

VIA CFTC PORTAL

14 June 2019

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

LCH Limited Self-Certification: Amendments to the Rates and ForexClear Default Management Groups

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 related to the composition, role and responsibilities of the:

1. Rates Service Default Management Group; and
2. ForexClear Service Default Management Group (each a "DMG")

Part I: Explanation and Analysis

Each DMG provides advice to the clearing services of LCH at regular intervals to review and provide advice on, *inter alia*, market and liquidity risk and the adequacy of the required margin (including add-ons). It also provides default management advice upon the default of an LCH clearing member.

The role and responsibilities of the DMG can be found in Schedule 2 (Rates Service DMP Annex) and Schedule 3 (ForexClear DMP Annex) of LCH's Default Rules. The proposed changes to the rulebook are intended to (i) provide further clarity and breadth on the roles and responsibilities of DMG participants, (ii) ensure an LCH representative is available to act as chairman of the relevant DMG and (iii) enshrine the members' obligation to participate in LCH fire-drill exercises.

The rule changes will go live on, or after, 01 July 2019.

Part II: Description of Rule Changes

Section 9 (Roles and Constitution of the Rates Service DMG) of Schedule 2 and section 9 (Roles and Constitution of the ForexClear DMG) of Schedule 3 of LCH's Default Rules have been amended to reflect the revised composition, role and responsibility of the DMG. Specifically section 9.1 of each schedule has been updated with the role and responsibilities of the DMG respectively. Section 9.2 of Schedule 2 and Section 9.3 of Schedule 3 highlights the membership of each DMG, including that the Head of Business Risk (or his or her nominee) of the Service shall act as the chairman of the DMG. Section 9.7 of Schedule 2 and Section 9.8 of Schedule 3 has been updated to require minimum attendance by members to the DMG and enshrines the members' obligation to participate in LCH fire-drill exercises.

The texts of the rule changes are attached hereto as:

- i. **Appendix I**, LCH Limited Default Rules

Part III: Core Principle Compliance

LCH reviewed the changes against the requirements of the Core Principles and found it 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 changes.

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
LCH Limited Default Rules

LCH The Markets'
Partner

LCH LIMITED
DEFAULT RULES

Clearing House may not take any such action that effects a material change to the terms of this Annex without the written consent of 50 percent of all SCMs and 50 percent of all Listed Interest Rates Clearing Members unless such change is invoked unilaterally against all SCMs and Listed Interest Rates Clearing Members and is necessary to manage the Clearing House's risk or otherwise to meet the Clearing House's continuing regulatory obligations including those applicable to it as a Recognised Clearing House and a Derivatives Clearing Organization. The Clearing House agrees that, in the ordinary course, it shall discuss any such Guidance with the Rates Service DMG prior to bringing the Guidance into effect except that it shall not be required to do so where (i) the Guidance is not material to the rights and obligations of the SCMs and the Listed Interest Rates Clearing Members; or (ii) the Clearing House deems it inappropriate to do so in the circumstances of the Default and it is not possible to convene the Rates Service DMG in timely fashion.

- 8.3 The timetable for implementation of the stages of the Rates Service Default Management Process following issue of a Default Notice by the Clearing House shall be either (i) as prescribed by the Clearing House from time to time in consultation with the Rates Service DMG and set out in the Guidance; or (ii) imposed by the Clearing House without prior notice to the SCMs on a case-by-case basis where the Clearing House, in consultation with the Rates Service DMG, deems it appropriate to do so in the circumstances of the Default.

9. Role and Constitution of Rates Service DMG

- 9.1 The Rates Service DMG shall meet at regular intervals in order to:

- (a) review the market risk of SCMs and Clearing Clients to ensure risk profiles and margin coverage are compatible with default management principles;
- (b) review market liquidity and associated margin add-ons to ensure risk concentrations and positions are adequately covered;
- (c) provide advice on valuation and margin techniques and models;
- (d) review market developments and changes in trading instruments and practices;
- (e) review new product proposals and existing product extensions, particularly focusing on pricing and margin computation and surrounding liquidity and market issues;
- ~~(a)~~(f) keep under review the Rates Service DMP, including the terms of reference thereof, together with any Guidance issued in respect thereof, to ensure that appropriate systems, reports and resources are available to manage an SCM default, and consider appropriate supplements or amendments to the Rates Service DMP and/or Guidance in order to improve the procedures in place;
- ~~(b)~~(g) review hedging strategies, auction processes, including portfolio splitting and loss allocation, and timescales for hedge and auction processes; and keep under review the terms of reference of the Rates Service DMG to ensure they remain appropriate;

~~(e) consider appropriate supplements or amendments to the Rates Service DMP and/or Guidance in order to improve the procedures in place; and~~

~~(d)~~(h) consider any other business relevant to the Rates Service DMP which any member of the Rates Service DMG from time to time sees fit to raise at such meetings.

The members of the Rates Service DMG shall also meet within one hour, or as soon as reasonably practicable, following notification by the Clearing House that a Default Notice has been served upon an SCM, and at sufficiently frequent intervals thereafter for so long as may be necessary to assist the Clearing House in the implementation of the Rates Service DMP as contemplated under the Rulebook. Such implementation shall include, without limitation, the provision of general default management advice with regard to: (i) the ongoing obligations of the Clearing House to its non-defaulting members; (ii) the neutralisation and closing-out of the individual obligations of the Defaulting SCM and any relevant Clearing Clients; (iii) execution of hedging strategy, the management of short term risk and likely market movement resulting from the given Default, including resulting from execution of hedging strategy; (iv) determination of Clearing Client portability (as applicable); and; ~~and (iiiiv)~~ the splitting of Portfolios and the disposal of OTC Auction Portfolios in accordance with the Rates Service DMP. Where it is not possible or practicable for the SCM to provide its nominated representative within an appropriate timeframe, it shall provide an alternate of suitable experience and expertise to participate on the Rates Service DMG.

9.2 The Rates Service DMG shall be made up of the following individuals who, unless stated otherwise, shall be appointed by the Clearing House which shall ensure that the composition is such as to provide effective review of the Rates Service DMP and suitable expertise and representation of market-making capacity in the event of a Default:

- (a) in the event of the issuance of a Default Notice, ~~the chief executive or deputy chief executive~~the Head of Business Risk of the ~~Clearing House~~Rates Service (or his or her nominee), who shall act as chairman;
- (b) representatives of at least five SCMs, being senior executives with appropriate skills and expertise to cover all products cleared in the Rates Service;
- (c) at least one director (staff member of director grade) of the Clearing House's or Rates Service's Risk Management department; and

such other individuals as the Rates Service DMG considers appropriate from time to time in relation to individual meetings.

In the event the Rates Service DMG is unable to convene with the full set of individuals set forth above due to extreme or improbable circumstances, upon approval from the Chief Executive Officer of the Clearing House or their delegate, the Rates Service DMG may be constituted with a subset of the above described individuals.

- 9.3 For the purpose of Rates Service DMG meetings convened to deal with a specific Defaulting SCM, the Clearing House may, after consultation with the Rates Service DMG, invite the Defaulting SCM to nominate one or more representatives to join the Rates Service DMG to assist it in carrying out its functions in the Rates Service DMP for that Defaulting SCM, and ~~also to~~ request representatives from any other SCMs. In the event of receiving such request, the SCM shall be obliged to provide its nominated representative, or an alternate with appropriate skills, experience and expertise, as if the SCM were a member of the Rates Service DMG.
- 9.4 In establishing the Rates Service DMG, the Clearing House agrees that in the normal course of events (not including the Clearing House's declaration of a Default and the invocation of the processes as outlined in Rules ~~0-2~~ and 4 of this Annex) it will, as far as practicable, ~~and in accordance with the terms of reference of the Rates Service DMG, rotate the membership of the Rates Service DMG on a regular basis and amongst all SCMs~~ review the membership of the Rates service DMG on a regular basis and may rotate membership of the Rates Service DMG amongst all SCMs. The SCM agrees that, when requested to do so by the Clearing House, it will make available a representative to participate in the Rates Service DMG. The Clearing House shall agree with the SCM the identity of such representative and shall ~~be able~~ have the right to request a substitute where it believes the SCM's nominated representative does not have the requisite skills or expertise.
- 9.5 Each SCM who makes available a representative to serve on the Rates Service DMG agrees, and shall procure that, to the extent applicable, its representative agrees:
- (a) to ensure that such representative will be fully available, at any time and for such periods of time as the Clearing House may require during the course of a Default, to perform their function as a member of the Rates Service DMG including attending meetings, and considering and advising the Clearing House upon aspects of the Rates Service DMP. The SCM shall ensure that ~~a~~ the representative's other work commitments do not affect their availability for this purpose;
 - ~~(b)~~ (b) to ensure that such representative meets the applicable requirements set forth in the terms of reference for the Rates Service DMG;
 - ~~(b)(c)~~ (c) to take all steps to respect the confidential capacity in which such ~~a~~ representative receives information through the Rates Service DMG and to establish adequate procedures to prevent the disclosure or use for any commercial purpose outside the scope of the Rates Service DMP of any such confidential information by the SCM or its representative. Such procedures shall normally include, without limitation, the establishment of ~~Chinese walls~~ information barriers within the SCM; ~~and~~
 - ~~(d)~~ (d) to be bound by and to ensure that it and any of its executives or directors serving on the Rates Service DMG complies with the requirements contained in the Procedures or the FCM Procedures (as the case may be); and
 - ~~(e)~~ (e) in the event the representative is unable to fulfil the requirements set forth in this Rule 9.5 and the terms of reference for the Rates Service DMG, including where there is a change of circumstance of the representative such that there is

an impact to the representative's ability to fulfil his or her role on the Rates Service DMG, the SCM shall immediately notify the Clearing House:-

9.6 Each SCM shall accept that:

- (a) representatives of SCMs serving on the Rates Service DMG are doing so in order to assist the Clearing House in ensuring the on-going integrity of the ~~SwapClear service~~Rates Service in the interests of Non-Defaulting SCMs; and
- (b) representatives of SCMs serving on the Rates Service DMG and their employers shall have no liability for any disinterested advice or actions, mandated or otherwise, that are undertaken as part of the Rates Service Default Management Process, **provided, however, that** nothing in this Rule 9.6(b) shall exclude the liability of such representatives and employers for any personal injury or death caused by their negligence or for any fraud or wilful default on the part of such representatives and employers.

9.7 SCMs are required to attend at least four (4) of the six (6) Rates Service DMG bi-monthly meetings and both fire-drill exercises, where required. In the event an SCM does not comply with the foregoing attendance requirements, the Clearing House reserves the right to replace any member of the Rates Service DMG.

9.79.8 The Clearing House agrees that, in exercising its rights and obligations in consulting with the Rates Service DMG pursuant to this Agreement, it will use all reasonable commercial endeavours to agree a common position with the Rates Service DMG, **provided that** nothing in this Rule shall prevent the Clearing House acting in a way which it reasonably determines necessary to manage its risk or otherwise meet its continuing regulatory obligations including those applicable to it as a Recognised Clearing House and a Derivatives Clearing Organization.

8. **Miscellaneous**

8.1 Subject to Rules 2.4 and 2.5 of this Annex, the resources available to the Clearing House and their order of use are defined in Rule 15 of the Default Rules as modified and/or supplemented by the ForexClear Default Fund Supplement.

- (a) The Clearing House may from time to time supplement the details of any of the stages set out in Rule 2 of this Annex or any other aspects of the ForexClear DMP, in consultation with the ForexClear DMG, either by way of further Guidance; or
- (b) immediately on notice to FXCCMs on a case-by-case basis where the Clearing House deems it appropriate to do so in the circumstances of the Default, **provided that** the Clearing House may not take any such action that effects a material change to the terms of this Annex without the written consent of 50 percent. of all ForexClear Clearing Members unless such change is invoked unilaterally against all FXCCMs and is necessary to manage the Clearing House's risk or otherwise to meet the Clearing House's continuing regulatory obligations including those applicable to it as a Recognised Clearing House and a Derivatives Clearing Organization.
- (c) The Clearing House agrees that, in the ordinary course, it shall discuss any such Guidance with the ForexClear DMG prior to bringing the Guidance into effect except that it shall not be required to do so where (i) the Guidance is not material to the rights and obligations of the FXCCMs or (ii) the Clearing House deems it inappropriate to do so in the circumstances of the Default and it is not possible to convene the ForexClear DMG in timely fashion.

8.2 The timetable for implementation of the stages of the ForexClear Default Management Process following issue of a Default Notice by the Clearing House shall be either (1) as prescribed by the Clearing House from time to time in consultation with the ForexClear DMG and set out in Guidance; or (2) imposed by the Clearing House without prior notice to the FXCCMs on a case-by-case basis where the Clearing House, in consultation with the ForexClear DMG, deems it appropriate to do so in the circumstances of the Default.

9. **Role and constitution of ForexClear DMG**

9.1 The ForexClear DMG shall meet at regular intervals in order to:

- (a) review the market risk of FXCCMs and Clearing Clients to ensure risk profiles and margin coverage are compatible with default management principles;
- (b) review market liquidity and associated margin add-ons to ensure risk concentrations and positions are adequately covered;
- (c) provide advice on valuation and margin techniques and models;
- (d) review market developments and changes in trading instruments and practices;

- (e) review new product proposals and existing product extensions, particularly focusing on pricing and margin computation and surrounding liquidity and market issues;
- ~~(a)(f)~~ keep under review the ForexClear DMP, including the terms of reference thereof, to ensure appropriate systems, reports and resources are available to manage an FXCCM default, and consider appropriate supplements or amendments to the ForexClear DMP and/or Guidance in order to improve the procedures in placetogether with any Guidance issued in respect thereof;
- ~~(b)~~ review hedging strategies, auction processes, including portfolio splitting and loss allocation, and timescales for hedge and auction processes; andkeep under review the terms of reference of the ForexClear DMG to ensure they remain appropriate;
- ~~(e)(g)~~ consider appropriate supplements or amendments to the ForexClear DMP and/or Guidance in order to improve the procedures in place; and
- ~~(d)(h)~~ consider any other business relevant to the ForexClear DMP which any member of the ForexClear DMG from time to time sees fit to raise at such meetings.

9.2 The members of the ForexClear DMG shall also meet within one hour, or as soon as reasonably practicable, following notification by the Clearing House that a Default Notice has been served upon an FXCCM, and at sufficiently frequent intervals thereafter for so long as may be necessary to assist the Clearing House in the implementation of the ForexClear DMP as contemplated under this Rulebook. Such implementation shall include, without limitation, the provision of general default management advice with regard to: (1) the ongoing obligations of the Clearing House to its non-defaulting members; (2) the neutralisation and closing-out of the individual obligations of the Defaulting FXCCM and any relevant Clearing Clients; (3) execution of hedging strategy, the management of short term risk and likely market movement resulting from the given Default, including resulting from execution of hedging strategy; (4) determination of Clearing Client portability (as applicable); and ~~and~~ (35) the splitting of Portfolios and the disposal of Auction Portfolios in accordance with the ForexClear DMP. Where it is not possible or practicable for the FXCCM to provide its nominated representative within an appropriate timeframe, it shall provide an alternate of suitable experience and expertise to participate on the ForexClear DMG.

9.3 The ForexClear DMG shall be made up of the following individuals who, unless stated otherwise, shall be appointed by the Clearing House which shall ensure that the composition is such as to provide effective review of the ForexClear DMP and suitable expertise and representation of market-making capacity in the event of a Default:

- (a) in the event of the issuance of a Default Notice, the ~~chief executive or deputy chief executive of the Clearing House~~ Head of Business Risk of the ForexClear Service (or his or her nominee), who shall act as chairman;

- (b) at least six representatives of at least four FXCCMs, being senior executives with appropriate skills and expertise to cover all products cleared in the ForexClear Service;
- (c) at least one director (staff member of director grade) of the Clearing House's or ForexClear Service's Risk Management department; and

such other individuals as the ForexClear DMG considers appropriate from time to time in relation to individual meetings.

In the event the ForexClear DMG is unable to convene with the full set of individuals set forth above due to extreme or improbable circumstances, upon approval from the Chief Executive Officer of the Clearing House, or his or her nominee, the ForexClear DMG may be constituted with a subset of the above described individuals.

- 9.4 For the purpose of ForexClear DMG meetings convened to deal with a specific Defaulting FXCCM, the Clearing House may, after consultation with the ForexClear DMG, invite the Defaulting FXCCM to nominate one or more representatives to join the ForexClear DMG to assist it in carrying out its functions in the ForexClear Default Management Process for that Defaulting FXCCM, and ~~also~~ request representatives from any other FXCCMs. In the event of receiving such request, the FXCCM shall be obliged to provide its nominated representative, or an alternate with appropriate skills, experience and expertise, as if the FXCCM were a member of the ForexClear DMG.
- 9.5 In establishing the ForexClear DMG, the Clearing House agrees that in the normal course of events (not including the Clearing House's declaration of a Default and the invocation of the processes as outlined in Rules 2, 3 and 4 of this Annex) it will, as far as practicable, ~~and in accordance with the terms of reference of the ForexClear DMG, rotate~~ review the membership of the ForexClear DMG on a regular basis and may rotate membership of the ForexClear DMG amongst all FXCCMs. The FXCCM agrees that, when requested to do so by the Clearing House, it will make available a representative to participate in the ForexClear DMG. The Clearing House shall agree with the FXCCM the identity of such representative and shall ~~be able~~ have the right to request a substitute where it believes the FXCCM's nominated representative does not have the requisite skills or expertise.
- 9.6 Each FXCCM who makes available a representative to serve on the ForexClear DMG agrees, and shall procure that, to the extent applicable, its representative agrees:
- (a) to ensure that such representative will be fully available, at any time and for such periods of time as the Clearing House may require during the course of a Default, to perform their function as a member of the ForexClear DMG including attending meetings, and considering and advising the Clearing House upon aspects of the ForexClear DMP. The FXCCM shall ensure that ~~a~~ the representative's other work commitments do not affect their availability for this purpose;
 - (b) to ensure that such representative meets the applicable requirements set forth in the terms of reference for the ForexClear DMG;

~~(b)~~(c) to take all steps to respect the confidential capacity in which such a representative receives information through the ForexClear DMG and to establish adequate procedures to prevent the disclosure or use for any commercial purpose outside the scope of the ForexClear DMP of any such confidential information by the FXCCM or its representative. Such procedures shall normally include, without limitation, the establishment of **Chinese walls**information barriers within the FXCCM; ~~and~~

(d) to be bound by and to ensure that it and any of its executives or directors serving on the ForexClear DMG complies with the requirements contained in the Procedures or the FCM Procedures (as the case may be); ~~and~~

~~(e)~~(e) in the event the representative is unable to fulfil the requirements set forth in this Rule 9.6 and the terms of reference for the ForexClear DMG, including where there is a change of circumstance of the representative such that there is an impact to the representative's ability to fulfil his or her role on the ForexClear, the FXCCM shall immediately notify the Clearing House.

9.7 Each FXCCM shall accept that:

- (a) representatives of FXCCMs serving on the ForexClear DMG are doing so in order to assist the Clearing House in ensuring the on-going integrity of the ForexClear Service in the interests of Non-Defaulting FXCCMs; and
- (b) representatives of FXCCMs serving on the ForexClear DMG and their employers shall have no liability for any disinterested advice or actions, mandated or otherwise, that are undertaken as part of the ForexClear Default Management Process, **provided, however, that** nothing in this Rule 9.7(b) shall exclude the liability of such representatives and employers for any personal injury or death caused by their negligence or for any fraud or wilful default on the part of such representatives and employers.

9.8 FXCCMs are required to attend at least three (3) of the four (4) ForexClear DMG quarterly meetings and the annual fire-drill exercise held each calendar year. In the event an FXCCM does not comply with the foregoing attendance requirements, the Clearing House reserves the right to replace any member of the ForexClear DMG.

9.89.9 The Clearing House agrees that, in exercising its rights and obligations in consulting with the ForexClear DMG pursuant to this Agreement, it will use all reasonable commercial endeavours to agree a common position with the ForexClear DMG, **provided that** nothing in this Rule shall prevent the Clearing House acting in a way which it reasonably determines necessary to manage its risk or otherwise meet its continuing regulatory obligations including those applicable to it as a Recognised Clearing House and a Derivatives Clearing Organization.