LCH.CLEARNET

Swiss Financial Market Supervisory Authority FINMA
Attn: Noël Bieri
Laupenstrasse 27
CH-3003 Bern

2 October 2015

Dear Sirs,

This paper provides the response of the LCH.Clearnet Group ("LCH.Clearnet") to the Federal Council's consultation on the FMI Ordinance ("FMIO").

LCH.Clearnet is the leading multi-asset class and multi-national clearing house 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, interest rate swaps, credit default swaps, foreign exchange derivatives and euro, sterling and US dollar denominated bonds and repos. LCH.Clearnet works closely with market participants and exchanges to continually identify and develop innovative clearing services for new asset classes.[1]

LCH.Clearnet is majority owned by the London Stock Exchange Group ("LSEG"), a diversified international exchange group that sits at the heart of the world's financial community.

General comments

LCH.Clearnet Limited, the UK entity of LCH.Clearnet, currently offers clearing services for the SIX Swiss Exchange and interoperates with Six x-clear. It is recognised by FINMA under Article 10 of the Federal Act on Stock Exchanges and Securities Trading (SESTA) and Article 53 of the Implementing Ordinance on Stock Exchanges and Securities Trading (SESTO). In addition, LCH.Clearnet Limited has been determined systemically important for the stability of the Swiss financial market by the Swiss National Bank (SNB). FINMA and SNB have entered into a Memorandum of Understanding of Cooperation and Coordination for the Supervision of Oversight of LCH.Clearnet Limited with the Financial Services Authority (now Financial Conduct Authority) and the Bank of England (BoE) and rely on the ongoing supervision by the BoE of LCH.Clearnet Limited.

[1] The Group consists of three operating subsidiaries: LCH.Clearnet Limited, LCH.Clearnet LLC and LCH.Clearnet SA. The details on the Group structure is available at: http://www.lchclearnet.com/about-us/company-structure

Following the adoption of the Financial Market Infrastructure Act ("Act") in June 2015, we appreciate the opportunity to provide comment on the secondary legislation of the Act. In summary our response makes the following points:

- We support the approach of the Swiss authorities to ensure consistency with the CPMI/IOSCO Principals for Financial Market Infrastructures as well as with the relevant European (EMIR) and US (Dodd Frank) regimes to the extent possible.
- We believe that systemically important CCPs domiciled in a jurisdiction which is deemed to be equivalent by the Swiss authorities and which has been recognised by FINMA should be permitted to meet the requirement under Article 24 of the Act by preparing a recovery plan and provide the necessary information for the resolution plan to the satisfaction of its home competent authority.
- LCH.Clearnet believes that the Swiss authorities should adopt a "principal to principal" reporting model; this would ensure that the reporting requirement under Swiss law aligns with EMIR and therefore reflects accurately the separate nature of the clearing obligations between CCP and clearing member and the clearing member and their client.
- In order to limit duplication of reporting requirements we would also strongly encourage substituted compliance to be accepted. Where substantially the same information for Swiss entities is reported under another regime, that is deemed equivalent and appropriate, then third country CCPs should not have to duplicate the reporting.

Recognition process of foreign CCPs and scope of exemption

The Act introduces specific requirements for CCPs broadly in line with EMIR. It also includes a process for the recognition of foreign CCPs that are established in jurisdictions whose legal and supervisory regime are deemed appropriate (Article 60 (2)). We note that the Act envisages a mutual recognition approach, whereby Swiss central counterparties should also be granted access to the relevant foreign jurisdiction. In this context, we understand that the EU Commission is about to officially deem the Swiss regime equivalent to EMIR, therefore allowing Swiss central counterparties to be recognised by ESMA and serve the EU market. We would find it useful to understand more about the process and timing for the Swiss authorities to determine the EU as equivalent/appropriate.

In addition, under Article 60 (4) of the Act, FINMA may exempt a foreign central counterparty from the obligation to obtain recognition. We would encourage the secondary legislation to specify the conditions to be met for FINMA to grant such exemption.

Application of additional requirements to foreign systemically important FMIs and related waivers

Article 23 (4) of the Act states that the SNB and FINMA may waive the obligation for foreign systemically important FMIs to comply with the special requirements if they assess as equivalent the supervision and oversight regime of the country where they are established and also if cooperation arrangements are concluded with the foreign relevant authorities. As noted for the recognition process, we understand that the EU Commission is about to officially deem the Swiss regime equivalent to EMIR, therefore allowing Swiss central counterparties to be recognised by the European Securities and Markets Authority (ESMA) and serve the EU market. We would find it useful to understand more about the process and timing for the Swiss authorities to make a reciprocal assessment on the EU.

Additional requirements for systemically important FMIs include drafting a recovery plan and providing FINMA with the necessary information to draft a resolution plan (Article 24 of the Act). Article 20 of the draft FMIO proposes specific requirements around this, including the requirement for the FMI to submit a recovery plan and information for the resolution plan annually, or more frequently if there are any changes. Where the foreign FMI is not granted a waiver from such requirements and, indeed, the Swiss authorities deem the regime of the country of that FMI appropriate/equivalent, we believe the intention is for this approach to extend to the preparation of the recovery plan and the provisions of the necessary information for the resolution plan (i.e. where SNB/FINMA have deemed a 3rd country regime to be equivalent, the foreign CCP in that country can meet the requirement under Article 24 of the Act by preparing a recovery plan and provide the necessary information for the resolution plan to the satisfaction of its home competent authority). The alternative, whereby the foreign CCP is required to prepare a recovery plan specifically for the Swiss authorities and also provide FINMA with the necessary information to draft a resolution plan, would seem disproportionate and inconsistent with the overall approach taken in the Act. We encourage the Swiss authorities to clarify the application of Article 24 of the Act to foreign CCPs by amending Article 20 of the proposed FMIO reflecting the above comments.

Furthermore, we note that under Article 20 recovery and resolution plans under the Swiss regime must take into account corresponding regimes in foreign jurisdictions. In this context we would encourage the draft FMIO to include references to the establishment of Crisis Management Groups, as recommeded in the FSB report on resolution of FMIs[2]. LCH.Clearnet supports the establishment of such groups to facilitate dialogue and discussion between the relevant supervisors, central banks and other public authorities in th context of resolution of cross-border CCPs. However the decision making would ultimately reside with a single resolution authority, which in our view should the resolution authority of the jurisdiction in which the CCP is established. Lastly, we also believe it is important for key domestic and relevant foreign authorities to have information-sharing agreements agreed in advance and, ideally, to have tested these in advance as part of a crisis management exercise.

Transitional arrangements

Article 159 of the Act notes that FMIs which have a form of recognition at the time of entry into force of the Act will need to submit a new application for authorisation/recognition to be assessed against the new requirements. We encourage the Swiss authorities to issue secondary legislation or guidance specifying the necessary steps and the timing for the whole recognition process of FMIs, including foreign FMIs.

Reporting obligation

Under Article 104 of the Act, CCPs will be required to report derivative transactions to a Trade Repository authorised or recognised by FINMA. We would welcome clarification on who will be considered 'the party

[2] http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf (October 2014)

to the derivative transaction'. In this respect we would welcome alignment with EMIR, under which the CCP, authorised or recognised under Swiss law, is expected to report the contract it has with the clearing member only, regardless of whether the contract being cleared is part of a chain of transactions constituting a client cleared transaction (i.e. principal to principal model). Furthermore, in order to limit duplication of reporting we would strongly encourage substituted compliance to be accepted i.e. where substantially the same information for Swiss entities is reported under another regime then CCPs should not have to duplicate the reporting. In this context, we would encourage the Swiss authorities to follow an approach similar to that implemented by the Australian Securities and Investments Commission (ASIC) in Australia. LCH.Clearnet Limited complies with the Australian reporting requirement as it offers clearing services for certain OTC derivatives to Australian market participants. Under the ASIC regime, foreign entities subject to reporting requirements in their home jurisdictions, that are deemed as substantially equivalent to those applying in Australia, are allowed to report the transaction to a trade repository 'prescribed' to offer services in Australia, by designating or 'tagging' the relevant information so that the home trade repository knows that it can be provided to ASIC.

Specific comments on the proposed reporting structure

We understand that the reporting requirement under Swiss law is based on the following:

- Single sided reporting is mandated (under Art 104 of the Act) and cleared trades should be reported by the CCP or the party closest to the CCP (Art 88.2 of the proposed "FMIO").
- Where an existing bilateral trade is subsequently cleared, Art 90.1 of the proposed "FMIO" states that this 'change' to the transaction must be reported.
- The commentary to Field 78 (Art 89, Annex 2) states that where trades are cleared on the same day as the execution, the bilateral trade does not need to be reported and only the cleared trade must be reported. We would highlight that were the counterparties choose to report the alpha trade (i.e. the original bilateral transaction), the CCP should not have any obligation to notify the relevant trade repository that the alpha trade has been terminated once the transaction has been cleared; we believe this should be the obligation of the entity that reported the alpha trade.

We have the following comments and questions which aim to clarify what the proposed reporting structure is under Swiss law:

EMIR in the EU and the revised CFTC rules in the US follow the alpha – beta/gamma model of reporting, i.e. the alpha transaction is the original bilateral transaction, which once cleared creates two new transactions – beta and gamma with the CCP as a counterparty to both sides of the transaction. As such alpha trade would be reported as terminated and the record for alpha replaced by beta and/or gamma (depending on whether both transactions are reportable to the relevant regulator). We therefore understand that the approach in the proposed "FMIO" is in line with the EU and US and that separate transactions will be reported for alpha vs beta/gamma. As such LCH.Clearnet would only report those beta/ gamma transactions that involve a Swiss clearing member, while it would not report the corresponding beta or gamma trade with a non-Swiss clearing member that originated from an original alpha transaction with a swiss counterparty (regardless of whether it is a clearing member or client).

Where it would be valuable for the legislation to provide additional clarity is with respect to whether reports for beta/gamma are expected to follow a "principal to principal" or "agency" model for client cleared

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transactions. Under the "principal to principal" approach (used by LCH.Clearnet to satisfy the EMIR reporting requirement) there are two 'cleared' transactions that are separately reported: "Client to Clearing Member" and "Clearing Member to CCP". Under this approach the transaction reported by the CCP will only identify those clearing members who are Swiss entities, as the CCP is not responsible for reporting the transaction between Clearing Member and Client (this would be reported by either the client or the Clearing Member according to their respective reporting obligations). Under the agency model (used by LCH.Clearnet to satisfy the reporting requirement under the CFTC rules in the US and those of the Ontario Securities Commission (OSC) and the Autorité des marchés financiers (Québec) in Canada) the CCP submits a single record that identifies both the clearing member and client, where known, for a client cleared transaction – this agency reporting structure is used irrespective of whether the underlying client cleared transaction is cleared under a "principal to principal" or agency model.

LCH.Clearnet believes that the Swiss authorities should adopt a "principal to principal" reporting model; this would ensure that requirememt for the client cleared transactions under Swiss law aligns with EMIR and therefore reflects accurately the separate nature of the clearing obligations between CCP and clearing member and the clearing member and their client. By adopting such a structure, counterparties subject to the proposed reporting obligation, including EU CCPs authorised under EMIR and recognised in Switzerland, would be able to rely on the reporting perfomed via their existing 'EMIR repositories' to satisfy the requirements under the Swiss law, where those repositories are recognised by the Swiss authorities. This would bring a significant benefit to reporting counterparties as it would help reducing the cost of complying with the proposed obligations and would minimise duplicative reporting.

We hope that the above response will assist the Swiss authorities in the development of the final framework implementing the G20 commitment in Switzerland. Please do not hesitate to contact myself at Valentina.Cirigliano@lchclearnet.com should you wish to discuss further this response.

Yours faithfully,

Valentina Cirigliano
Manager, Post Trade Regulatory Strategy