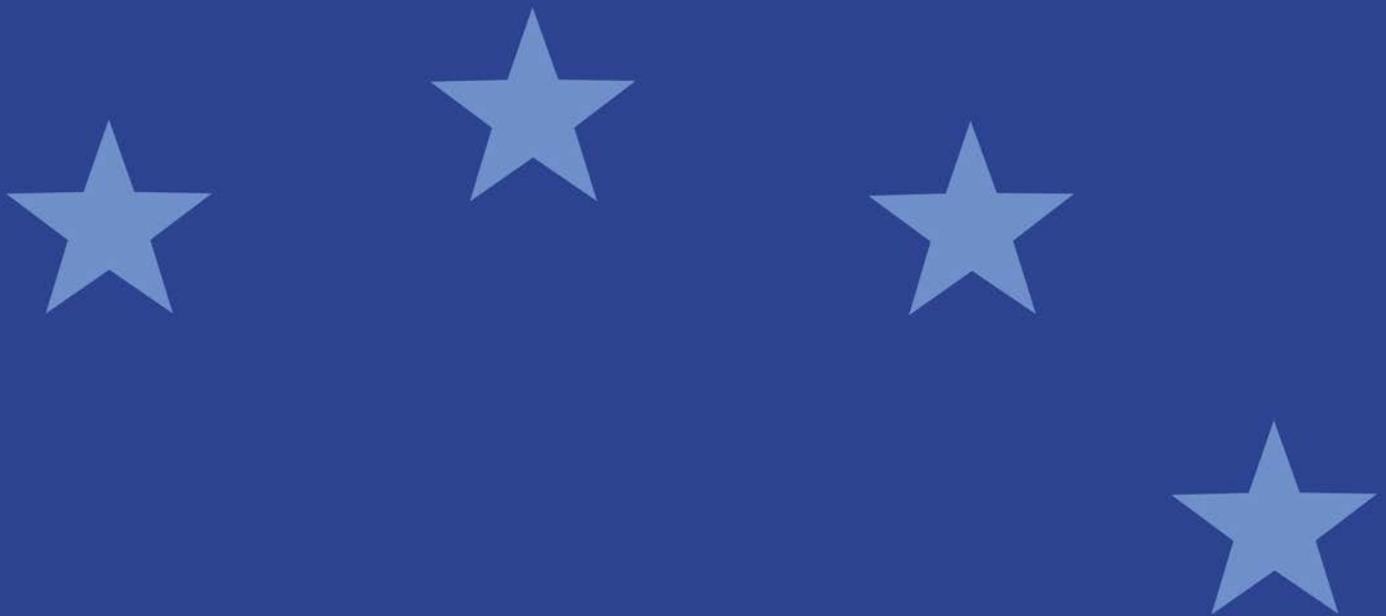




European Securities and
Markets Authority

Reply form for the Consultation Paper On the Clearing Obligation under EMIR (no. 3)



Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper - Clearing Obligation under EMIR (no. 3), published on the ESMA website.

Responses are most helpful:

- i. if they respond to the question stated;
- ii. contain a clear rationale, including on any related costs and benefits; and
- iii. describe any alternatives that ESMA should consider

To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007.

Responses must reach us by **6 November 2014**.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.

Instructions

Please note that, in order to facilitate the analysis of the responses, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

- i. use this form and send your responses in Word format;
- ii. do not remove the tags of type < ESMA_CA3_QUESTION_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- iii. if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading ‘Disclaimer’.



General information about respondent

Are you representing an association?	No
Activity:	Central Counterparty
Country/Region	Europe



Introduction

Please make your introductory comments below:

<ESMA_CO3_COMMENT_1>

LCH.Clearnet Group

The LCH.Clearnet Group is the leading multi-asset class and multi-national clearinghouse, serving major international exchanges and platforms as well as a range of OTC markets. It clears a broad range of asset classes including securities, exchange-traded derivatives, commodities, energy, freight, foreign exchange derivatives, interest rate swaps, credit default swaps, and euro and sterling denominated bonds and repos.

The LCH.Clearnet Group consists of three operating subsidiaries: LCH Clearnet Ltd, LCH.Clearnet SA and LCH.Clearnet LLC.

- LCH.Clearnet Ltd is authorised by the Bank of England as a central counterparty to offer services and activities in the Union in accordance with the European Markets Infrastructure Regulation (EMIR). It is registered as a Derivatives Clearing Organization (DCO) with the Commodity Futures Trading Commission (CFTC) in the USA. It is also licenced/recognised by the Ontario Securities Commission, the Autorité des Marchés Financiers of Québec and the Australian Securities & Investments Commission.
- LCH.Clearnet SA is authorised by the French Authorities (L'Autorité des Marchés Financiers, l'Autorité de Contrôle Prudentiel et de Résolution and Banque de France) as a central counterparty to offer services and activities in the Union in accordance with EMIR. It is also regulated as a Credit Institution by the French Authorities and registered as a DCO with the CFTC.
- LCH.Clearnet LLC is registered as a DCO with the CFTC and permitted to clear for Ontario-based clearing members pursuant to Ontario Securities Commission Order granting exemption from Clearing Agency License. It has applied for recognition under EMIR as a third-country CCP.

Overall Comments

LCH.Clearnet supports the clearing obligation for NDFs and the approach taken by ESMA in assessing the class which is subject to this obligation. We agree that the analysis conducted by ESMA is of sufficient depth and accuracy and therefore believe the clearing obligation will address a significant majority of systemic risk which is associated with the NDF class.

LCH.Clearnet believes that the similarity between the Prime Broker and CCP models, the former having been in operation for over a decade, will make the transition to clearing a simple one for most market participants. Additionally, LCH.Clearnet sees CCP models bringing further benefits to the industry as a whole, specifically:

- I. During price disruption events the CCP adheres to existing Emerging Markets Trade Association (EMTA) standards but thereafter may act as the calculation agent and determine the settlement rate as articulated in the CCP rulebook. In support of this LCH.Clearnet is in discussion with EMTA to be a provider of the fallback rate.
- II. When the local NDF authorities announce additional holidays unexpectedly, the ForexClear service applies the Automated Date Adjustment (ADA) mechanism ensuring that trades of all members and their clients are amended to valid dates seamlessly, thereby reducing the operational risk that exists in the current bilateral management of these events.

LCH.Clearnet welcomes the opportunity to provide feedback regarding the categorisation of counterparties in respect to NDFs and looks forward to seeing the progression of this subject.

<ESMA_CO3_COMMENT_1>



1. The clearing obligation procedure

Q1: Do you have any comment on the clearing obligation procedure described in Section 1?

<ESMA_CO3_QUESTION_1>

We fully support the procedure as described in Section 1. LCH.Clearnet's authorisation under EMIR in June this year triggered the bottom-up approach which resulted in this consultation paper. Further, we note ESMA's statement that additional European CCPs, as well as third-country CCPs, are considering expanding their offering to include the NDF class. This suggests the number of CCPs clearing this class is expected to increase in the near future, fostering competition. <ESMA_CO3_QUESTION_1>



2. Structure of the non-deliverable forward derivatives classes

Q2: Do you consider that the proposed structure for the FX NDF classes enables counterparties to identify which contracts are subject to the clearing obligation?

<ESMA_CO3_QUESTION_2>

LCH.Clearnet believes the proposed structure of five characteristics enables participants to easily identify which contracts are subject to the clearing obligation. We further support the compatibility of ESMA's proposal with the taxonomy defined by the GFMA Global FX Division.

LCH.Clearnet observes that the term "cash settled forwards" has become accepted market usage for those cash settled products in currencies that have no restrictions imposed by the local central bank and can be physically settled, but for which the user elects to have financial settlement, for example GBP/USD, EUR/USD and USD/JPY. The term NDF, whilst having the underlying feature of cash settlement, is used to refer to the product used for currencies, as listed in table 2 of the consultation paper, on which there are such restrictions.

LCH.Clearnet would like to add that the definition in paragraph 14 could be enhanced by referring to "the official fixing rate, as listed in the EMTA template for that currency" instead of "the spot market exchange rate" (see reference to fixing price in paragraph 34).

<ESMA_CO3_QUESTION_2>



3. Determination of the classes of OTC derivatives to be subject to the clearing obligation

Q3: In view of the criteria set in Article 5(4) of EMIR, do you consider that the determination of this class addresses appropriately the objective of reduction of the systemic risk associated to NDF derivatives?

<ESMA_CO3_QUESTION_3>

In light of the criteria set out in Article 5(4) of EMIR, (degree of standardisation, liquidity and availability of pricing information), LCH.Clearnet supports the analysis laid out in the paper which logically leads to the definition of the class and agrees that the obligation to clear this class would reduce a significant portion of systemic risk associated with NDFs.

As noted by ESMA in the consultation, the NDF market has experienced strong growth in the past five years. Outstanding notional and trading volumes in this class of derivative, measured in absolute terms, are significant and represent a substantial quantum of uncleared systemic risk.

We believe it is important to stress that LCH.Clearnet's ForexClear service not only allows bilaterally traded FX NDF contracts to be cleared on identical terms to those defined by the EMTA, but also uses real-time price data sourced directly from market participants to ensure accurate and up-to-date pricing.

LCH.Clearnet would welcome further clarification of the definition of maturity, particularly with regards to the 2 year tenor and the corresponding final settlement date that is covered by the clearing obligation. LCH.Clearnet's ForexClear service measures the 2 year maximum tenor as the settlement date falling two calendar years plus two business days immediately following the Submission Date.

<ESMA_CO3_QUESTION_3>

Q4: For the currency pairs proposed for the clearing obligation on the NDF class, do you consider there are risks to include longer maturities, up to the 2 year tenor?

<ESMA_CO3_QUESTION_4>

LCH.Clearnet is supportive of the 11 currency pairs selected for the clearing obligation and notes that preceding the publication of this consultation paper, the ForexClear service added a twelfth currency pair, USD/PEN.

LCH.Clearnet recognises that volumes in NDF contracts are significantly lower in tenors greater than 2 years and agrees that contracts with longer maturities do carry additional risks; however this should not imply that longer tenors be excluded from the clearing obligation unless such contracts do not meet the criteria as described in section 3.2 of this consultation paper.

Prior to launching the ForexClear service, LCH.Clearnet consulted with market participants on the design of the service including tenors up to 5 years. The risk and liquidity analysis carried out by LCH.Clearnet in order to gain internal and Regulatory approvals positively supported the inclusion of all tenors up to and including 2 years as the most effective risk management coverage for the product. The 2 year tenor meets LCH.Clearnet's risk management principles and fits within the ForexClear risk model.

<ESMA_CO3_QUESTION_4>



4. Determination of the dates on which the obligation applies and the categories of counterparties

Q5: Do you have any comment on the analysis presented in Section Error! Reference source not found.?

<ESMA_CO3_QUESTION_5>

LCH.Clearnet agrees that the analysis presented here is appropriate and we support the conclusion that the number of CCPs and the number of clearing members is sufficient to support the clearing obligation in its current form.

We think it is important to note that from a market access, default management and service usage perspective whilst cleared volumes remain low in respect to the potential size of the market, LCH.Clearnet's ForexClear service now has 21 clearing members of which 4 are able to offer client clearing. The reference in paragraph 100 of the paper is therefore out of date

<ESMA_CO3_QUESTION_5>

Q6: Do you agree with the proposal to keep the same definition of the categories of counterparties for the NDF classes than for the credit and the interest rate classes? Please explain why and possible alternatives.

<ESMA_CO3_QUESTION_6>

LCH.Clearnet recognises that either Option 1 (classification of members per asset class) or Option 2 (cumulative classification of clearing members) may present challenges for market participants, however we would like to stress that LCH.Clearnet's ForexClear service is capable of accommodating either model.

Whilst a classification of members per asset class (Option 1) may limit the number of participants subject to the mandate in the first phase, it is still likely to address a significant proportion of the systemic risk in the market place, as would the cumulative classification; as stated in paragraph 101 of the consultation paper, members of our ForexClear service account for a significant portion of the traded volume and usually are the most relevant liquidity providers.

We also agree that the cumulative model (Option 2) helps to impose standardisation and clarity for market participants. However, it should be noted that being a significant participant in IRS and CDS classes should not imply having the necessary infrastructure or processes in place to clear FX. More specifically, the industry is prepared for clearing IRS and CDS classes due to the presence of a mandate under the US Dodd-Frank Act, which is currently not the case for NDFs.

One alternative option would be to pursue a hybrid model for NDFs whereby, Category 1 would include clearing members of NDFs, in addition to capturing participants of other classes who have significant NDFs volumes, for example greater than EUR 8 Billion average notional for the last three months preceding the entry into force of the RTS. We believe that this approach might address concerns that Category 1 is not sufficient to reduce systemic risk at a reasonable pace, in addition to ensuring that only those members with significant NDFs business are included. On the other hand, this option could provide less clarity to market participants on the process to categorise a counterparty, which in turn could impact a smooth implementation of the clearing mandate for NDFs.

Irrespective of which category definition is pursued, LCH.Clearnet would welcome ESMA's further consideration in establishing a mechanism whereby the categorisation of counterparties is communicated accurately across the market. For example, under the Dodd-Frank Act the CFTC maintains a list of both Swap Dealers and Major Swap Participants on its website. We encourage ESMA to follow a similar approach.

LCH.Clearnet strongly believes that the phase-in periods should not be extended further than what it is proposed in the consultation, as this could lead to bifurcation within the NDF market place.

<ESMA_CO3_QUESTION_6>



Q7: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

<ESMA_CO3_QUESTION_7>

LCH.Clearnet is fully ready to support clearing for the four categories outlined in the consultation, whether that be under the currently proposed dates of application or any amended dates of application. We particularly support ESMA's decision to shorten the phase-in period for Category 4 participants in light of the elapsed time between the interest rates RTS and this consultation paper.

LCH.Clearnet believes that due to the short nature of NDFs in comparison to other classes, (i.e. IRS), and consequently the lower frontloading requirements, a more accelerated phase-in period between counterparties, compared to that proposed by ESMA, could be achieved without causing disruption for market participants. Further, a shorter phase in period would deliver a harmonised approach to what is a truly global asset class and help address the systemic risk present within the NDF class at a swifter pace.

<ESMA_CO3_QUESTION_7>



5. Remaining maturity and frontloading

Q8: Do you have comments on the minimum remaining maturities for NDF?

<ESMA_CO3_QUESTION_8>

LCH.Clearnet supports ESMA's proposal to address the systemic risk still present in this class at the point the clearing obligation takes effect. We are also supportive of ESMA's approach in reducing the minimum remaining maturity for this class to 3 months as it recognises the short-dated nature of NDFs, compared to other classes.

<ESMA_CO3_QUESTION_8>



Annex I - Draft Regulatory Technical Standards on the Clearing Obligation

Q9: Please indicate your comments on the draft RTS other than those already made in the previous questions.

<ESMA_CO3_QUESTION_9>

LCH.Clearnet added Peruvian Nuevo Sol to its ForexClear service in September 2014. We are therefore particularly interested in a clarification by ESMA around the process of further additions to a class subject to a mandate.

LCH.Clearnet supports ESMA's intention, as noted in the final report on the RTS for IRS, to define an efficient and flexible process for the establishment and removal of a specific class from the clearing obligation. We also expect this to be reflected in the final report on the RTS for NDFs.

We would also welcome a clarification to the triggers and procedures for reviewing a decision not to impose a clearing obligation on a class or sub-class of OTC derivatives. <ESMA_CO3_QUESTION_9>



Annex II – Impact assessment

Q10: Please indicate your comments on the Impact Assessment.

<ESMA_CO3_QUESTION_10>

We believe that of key consideration for market participants will be the final decision on the approach to define the categories of counterparties. Our analysis demonstrates that Option 2 (cumulative approach) could potentially require about 70-80 firms to onboard as members of an authorised CCP offering an FX NDF clearing service.

<ESMA_CO3_QUESTION_10>