

VIA CFTC PORTAL

1 February 2019

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

LCH Limited Self Certification: Rule Changes on Rates Default Fund Allocation

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 to change how the SwapClear service allocates its default fund contributions to its Clearing Members.

Part I: Explanation and Analysis

Currently (subject to a minimum contribution of GBP10million) the SwapClear market risk portion of the Rates Default Fund is allocated to its Clearing Members based on their average House daily Initial Margin (“IM”) over the last 20 days. Client positions are not included in this calculation.

LCH proposes to include client positions in the allocation of the SwapClear market risk portion of the Rates Default Fund. This will be done with the introduction of a client classification relating to portability, the introduction of an Internal Portability Score (IPS) for client clearing members and an allocation method for the default fund to include client risk utilising the IPS. The likelihood of porting is a key element in the evaluation of client risk, and it is possible to generally classify a client using a number of key elements, in particular the number of readily available backup relationships. Thus, LCH proposes that client positions would be weighted dependent on the overall portability of the client portfolio.

This proposal also amends the metric used to measure Clearing Member contribution to the SwapClear market risk portion of the Rates Default Fund (still subject to a minimum contribution of GBP10million) from core IM to “Stress Test Loss over Initial Margin” (STLOIM). Switching the metric used for the default fund allocation from core IM to STLOIM will improve consistency by aligning it with the metric used to size the default fund.

The relevant sections of the LCH Rulebook have been updated to this effect.

The rule changes will go live on, or after, 11 March 2019.

Part II: Description of Rule Changes

Subsection 1.28.6 of Procedures Section 2C (“SwapClear Clearing Service”) has been updated to include client positions in the calculation of the non-tolerance weight of an SCM.

Equivalent changes have been made to the FCM Procedures in section 3.8 (“quantifying SwapClear Contributions”) relevant to FCM Clearing Members.

Section S1 of Part A of the Rates Service Default Fund Supplement in the LCH Default Rules has been updated to show that the SwapClear non-tolerance weight is calculated using STLOIM and includes the member and their clients positions. It also notes the clearing house will take into account the portability of the client portfolio to determine the overall uncovered stress loss of the clearing member.

The texts of the rule changes are attached hereto as:

- i. **Appendix I**, Procedures Section 2C (SwapClear)
- ii. **Appendix II**, FCM Procedures
- iii. **Appendix III**, LCH Ltd Default Rules

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.

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

Yours sincerely



Julian Oliver
Chief Compliance Officer
LCH Limited

Appendix I
Procedures Section 2C (SwapClear)



LCH LIMITED

PROCEDURES SECTION 2C

SWAPCLEAR CLEARING SERVICE

Where, following the Default of a SwapClear Clearing Member, the Clearing House is notified of the existence of such a Backup Clearing Member in respect of a SwapClear Clearing Client, the Clearing House is entitled, in accordance with the Client Clearing Annex, to immediately and without notice to any person, send details of the Relevant Contracts and Account Balances to that appointed Backup Clearing Member. The Clearing House shall not require consent from any person in advance of sending these details.

Note: The appointment by a SwapClear Clearing Client of a Backup Clearing Member and the notification of a Backup Clearing Member to the Clearing House does not mean that SwapClear Contracts will always be transferred to that Backup Clearing Member. Porting of SwapClear Contracts, following a SwapClear Clearing Member's Default is always subject to the Clearing House's receipt of consent from the relevant Backup Clearing Member.

1.28.5 *Default Fund: SwapClear Contributions*

SwapClear Contributions (as defined in the Default Rules) will be called via PPS on the fourth working day of each month or more frequently pursuant to a determination of the SwapClear Contribution under ~~S2(p)~~S1 of the [Rates Service Default Rules Fund Supplement – SwapClear](#) (each a "SwapClear Reset Day").

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

Interest on SwapClear Contributions will be paid to SwapClear Clearing Members' PPS accounts on the first working day after the SwapClear 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 SwapClear Reset Day and ends on (and includes) the calendar day immediately before the next SwapClear Reset Day. Notwithstanding the preceding paragraphs, if the rate of interest payable on SwapClear Contributions is negative, interest shall be payable by SwapClear Clearing Members to the Clearing House.

1.28.6 *Quantifying SwapClear Contributions*

For the purposes of calculating the SwapClear ~~Margin~~[Non-Tolerance Weight of an SCM](#) under Rule ~~S2(e)~~S1(f) of the [Rates Service Default Fund Supplement – SwapClear](#), the ~~average daily requirement for initial margin applied to~~[Uncovered Stress Loss \(as defined in Rule S1\(f\)\) of](#) an SCM shall be determined by reference to the SwapClear Contracts ~~comprising entered into (1) on behalf of the SwapClear House Business of that SCM only. Nothing in the foregoing sentence shall prevent the relevant SCM and (2) with respect to the SwapClear Clearing House from introducing changes to the methodology used for calculating the SwapClear Margin Weight and, in particular, the average daily requirement for initial margin applied to an SCM for the purposes~~[Clients and FCM Clients](#) of such ~~calculation may be determined by reference to the~~

~~SwapClear Contracts comprising both the SwapClear House Business and the SwapClear Client Clearing Business of that SCM.~~

1.28.7 *Outsourcing*

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

The following entities are eligible for appointment as an LCH Approved Outsourcing Agent:

- (a) a SwapClear Clearing Member;
- (b) an FCM Clearing Member;
- (c) an FCM Client or SwapClear Clearing Client;
- (d) any other entity that the Clearing House deems appropriate in its sole discretion.

Where an SCM wishes to appoint a third party to carry out any obligation on its behalf, it should contact the Clearing House's Membership Department with the:

- (a) details of the third party entity that the SCM wishes to appoint as an LCH Approved Outsourcing Agent. Such information should include details of the applicant's regulatory status;
- (b) evidence of the existence of a legally binding agreement between the SCM Clearing Member and the third party; and
- (c) such other information that the Clearing House reasonably considers necessary for the purposes of determining whether an entity should be approved as an LCH Approved Outsourcing Agent.

Following the receipt of all of the information above, the Clearing House shall determine in its sole discretion, whether to approve the third party as an LCH Approved Outsourcing Agent. In making its determination, the Clearing House shall consider the third party's ability to demonstrate that it has the necessary operational infrastructure and appropriate asset class expertise.

Where an SCM successfully appoints an LCH Approved Outsourcing Agent, that SCMs may be subject to increased Collateral requirements to cater for the additional time required to invoke an outsourcing process in the event of a default.

SCMs should note that LCH Approved Outsourcing Agents may be subject to a more rigorous driving test and fire-drill than SCMs (i.e. required to

Appendix II
FCM Procedures



FCM PROCEDURES OF THE CLEARING HOUSE

LCH LIMITED

invoice is also issued on the third business day of each month detailing, PAA the interest and accommodation charges applicable for the previous month. Separate invoices are issued for each currency which can be found on the Member Reporting Website.

VAT is charged where relevant, dependent on contract and accommodation charges, at current rates. On foreign currency amounts VAT is charged in sterling on the converted value of any relevant charges. The sterling Collateral account shows separate postings for sterling VAT amounts arising from foreign currency charges.

The net invoice value for each currency is posted to the relevant Collateral account for value on the second working day of the month succeeding the month in which the charges arose.

The invoice provides detail in respect of:

- (a) interest due to be credited or debited;
- (b) PAA; and
- (c) accommodation charges;

VAT on accommodation charges is subject to the standard rate, some markets may be excluded.

3.6 Fees

Details of fees and refunds pending are collated during the month.

An invoice or credit note is produced detailing the fees to be furnished with respect to a Proprietary Account to which Margin is attributed.

The invoice/credit note displays the type of fee, contract, future or options type, currency, fee rate, volume, fee amount, VAT amount, sub totals for each fee class and the overall total Collateral in the relevant account.

Monthly postings are processed via the relevant account to which Collateral is posted at the beginning of the following month, on the third working day. Other postings, such as various Market Maker Scheme rebates, are processed by the Clearing House following receipt of data from the relevant Exchange.

3.7 Default Fund; SwapClear Contributions

SwapClear Contributions (as defined in the Default Rules) will be called via PPS on the fourth working day of each month or more frequently pursuant to a determination of the SwapClear Contribution under Rule ~~S2(4)S1~~ of the Rates Service Default Fund Supplement – SwapClear (each, a “**SwapClear Reset Day**”). SwapClear Contribution requirements will be notified to the applicable FCM Clearing Members at least two working days prior to each SwapClear Reset Day on Member Intranet Report 000032.

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

Interest on SwapClear Contributions will be paid to FCM Clearing Members' PPS accounts on the first working day after the SwapClear 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 SwapClear Reset Day and ends on (and includes) the calendar day immediately before the next SwapClear Reset Day. Notwithstanding anything else herein, if the rate of interest payable on SwapClear Contributions is negative, interest shall be payable by FCM Clearing Members to the Clearing House.

3.8 Quantifying SwapClear Contributions

For the purposes of calculating the SwapClear ~~Margin/Non-Tolerance~~ Weight of an FCM Clearing Member under Rule ~~S2(e)S1(f)~~ of the Rates Service Default Fund Supplement, the ~~average daily requirement for Initial Margin applied to Uncovered Stress Loss (as defined in Rule S1(f)) of~~ an FCM Clearing Member shall be determined by reference to the FCM SwapClear Contracts ~~comprising entered into (1) on behalf of the SwapClear House Business of that FCM Clearing Member only. Nothing in the foregoing sentence shall prevent the Clearing House from introducing changes to the methodology used for calculating the SwapClear Margin Weight and, in particular, with effect from 28 September 2012, the average daily requirement for Initial Margin applied to an~~ relevant FCM Clearing Member ~~for the purposes of such calculation shall be determined by reference and (2) with respect to the FCM SwapClear Contracts comprising both the SwapClear House Business and the SwapClear Clearing Client Business of that~~ Clients of such FCM Clearing Member.

3.9 Default Fund; ForexClear Contributions

ForexClear Contributions (as defined in the Default Rules) 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.

Appendix III
LCH Ltd Default Rules

LCH The Markets'
Partner

**LCH LIMITED
DEFAULT RULES**

PART A

RATES SERVICE DEFAULT FUND SUPPLEMENT – SWAPCLEAR

S1. SwapClear Contributions to the Rates Service Fund

Each SCM's SwapClear Contribution (other than any SwapClear 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 at the close of business on the first business day of each month, and otherwise in accordance with paragraph (n) below (each a "**SwapClear Determination Date**") on the basis of information available as at close of business on the immediately preceding business day and notified to such Member as soon as practicable after such determination in accordance with the Procedures. In addition, the amount payable in respect of the SwapClear Contribution of an SCM which is a New Member will be determined on the date that the relevant New Member joins the SwapClear Service. Notwithstanding the foregoing, following a Default, any determinations on a SwapClear Determination Date and any such SwapClear Determination Date which might otherwise have occurred under this Rule S1 shall be suspended for the duration of the period (the "**SwapClear Default Period**") commencing on the date of such Default and terminating on the later to occur of the following dates:
 - (i) the date which is the close of business on the day falling 30 calendar days after the Rates Service 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 sub-paragraph (i) above (or such period as has already been extended pursuant to this sub-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 Rates Service 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) the "**SwapClear Tolerance Weight**" of an SCM (other than an SCM which is a New Member) shall be calculated by dividing (x) the average SwapClear Tolerance Utilisation of the relevant SCM during the 20 business day period preceding the relevant SwapClear Determination Date in respect of all SwapClear Contracts to which such SCM is a party, which average shall be calculated by adding together the peak SwapClear Tolerance Utilisation of such SCM for each relevant business day and then dividing such sum by 20, **provided** that for SCMs where the peak SwapClear Tolerance Utilisation does not yet exist or is otherwise unavailable in respect of a business day the Clearing House shall estimate the relevant peak SwapClear Tolerance Utilisation by reference to the actual or expected level of clearing activity of the relevant SCM in relation to SwapClear Contracts; by (y) the total of such average SwapClear

Tolerance Utilisations of all Non-Defaulting SCMs other than SCMs which are New Members;

- (c) the value of the "**SwapClear Tolerance Contribution Amount**" of: (x) an SCM (other than an SCM which is a New Member) shall be calculated by multiplying the SwapClear Tolerance Amount by the SCM's SwapClear Tolerance Weight, provided that (i) where that calculation results in a value which is less than or equal to £3 million pounds, or in the case of a New Member, the value of the relevant SCM's SwapClear Tolerance Contribution Amount shall be £3 million pounds; and (ii) where that calculation results in a value which is greater than or equal to £30 million pounds, the value of the relevant SCM's SwapClear Tolerance Contribution Amount shall be £30 million pounds; and (y) a New Member shall be £3 million pounds, **PROVIDED FURTHER** that where, as a result of the adjustments in individual SCM SwapClear Tolerance Contribution Amounts as described in this paragraph, the aggregate of the SwapClear Tolerance Contribution Amounts is greater or less than the SwapClear Tolerance Amount, the Clearing House will adjust SCMs individual SwapClear Tolerance Contribution Amounts such that the aggregate of the SwapClear Tolerance Contributions equals the SwapClear Tolerance Amount;
- (d) the "**SwapClear Non-Tolerance Amount**" shall be the value of that portion of the Rates Service Fund Amount – SwapClear after deducting the SwapClear Tolerance Amount;
- (e) the "**SwapClear Non-Tolerance Weight**" value of the "**SwapClear Non-Tolerance Contribution Amount**" for a given SCM (other than an SCM which that is a New Member) shall be calculated by multiplying the SwapClear Non-Tolerance Amount by the SCM's SwapClear Non-Tolerance Weight;
- (f) the "**SwapClear Non-Tolerance Weight**" of an SCM shall be calculated by dividing (i) the ~~average daily requirement for initial margin (as calculated under the Procedures or other arrangements applicable) which has applied to the SCM~~ Uncovered Stress Loss associated with such SCM's SwapClear Contracts by (ii) the total Uncovered Stress Loss applied to all Non-Defaulting SCMs with respect to their SwapClear Contracts, in each case where the SwapClear Contracts are (A) entered into on the SCM's own behalf or with respect to a SwapClear Clearing Client or an FCM Client and (B) open and outstanding during the 20 business day period preceding the relevant SwapClear Determination Date ~~in respect of all SwapClear Contracts to which such~~. An SCM's "**Uncovered Stress Loss**," as determined in accordance with the foregoing, shall be determined by the Clearing House (and notified to each SCM is a party) from time to time by ~~(ii), inter alia, deducting the total amount of eligible margin held by the Clearing House with respect to the relevant SwapClear Contracts from the stress loss associated with such average daily requirements applied to all Non-Defaulting SCMs SwapClear Contracts,~~ **provided** that the Clearing House may, in determining the Uncovered Stress Loss of an SCM, take into account, *inter alia*, the number of alternative SwapClear Clearing Members that clear SwapClear Contracts with respect to that SCM's SwapClear Clearing Clients or FCM Clients. The provisions of this sub-paragraph (f) shall not apply to New Members and, for the avoidance of

doubt, New Members shall not constitute Non-Defaulting SCMs for the purposes of limb (ii) of this sub-paragraph;

~~(e)(g)~~ the "**SwapClear Contribution**" of: (x) an SCM (other than ~~SCMs which are New Members~~ an SCM that is a New Member) shall be the sum of (i) that SCM's SwapClear Non-Tolerance Contribution Amount adjusted, where applicable, in accordance with paragraph (h) or (m) below; and (ii) that SCM's Tolerance Contribution Amount; and (y) an SCM that is a New Member shall be calculated in accordance with S3;

~~(f)(h)~~ if an SCM's SwapClear Non-Tolerance Contribution Amount (calculated in accordance with paragraph ~~(f)~~ above) is below the Minimum Non-Tolerance SwapClear Contribution for the time being, the SCM's SwapClear Non-Tolerance Contribution Amount shall be adjusted so as to equal the Minimum Non-Tolerance SwapClear Contribution; **provided that** where, as a result of the adjustments in individual SCM SwapClear Non-Tolerance Contribution Amounts as described in this paragraph, the aggregate of the SwapClear Non-Tolerance Contribution Amounts is greater than the SwapClear Non-Tolerance Amount, the Clearing House will adjust individual SwapClear Non-Tolerance Contribution Amounts such that the aggregate of the SwapClear Non-Tolerance Contributions equals the SwapClear Non-Tolerance Amount;

~~(g)~~ the "**SwapClear Contribution**" of: (x) an SCM (other than an SCM which is a New Member) shall be the sum of (i) that SCM's SwapClear Non-Tolerance Contribution Amount adjusted, where applicable, in accordance with paragraph (h) or (m) below; and (ii) that SCM's Tolerance Contribution Amount; and (y) an SCM which is a New Member shall be calculated in accordance with S4;

~~(h)~~ if an SCM's SwapClear Non-Tolerance Contribution Amount (calculated in accordance with paragraph ~~(f)~~ above) is below the Minimum Non-Tolerance SwapClear Contribution for the time being, the SCM's SwapClear Non-Tolerance Contribution Amount shall be adjusted so as to equal the Minimum Non-Tolerance SwapClear Contribution; **provided that** where, as a result of the adjustments in individual SCM SwapClear Non-Tolerance Contribution Amounts as described in this paragraph, the aggregate of the SwapClear Non-Tolerance Contribution Amounts is greater than the SwapClear Non-Tolerance Amount, the Clearing House will adjust individual SwapClear Non-Tolerance Contribution Amounts such that the aggregate of the SwapClear Non-Tolerance Contributions equals the SwapClear Non-Tolerance Amount;

(i) the "**SwapClear Actual Total**" shall be calculated by adding together (i) the amount which is the product of the Minimum Non-Tolerance SwapClear Contribution (as defined in the General Regulations) and the number of Minimum SwapClear Contribution Members; and (ii) the aggregate SwapClear Non-Tolerance Contribution Amounts (calculated in accordance with paragraph ~~(f)~~ above) of those SCMs which are not Minimum SwapClear Contribution Members; (iii) the aggregate SwapClear Tolerance Contribution Amounts of all SCMs other than SCMs which are New Members; and (iv) the aggregate SwapClear Contributions of all SCMs which are New Members;

- (j) where the SwapClear Actual Total is greater than the Rates Service Fund Amount - SwapClear, the "**SwapClear Excess**" shall be the arithmetical difference between the SwapClear Actual Total and the Rates Service Fund Amount - SwapClear;
- (k) [reserved];
- (l) for each SCM other than a Minimum SwapClear Contribution Member or a New Member, the SCM's "**SwapClear Discount**" (if any) shall be such SCM's *pro rata* share of the SwapClear Excess calculated as the proportion of such SCM's SwapClear Non-Tolerance Contribution Amount relative to the aggregate SwapClear Non-Tolerance Contribution Amounts of all SCMs other than Minimum SwapClear Contribution Members and New Members;
- (m) for each SCM other than a Minimum SwapClear Contribution Member or a New Member, the SCM's SwapClear Non-Tolerance Contribution Amount shall be adjusted by the subtraction of any SwapClear Discount applicable to the SCM; **provided that** if the application of any SwapClear Discount would result in a SwapClear Non-Tolerance Contribution Amount of an SCM that is less than the Minimum Non-Tolerance SwapClear Contribution, such SCM shall pay the Minimum Non-Tolerance SwapClear Contribution in respect of the SwapClear Non-Tolerance Contribution Amount applicable to it, notwithstanding that the arithmetical sum of SwapClear Contributions paid by all SCMs may thereby exceed the Rates Service Fund Amount - SwapClear; and
- (n) the Clearing House may recalculate the SwapClear Contributions due from each SCM on any business day if the largest of the 60 Combined Loss Values determined under Rule CS1 on that day differs by more than 25 per cent. from the Combined Loss Value on which the previous SwapClear Contribution determination was based and, on such business day, the Clearing House shall be entitled to require those SCMs whose portfolios have caused the increase in the Combined Loss Value to pay an additional amount in respect of their SwapClear Contributions.

S2. For the purposes of the calculations under Rule CS1:

- (a) references to "SwapClear Clearing Members" or to "SCMs" do not include references to Defaulting SCMs (apart from any Defaulting SCM in respect of which the Clearing House permits the application of Rule CS1) or persons which were formerly SCMs but are not SCMs at the SwapClear 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 pounds, notwithstanding that the arithmetical sum of SwapClear Contributions paid by all SCMs may thereby exceed the SwapClear Fund Cap;
- (c) no account shall be taken, in calculating initial margin or SwapClear Non-Tolerance Weight under Rule S1 of this part A of any offsets applied in calculating initial margin obligations imposed on an SCM in respect of