

VIA CFTC Portal

14 September 2018

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

**LCH Limited Self Certification: Rule changes related to the allocation of the default fund's contributions to ForexClear Clearing Members**

Dear Mr Kirkpatrick

Pursuant to CFTC regulation §40.6(a), LCH Limited ("LCH"), a derivatives clearing organization registered with the Commodity Futures Trading Commission (the "CFTC"), is submitting for self-certification changes to its rules regarding the metric used by the ForexClear service to allocate the default fund contributions across Clearing Members.

**Part I: Explanation and Analysis**

The ForexClear Default Fund is allocated to ForexClear Clearing Members in respect to both their proprietary and clients' contracts on a monthly basis. Currently, the allocation is based on the Clearing Members' average daily Initial Margin over the last 30 days, subject to an individual minimum contribution of USD 5million. The proposal is to change the metric for allocation from Initial Margin to Stress Test Loss over Initial Margin ("STLOIM"). The change will allow ForexClear to take into account the sovereign risk add-on and the credit risk add-on margins, as well as core initial margin, when allocating the default fund contributions to Clearing Members.

The change will lead to a more equitable default fund allocation each month across the ForexClear membership that is more closely aligned with the 'defaulter pays' principle. In addition, it introduces consistency between the metric used to size the default fund and the metric used to allocate the contributions to the default fund.

The rule changes will go live on, or after, October 2, 2018.

**Part II: Description of Rule Changes**

Schedule 5 of the Default Rules ("ForexClear Default Fund Supplement") includes changes to paragraph F2 (d) (i) to (iv) setting out the details on how the ForexClear Default Fund is allocated

across Clearing Members in respect to NDF and non-NDF contracts<sup>1</sup>. The sub-paragraph (iv) notes that the changes do not apply to New Members<sup>2</sup>. To note, such New Members would still be subject to the individual minimum contribution to the default fund, as required under the existing paragraph F4.

The Procedures 2I (“ForexClear Clearing Service”) and the FCM Procedures include equivalent changes in the respective sections 1.10.5 and 3.10 (“Quantifying ForexClear Contributions”) noting that the ForexClear default fund allocation is based on the uncovered stress losses (“STLOIM”) calculated in respect to both the proprietary and clients’ contracts of a ForexClear Clearing Member.

The text of the changes are attached hereto as:

- **Appendix I** (Default Rules)
- **Appendix II** (Section 2I Procedures)
- **Appendix III** (FCM Procedures)

### Part III: Core Principle Compliance

LCH has reviewed the changes against the requirements of the Core Principles and finds that they will continue to comply with all the requirements and standards therein.

### Part IV: Public Information

LCH has posted a notice of pending certification with the CFTC and a copy of the submission on LCH’s website at:

<http://www.lch.com/rules-regulations/proposed-rules-changes>

### Part V: Opposing Views

There were no opposing views expressed to LCH by governing board or committee members, members of LCH or market participants that were not incorporated into the rule.

### Certification

LCH hereby certifies to the Commodity Futures Trading Commission, pursuant to the procedures set forth in the Commission regulation § 40.6, that attached rule submission complies with the Commodity Exchange Act, as amended, and the regulations promulgated there under.

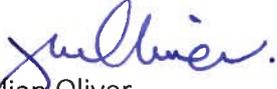
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<sup>1</sup> The ForexClear Default Fund comprise two separate segments for Non-Deliverable Forward (“NDF”) contracts and for FX Options contracts (“non-NDF contracts”). Each segment is independently sized, to reflect the risk exposures arising from the respective contracts, and then combined to constitute a single aggregated ForexClear Default Fund.

<sup>2</sup> The General Regulations includes a definition of “New Members” as Clearing Members joining a LCH clearing service on the day, or on the preceding day, that the contributions to the relevant default fund are allocated.

Should you have any questions please contact me at [julian.oliver@lch.com](mailto:julian.oliver@lch.com).

Yours sincerely



Julian Oliver  
Chief Compliance Officer  
LCH Limited

**Appendix I**  
Default Rules

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**LCH** The Markets'  
Partner

**LCH LIMITED  
DEFAULT RULES**

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**SCHEDULE 5**  
**FOREXCLEAR DEFAULT FUND SUPPLEMENT**

- F1. **In accordance** with and subject to Rule F2, the amount of each ForexClear Clearing Member's ForexClear Contributions shall be determined by the Clearing House as soon as practicable after each ForexClear Determination Date as appropriate on the basis of information available as at close of business on such ForexClear Determination Date and notified to such FXCCM as soon as practicable after such determination in accordance with the Procedures.
- F2. Each FXCCM's ForexClear Contribution (other than any ForexClear Unfunded Contribution or any Supplementary Contribution) shall be determined by the Clearing House in accordance with the following provisions:
- (a) determinations will be made by the Clearing House on the date that an FXCCM joins the ForexClear Service, and at the close of business on the first business day of each subsequent month, and otherwise in accordance with paragraph (f) below (each a "**ForexClear Determination Date**") **provided, however, that** following a Default, any such determinations and any such ForexClear Determination Date which might otherwise have occurred under this Rule F2 shall be suspended for the duration of the period (the "**ForexClear Default Period**") commencing on the date of such Default and terminating on the last to occur of the following dates:
    - (i) the date which is the close of business on the day falling 30 calendar days after the ForexClear Default Management Process Completion Date in relation to such Default (or, if such day is not a business day, the next succeeding business day); and
    - (ii) where, prior to the end of the period referred to in (i) above (or such period as has already been extended pursuant to this paragraph (ii)), one or more subsequent Defaults (each a "**Relevant Default**") occur, the date which is the close of business on the day falling 30 calendar days after the ForexClear Default Management Process Completion Date in relation to a Relevant Default which falls latest in time (or, if such day is not a business day, the next succeeding business day);
  - (b) On each business day, the Clearing House will determine a "**Combined Loss Value**" in respect of each of the 30 preceding business days. The Combined Loss Value in respect of a particular day will be the sum of the largest and the second largest stress-testing loss incurred on that day in relation to ForexClear Business (for a given scenario);
  - (c) the "**ForexClear Fund Amount**" comprises the "**ForexClear NDF Sub-Fund Amount**" and the "**ForexClear Non-NDF Sub-Fund Amount**". The ForexClear NDF Sub-Fund Amount and ForexClear Non-NDF Sub-Fund Amount shall be calculated in United States dollars ("**USD**") and, for a given ForexClear Determination Date, shall be (i) in relation to the ForexClear NDF Sub-Fund Amount, the largest of the 30 Combined Loss Values in respect of ForexClear NDF Contracts, and (ii) in relation to the ForexClear Non-NDF Sub-Fund Amount, the largest of the 30 Combined Loss Values in respect of

ForexClear Contracts other than ForexClear NDF Contracts, each as determined under paragraph (b) above plus 10 per cent. Each of the ForexClear NDF Sub-Fund Amount and ForexClear Non-NDF Sub-Fund Amount shall not be less than USD 70 million (the "**ForexClear Fund Floor**");

- (d) the "**ForexClear Margin Weight**" means the "**ForexClear NDF Margin Weight**" or the "**ForexClear Non-NDF Margin Weight**", as applicable. ~~The FXCCM's **ForexClear NDF Margin Weight** shall be calculated by dividing the average daily initial margin obligation (as calculated under the Procedures or other arrangements applicable) which has applied to the FXCCM during the reference period in paragraph (b) above, in respect of all ForexClear NDF Contracts to which the FXCCM is a party, by the total of such average daily obligations applied to all Non-Defaulting FXCCMs. The FXCCM's **ForexClear Non-NDF Margin Weight** shall be calculated by dividing the average daily initial margin obligation (as calculated under the Procedures or other arrangements applicable) which has applied to the FXCCM during the reference period in paragraph (b) above, in respect of all ForexClear Contracts other than ForexClear NDF Contracts to which the FXCCM is a party, by the total of such average daily obligations applied to all Non-Defaulting FXCCMs;~~
- (i) an FXCCM's **ForexClear NDF Margin Weight** shall be calculated by dividing (A) the Uncovered Stress Loss associated with such FXCCM's ForexClear NDF Contracts by (B) the total Uncovered Stress Loss applied to all Non-Defaulting FXCCMs with respect to their ForexClear NDF Contracts, in each case where the ForexClear NDF Contracts are (I) entered into on the FXCCM's own behalf or with respect to a ForexClear Clearing Client or an FCM Client and (II) open and outstanding during the reference period set forth in paragraph (b) above;
- (ii) an FXCCM's **ForexClear Non-NDF Margin Weight** shall be calculated by dividing (A) the Uncovered Stress Loss associated with all of such FXCCM's ForexClear Contracts other than ForexClear NDF Contracts by (B) the total Uncovered Stress Loss applied to all Non-Defaulting FXCCMs with respect to their ForexClear Contracts that are not ForexClear NDF Contracts, in each case where the ForexClear Contracts are (I) entered into on the FXCCM's own behalf or with respect to a ForexClear Clearing Client or an FCM Client and (II) open and outstanding during the reference period set forth in paragraph (b) above;
- (iii) an FXCCM's "**Uncovered Stress Loss**," as determined in accordance with sub-paragraphs (i) and/or (ii) above, shall be determined by the Clearing House (and notified to each FXCCM) from time to time by, *inter alia*, deducting the amount of eligible margin held by the Clearing House with respect to the relevant ForexClear Contracts from the stress loss associated with such ForexClear Contracts;
- (iv) the provisions of this sub-paragraph (d) shall not apply to New Members and, for the avoidance of doubt, New Members shall not constitute Non-Defaulting FXCCMs for the purposes of limb (B) of sub-paragraphs (i) and (ii);

- (e) each FXCCM's ForexClear Contribution comprises the "**ForexClear NDF Contribution**" and the "**ForexClear Non-NDF Contribution**". The FXCCM's ForexClear NDF Contribution shall be calculated by multiplying the ForexClear NDF Sub-Fund Amount by the FXCCM's ForexClear NDF Margin Weight, and shall be no less than the Minimum ForexClear Contribution. The FXCCM's ForexClear Non-NDF Contribution shall be calculated by multiplying the ForexClear Non-NDF Sub-Fund Amount by the FXCCM's ForexClear Non-NDF Margin Weight, and shall be no less than the Minimum ForexClear Contribution; and
- (f) subject to a suspension pursuant to paragraph (a) above, the Clearing House may recalculate the ForexClear Fund Amount on any business day if the Combined Loss Value differs by more than 25 per cent. from the figure on which the previous ForexClear Contribution determination was based.

F3. For the purposes of the calculations under Rule F2:

- (a) references to "ForexClear Clearing Members" or "FXCCMs" do not include references to Defaulting FXCCMs (apart from any Defaulting FXCCM in respect of which the Clearing House permits the application of Rule F2) or persons which were formerly FXCCMs but are not FXCCMs at the ForexClear Determination Date at which the relevant determination is made;
- (b) contributions shall be rounded upwards, if not already such a multiple, to the next integral multiple of one thousand US dollars;
- (c) no account shall be taken, in calculating initial margin or ForexClear Margin Weight under Rule F2 of any offsets applied in calculating initial margin obligations imposed on an FXCCM in respect of ForexClear Contracts, which may otherwise be permissible under the Procedures or other arrangements applicable;
- (d) **provided that** the FXCCM is not a Defaulter, the amount of its ForexClear Contribution shall be calculated in accordance with and subject to Rule F2. The provisions of Rule F1, Rule F2, this Rule F3 and Rule F5 do not apply to a Defaulting FXCCM, unless the Clearing House so permits in any particular case; and
- (e) notwithstanding Rule 25 of the Default Rules, if an FXCCM notifies the Clearing House on the ForexClear Default Management Process Completion Date that it wishes to resign from the ForexClear Service, such FXCCM, assuming all other requirements for termination of membership have been satisfied by the next following ForexClear Determination Date, shall cease to be an FXCCM for the purpose of Rule F2 on and from the date upon which its ForexClear Contribution is repaid to it by the Clearing House and such payment will be made by the Clearing House following the subsequent ForexClear Determination Date in accordance with the Procedures.

F4. Without prejudice to any other requirements which the Clearing House may impose, the amount of the ForexClear Contribution of a New Member shall be the sum of (a) the Minimum ForexClear Contribution and (b) any supplementary sum determined by

**Appendix II**  
Procedures Section 2I



**LCH LIMITED**

**PROCEDURES SECTION 2I**

**FOREXCLEAR CLEARING SERVICE**

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Where a ForexClear Clearing Member makes a bid and that ForexClear Clearing Member has an affiliated ForexClear Clearing Member that does not make a bid, the Clearing House shall not (unless instructed otherwise in accordance with the paragraph below) assume that the bidding ForexClear Clearing Member has made the relevant bid on behalf of a non-bidding, affiliated ForexClear Clearing Member.

A ForexClear Clearing Member may notify the Clearing House, in advance of an Auction, that it wishes to bid on behalf of an affiliated ForexClear Clearing Member. Where it wishes to do so, the ForexClear Clearing Member should contact the Clearing House's Client Services Team (membership@lchclearnet.com; +44 (0)207 426 7949).

- 1.10.4 *Default Fund: ForexClear Contributions:* ForexClear Contributions will be called via PPS on the fourth working day of each month or more frequently pursuant to a determination of the ForexClear Contribution under Rule F2(a) of the Default Rules (each a "**ForexClear Reset Day**"). ForexClear Contribution requirements will be notified to ForexClear Clearing Members at least two working days prior to each ForexClear Reset Day on Member Intranet Report 000032.

Excess ForexClear Contribution amounts due to ForexClear Clearing Members following the adjustment to the ForexClear Contribution will be repaid to ForexClear Clearing Members' PPS accounts on the ForexClear Reset Day immediately following the adjustment to the ForexClear Contribution.

Interest on ForexClear Contributions will be paid to ForexClear Clearing Members' PPS accounts on the first working day after the ForexClear Reset Day following the end of the relevant "**interest accrual period**". Interest is calculated in respect of each "**interest accrual period**", which commences on (and includes) a ForexClear Reset Day and ends on (and includes) the calendar day immediately before the next ForexClear Reset Day.

- 1.10.5 *Quantifying ForexClear Contributions:* For the purposes of calculating the ForexClear Margin Weight under Rule F2(d) of the ForexClear Default Fund Supplement, the ~~average daily requirement for the initial margin obligation applied to uncovered stress loss of~~ an FXCCM shall be determined by reference to the ForexClear Contracts ~~comprising both the ForexClear House Business entered into (1) on behalf of the relevant FXCCM and (2) with respect to the ForexClear Client Clearing Business Clients and FCM Clients of that such~~ FXCCM.

- 1.10.6 *Outsourcing:* Pursuant to Section 1 (*Clearing Member and Dealer Status*) of the Procedures, an FXCCM may appoint a third party to fulfil one or both of the Clearing House's Membership requirements to: (i) participate in a ForexClear "**fire drill**" run by the Clearing House; and (ii) participate in the ForexClear Default Management Process operated by the Clearing House. Where an FXCCM chooses to outsource one or both of these functions it must appoint and maintain at least three LCH Approved Outsourcing Agents.

**Appendix I**  
FCM Procedures



**FCM PROCEDURES OF THE CLEARING HOUSE**

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### 3.10 Quantifying ForexClear Contributions

For the purposes of calculating the ForexClear Margin Weight under Rule F2(d) of the ForexClear Default Fund Supplement, the ~~average daily requirement for Initial Margin applied to uncovered stress loss of an FX-FCM/FXCCM~~ shall be determined by reference to the ForexClear Contracts ~~comprising~~ entered into (1) on behalf of the ForexClear House relevant FXCCM and Client Business of that FX-FCM only (2) with respect to the Clearing Clients and FCM Clients of such FXCCM.

### 3.11 [Reserved.]

### 3.12 Clearing House Reporting

The Clearing House (acting, where applicable, through the entity to which it has elected to delegate the relevant reporting obligation) shall report to one or more data or trade repository or similar body (including a swap data repository) the details of an FCM Contract and any modification or termination of such FCM Contract without duplication and no later than the working day following the conclusion, modification or termination of such FCM Contract, in line with the requirements of Applicable Law. In order to avoid any such duplication of reports, each FCM Clearing Member acknowledges and agrees that it will not report the details referred to in this paragraph to the bodies referred to in this paragraph, unless otherwise agreed with the Clearing House.