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8 Finance Street, Central  
Hong Kong

Supervision of Markets Division  
The Securities and Futures Commission  
35/F Cheung Kong Center  
2 Queen's Road, Central  
Hong Kong

October 29 2015

Dear sirs,

**CONSULTATION PAPER ON INTRODUCING MANDATORY CLEARING AND  
EXPANDING MANDATORY REPORTING**

This letter provides the submission of LCH.Clearnet Ltd ("LCH.Clearnet") to the HKMA's and SFC's ("the Authorities") Consultation paper on introducing mandatory clearing and expanding mandatory reporting.

LCH.Clearnet is a subsidiary of the LCH.Clearnet Group, the world's leading clearing house group, which services major international exchanges and platforms, as well as a range of over-the-counter ("OTC") markets. It clears a broad range of asset classes including cash equities, exchange traded derivatives, commodities, energy, freight, interest rate swaps, credit default swaps, bonds, repos, and foreign exchange derivatives. The Group's central clearing counterparties ("CCPs") have over 190 clearing members and over 600 clients across 22 countries.

LCH.Clearnet Ltd is a Recognised Clearing House in the United Kingdom and authorised by the Bank of England under Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("EMIR"). In addition to the EU, LCH.Clearnet is regulated in the US, Australia, Norway, Switzerland, Quebec and Ontario. LCH.Clearnet SA is regulated in the EU and the US. LCH.Clearnet LLC is regulated in the US, and has applied for recognition in the EU.

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LCH.Clearnet is currently providing clearing services, directly or indirectly, to entities in Hong Kong for OTC derivatives transaction. It intends to apply for authorisation as an ATS provider under section 96 of the Securities and Futures Ordinance (SFO) in respect of its ForexClear foreign exchange clearing service and SwapClear interest and inflation rates service, and for designation as a CCP under section 101J of the SFO in respect of relevant instruments included in its SwapClear service.

### **Comments on the proposals**

We answer some specific questions below. Where we do not offer comment, the Authorities should assume we have no view or are content with the proposals.

**Q2. Do you have any comments or concerns about our proposals on the types of IRS that should be subject to mandatory clearing? If you do, please provide specific details.**

While we agree with the proposal to mandate clearing of certain fixed-to-floating, basis and overnight index swaps we believe that certain variable notional swaps and forward rate agreements should be included. In some currencies and maturities of these single-currency instruments there is sufficient activity, as part of global markets, to enable clearing. We include further details after our answer to Question 9.

**Q3. Do you have any comments or concerns about our proposals to only include plain vanilla IRS with constant notional amounts and no optionality? If so, please provide specific details.**

We agree that dual-currency swaps and those with optionality should be excluded from the mandate. However as noted above we believe that in certain cases swaps with variable notional amounts are suitable for inclusion.

**Q6. Do you have any comments or concerns about our proposal to only cover IRS that feature the indexes set out in the two tables above? If you do, please provide specific details.**

We recommend that for HIBOR it is clarified that each of HIBOR-HIBOR, HIBOR-HKAB and HIBOR-ISDC are included; and for EUR, both EUR-Telerate and EUR-Reuters. Additionally we believe EUR on LIBOR should be included.

**Q7. Do you have any comments or concerns about our proposals on whether OIS should be included under phase 1 clearing, and in what circumstances? If you do, please provide specific details.**

We note that in paragraph 67 the Authorities state that “we have (for now) included IRS denominated EUR, GBP and JPY in our Draft Clearing Rules, we have also done the same for OIS”. However Table 3 of Schedule 1 of the Draft Clearing Rules includes only

OIS denominated in EUR and GBP (in addition to USD). We believe that JPY on TONA should be included.

**Q8. Do you have any comments or concerns about our proposal that mandatory clearing should apply to IRS that feature the range of tenors described above? If you do, please provide specific details.**

LCH.Clearnet's SwapClear service regularly assesses liquidity and potential close-out costs in all products offered for clearing. Our surveys indicate that there is adequate liquidity in certain instruments beyond ten years that make them suitable for mandatory clearing and we propose that these be included for that reason and to ensure consistency with mandates in other jurisdictions. [Comments on minimum maturities?]

We propose that maximum maturities should be:

	Fixed-to-floating and Basis	Overnight
USD	50 years	30 years
EUR	50 years	30 years
GBP	50 years	30 years
JPY	40 years	30 years
HKD	10 years	n/a

**Q9. Do you have any comments or concerns about our proposal not to cover NDF transactions under phase 1 clearing? If so, please provide specific details.**

LCH.Clearnet supports the decision to delay mandatory clearing for NDFs, given the lack of mandates in other jurisdictions, in particular the US and the EU. FX is a truly global market and any clearing mandates should be coordinated internationally to avoid fragmentation. However, we would like to stress that even without a mandate, NDF clearing continues to prosper and as such the appropriateness of a mandate for FX products should be regularly reviewed.

LCH.Clearnet's ForexClear currently has a service offering which covers over 95% of the entire NDF market, and although volumes of cleared NDFs are small relative to the size of the market, volumes continue to grow. August 2015 saw the largest ever monthly volume cleared by ForexClear at \$108 billion. Additionally, as of May this year, ForexClear offers an international client clearing model, and in September the service cleared the first SEF executed NDF trade. These significant milestones demonstrate the interest and growth in clearing within the NDF space.

**Additional transactions that we recommend be included in the mandate**

In addition to the instruments described above, we believe that there are further instruments denominated in the G4 currencies that should be included. These are certain

variable notional swaps, overnight basis swaps and forward rate agreements. The specific instruments are:

	Variable notional	Overnight basis	FRAs
USD	LIBOR to 50 years	LIBOR v FedFunds to 30 years	LIBOR to 3 years
EUR	Euribor-Reuters, Euribor-Telerate and LIBOR to 50 years	n/a	Euribor-Reuters and LIBOR to 3 years
GBP	LIBOR to 50 years	LIBOR v SONIA to 30 years	LIBOR to 3 years
JPY	n/a	n/a	LIBOR to 3 years

**Q31. Do you have any comments or concerns about our proposed processes for designating CCPs or for revoking a CCP designation? If you do, please provide specific details.**

We have no specific issues to raise about the details of the processes described but have a serious concern over the timing and sequencing of the authorisation/designation process in relation to the introduction of the mandate. A number of Hong Kong entities whom we believe will be subject to the mandate are already clearing with LCH.Clearnet (either as a member or as a client). These entities will need sufficient assurance in advance of the introduction of the mandate that they will be able to continue to clear, and to fulfil their clearing obligation, with LCH.Clearnet, and not have to make alternative arrangements. We would welcome the opportunity to discuss how this matter can be addressed with the Authorities and affected entities.

**Q32. Do you have any comments or concerns about our proposal to implement only the clearing leg of the extended definition of “ATS” at this stage? If you do, please provide specific details.**

We support this proposal, for the reasons given by the Authorities.

**Q33. Do you have any comments or concerns about our proposal to defer implementation of the changes to the definition of “market contract” to cover CCPs that are authorised ATS providers and designated CCPs? If you do, please provide specific details.**

The insolvency override protections granted to CCPs, particularly in relation to the operation of a CCP’s default rules, are an important element of a CCP’s ability to offer clearing services in any particular jurisdiction. The fact that a CCP acquiring authorised ATS status would not benefit from the protections afforded to recognised clearing houses may therefore act as a disincentive for CCPs to seek to obtain authorisation in this manner. The reason given for not extending the insolvency protection to ATS is based on the belief that some CCPs net exposure across asset classes. LCH.Clearnet does not currently do

this and, while it intends to introduce cross-margining between OTC and futures contracts in 2016, this will be an optional product that members can elect to take advantage of. We consider that it would be preferable to extend the insolvency protections to all CCPs for OTC contracts and then allow CCPs to manage whether they allow Hong Kong incorporated members to cross-margin, or otherwise net their OTC exposure to such members with that in other products, and potentially forego that protection, than simply remove the protection from any CCP that is an ATS regardless of whether it cross margins or nets exposure. It is our view that the benefit of having the insolvency override protections outweighs any potential doubt or confusion that may arise from extending the protection to authorised ATS in respect of OTC contracts only.

**Q39. Do you have any comments or concerns about the specific data fields set out in the tables at Appendix D? If you do, please provide specific details, including suggestions for alternative ways to capture the relevant information.**

We query item 9(e) “whether or not the clearing obligation applies to a person in relation to the transaction.” As an ATS-CCP, we ourselves would not be subject to the clearing obligation and we may not have the relevant information to determine whether any other party (e.g. the clearing member, a client of the clearing member, or someone else) is subject to the clearing obligation and suggest that this field need not be reported by an ATS-CCP.

**Q42. Do you have any comments or concerns about our proposal to expand the mandatory record keeping obligation so that it applies in respect of the expanded product scope, but to leave the obligation otherwise unchanged? If you do, please provide specific details.**

There is one element of the record keeping obligation that we query and may also perhaps apply differently to an ATS-CCP: “29(1)(a) records sufficient to demonstrate that the person has complied with rule 9” (i.e. the obligation to report). This implies that we have to capture and retain the acknowledgement we receive from the repository in response to our submission. We suggest that, given that an ATS-CCP is unlikely to be reporting any trades other than what it received from its clearing members nor be subject to any exemptions, evidence of compliance may be taken directly from the TR, supplemented if necessary by the records the ATS-CCP retains of the transactions it clears.

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We hope that the Authorities find this submission useful and we look forward to engaging further as the proposals are refined. At this stage we do expect to provide a further submission on Appendix D before the end of November. Please do not hesitate to contact me at [rory.cunningham@lchclearnet.com](mailto:rory.cunningham@lchclearnet.com) or on +61 2 8259 4111 regarding any questions raised by this letter or to discuss these comments in greater detail.

Yours faithfully



**Rory Cunningham**  
**Director, Asia Pacific Compliance & Regulatory Affairs**