members shall be included with the submission).

LCH engages its clearing members in the design and testing of new products at an early stage, through regular meetings and working groups. No material feedback was received in relation to this initiative. Prior to clearing the Submitted Swaps, clearing members will be notified of required Rulebook changes. Furthermore, this submission related to a mandatory clearing determination is publicly available.⁴

LCH intends to launch these products with its Clearing Members and clients no earlier than November 29, 2021.

Should you have questions please contact me at julian.oliver@lseg.com.

Yours sincerely,



Julian Oliver
Chief Compliance Officer
LCH Limited

⁴ <https://www.lch.com/resources/regulatory-responses>

Exhibits

Exhibit 1 – LCH Volumes (<https://www.lch.com/services/swapclear/volumes>)

Exhibit 2 – LCH Fees (<https://www.lch.com/services/swapclear/fees>)

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