

VIA CFTC Portal

14 October 2019

Mr Christopher Kirkpatrick
Commodity Futures Trading Commission
115 21st Street NW
Three Lafayette Centre
Washington DC 20581

Dear Mr Kirkpatrick

€STR Swaps

Pursuant to CFTC regulation §39.5(b), LCH Limited (“LCH”), a derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission (the “CFTC”), is submitting Euro Short-Term Rate (€STR) based swaps for determination of whether mandatory clearing should apply.

Background

Interest rate benchmarks globally are currently undergoing in-depth reforms. In Europe the European Central Bank (ECB) is transitioning from Euro Over-Night Index Average (EONIA) to €STR as the new Euro risk-free rate. LCH currently clears EONIA based Swaps out to 51 years and as such is proposing to clear €STR linked products out to 51 years. The €STR overnight rate will reflect the wholesale euro unsecured overnight borrowing costs of euro area banks and will complement existing benchmark rates produced by the private sector. The ECB began publishing the €STR overnight rate on 2 October 2019.

Factors for determination

The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data

As €STR’s publication only occurred a couple of weeks ago, there is limited information on notional exposures and trading liquidity. However, it is noted that from publication the European Money Markets Institute (EMMI) will recalibrate EONIA to equal €STR + 8.5bps and therefore the two indices will be linked by a fixed, invariant and non-zero spread.

Market data is available from large brokers with quotes available out to 50 years.

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 intends to leverage this existing operational capability when extending its offering to €STR swaps.

In order to prepare for the launch of this product, 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 has notified its Clearing Members of changes to the “Product Specific Contract Terms and Eligibility Criteria Manual” and “FCM Product Specific Contract Terms and Eligibility Criteria Manual” to reflect the new swaps. The changes have been certified with the CFTC and is available on the LCH website.

The effect on mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract

€STR based products do not introduce any novel risks to LCH, as the operational capability to manage the product are already in place.

LCH expects current SwapClear Clearing Members to start clearing €STR Swaps, once the service is live.

Following consultation with its Members, LCH does not expect this product launch to lead to an overall increase in the volume or riskiness associated with Euro swaps in the clearing house, rather that users will transition their positions from the EONIA swap into the €STR swap over time.

Therefore, the introduction of €STR Swaps is unlikely to have a significant impact on the risk profile or total resources held by the SwapClear service. The systemic risk profile of LCH should thus remain unchanged as a result of this product offering.

The effect on competition, including appropriate fees and charges applied to clearing

Another European DCO has announced it is targeting 18 November 2019 for clearing €STR swaps.

LCH’s fees and charges for €STR swaps will be in line with those charged for existing SwapClear contracts.

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

The level of legal certainty around the clearing of €STR contracts is in all material respects the same as that of the products already cleared in the SwapClear service at LCH.

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

Further information §39.5(b)(iii-viii)

Product terms for €STR Swaps are market standard and follow **2006 ISDA Definitions** and are also part of the Financial products Markup Language (FpML) standard (specifically <http://www.fpml.org/coding-scheme/floating-rate-index> published on 21st December 2017), which is a protocol for sharing information on derivatives and other products.

The participant eligibility standards for €STR are the same as those for existing SwapClear Clearing Members.

No material revisions to the existing risk models/parameters and/or liquidity management framework are required for LCH to offer the clearing of the product.

The core IM model for €STR linked products will utilise the standard methodology as for other products and currencies in the OTC Rates service with the addition of one new specific €STR time series. For variation margin all EUR cashflows are currently discounted using the EONIA rate, with PAI set using the same index. It is proposed to retain this approach for €STR linked products. The migration to €STR discounting and PAI is the expected next step in the process.

Updates will also be made to the eligibility manual and the LCH procedures in order to show €STR based trades as eligible. The amendments will be submitted to the CFTC pursuant to §40.6(a), following notification to LCH's Clearing Members.

LCH engages its Clearing Members in the design and testing of new products at an early stage, through regular meetings and working groups. Clearing Members have been formally notified of the changes which LCH is required to make to its Rulebook.

Notice of this submission under CFTC regulation §39.5(b) was given to SwapClear Clearing Members on 30 September 2019 and a copy of this notice is provided at Appendix A. Furthermore, this submission is publicly available at: <http://www.lch.com/rules-regulations/regulatory-responses>

LCH intends to launch these products with its Clearing Members and clients no earlier than 21 October, 2019.

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

Yours sincerely



Julian Oliver
Chief Compliance Officer
LCH Limited

Appendix A

Notice of this submission provided to SwapClear Clearing Members

Memo

To	SwapClear Clearing Members
From	David Horner, Head of In-Business Risk Rates
Date	30 September 2019
Subject	€STR submission for determination of clearing requirements

Pursuant to CFTC regulation §39.5(b), LCH Limited (LCH), a derivatives clearing organization (DCO) registered with the Commodity Futures Trading Commission (the CFTC), is submitting €STR based swaps for determination of whether mandatory clearing should apply.

As per CFTC regulation §39.5(b)(viii), LCH is required to notify members of its submission. This note does not constitute a notification that the products are live for clearing. A notice announcing the live date and arrangements for the formal product launch will be published separately.

Factors for determination

The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data

Interest rate benchmarks globally are currently undergoing in-depth reforms. In Europe the European Central Bank (ECB) is transitioning from EONIA to €STR as the new Euro risk-free rate. LCH currently clears EONIA based Swaps out to 51 years and as such is proposing to clear €STR linked products out to 51 years. The €STR overnight rate will reflect the wholesale euro unsecured overnight borrowing costs of euro area banks and will complement existing benchmark rates produced by the private sector. The ECB will begin publishing the €STR overnight rate on 2 October 2019.

As €STR is not published yet, there is no outstanding notional exposures or liquidity. However, it is noted that from 2 October 2019 EMMI will recalibrate EONIA to equal €STR + 8.5bps and therefore the two indices will be linked by a fixed, invariant and non-zero spread

Market data will be available from large brokers with quotes available out to 50 years.

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 intends to leverage this existing operational capability when extending its offering to €STR swaps.

In order to prepare for the launch of this product, 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 €STR swaps out to 51 years. The changes will be certified with the CFTC and be made available on the LCH website.

The effect on mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract

€STR based products do not introduce any novel risks to LCH, as the operational capability to manage the product are already in place.

LCH expects current SwapClear Clearing Members to start clearing €STR Swaps, once the service is live.

Following consultation with its Members, LCH does not expect this product launch to lead to an overall increase in the volume or riskiness associated with Euro swaps in the clearing house, rather that users will transition their positions from the EONIA swap into the €STR swap over time. Therefore, the introduction of €STR Swaps is unlikely to have a significant impact on the risk profile or total resources held by the SwapClear service. The systemic risk profile of LCH should thus remain unchanged as a result of this product offering.

The effect on competition, including appropriate fees and charges applied to clearing

EUREX Clearing is targeting 18 November 2019 for clearing €STR swaps.

LCH's fees and charges for the above product will be in line with those charged for existing SwapClear contracts.

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

The level of legal certainty around the clearing of €STR contracts is in all material respects the same as that of the products already cleared in the SwapClear service at LCH.

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

Further information §39.5(b)(iii-viii)

Product terms for €STR Swaps are market standard and follow **2006 ISDA Definitions** and are also part of the Financial products Markup Language (FpML) standard (specifically <http://www.fpml.org/coding-scheme/floating-rate-index> published on 21st December 2017), which is a protocol for sharing information on derivatives and other products.

The participant eligibility standards for €STR are the same as those for existing SwapClear Clearing Members.

No material revisions to the existing risk models/parameters and/or liquidity management framework are required for LCH to offer the clearing of the product.

The core IM model for €STR linked products will utilise the standard methodology as for other products and currencies in the OTC Rates service with the addition of one new specific €STR time series. For variation margin all EUR cashflows are currently discounted using the EONIA rate, with PAI set using the same index. It is proposed to retain this approach for €STR linked products. The migration to €STR discounting and PAI is the expected next step in the process.

Updates will also be made to the eligibility manual and the LCH procedures in order to show €STR based trades as eligible. The amendments will be submitted to the CFTC pursuant to §40.6(a), following notification to LCH's Clearing Members.

LCH engages its Clearing Members in the design and testing of new products at an early stage, through regular meetings and working groups. Clearing Members have been formally notified of the changes which LCH is required to make to its Rulebook.

Further information will form part of the full §39.5 filing which will be publicly available on the LCH website.

LCH looks forward to working with Clearing Members and the CFTC in the determination of clearing requirements. Please do not hesitate to contact me regarding any questions raised by this information.