



Christopher Kirkpatrick,
Secretary of the Commission,
Commodity Futures Trading Commission,
Three Lafayette Centre, 1155 21st Street NW.,
Washington, DC 20581

14 September 2015

Dear Mr Kirkpatrick:

Re: RIN 3038–AC97, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements

LCH.Clearnet Group Limited (“LCH.Clearnet” or “The Group”) is pleased to respond to the request for comment on the Commodity Futures Trading Commission’s (“the CFTC” or “Commission”) proposed rules on Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements (“proposed rules” or “proposal”).¹

The Group strongly supports the policy goals underpinned by the proposed rules and the statutory provisions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).

On October 3, 2014, the Commission published proposed regulations to implement section 4s(e) of the Commodity Exchange Act, as added by section 731 of Dodd-Frank. This provision requires the Commission to adopt initial and variation margin requirements for swap dealers and major swap participants that do not have a Prudential Regulator. In the October 3, 2014 proposing release, the Commission also issued an Advance Notice of Proposed Rulemaking requesting public comment on the cross-border application of such margin requirements. In this release, the Commission is proposing a rule for the application of the Commission’s margin requirements.

The Group strongly supports the Commission’s proposal to adopt margin requirements for uncleared swaps for swap dealers and major swap participants issued in October 2014² as well as the proposal to apply such requirements at cross border level. The comment letter provides a view on the overall approach of the CFTC on this extremely important topic which will help shape the future of the OTC derivatives market.

LCH.Clearnet Overview

LCH.Clearnet³ is a 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,

¹ 17 CFR Part 23 (July 14, 2015).

² 17 CFR Part 23 (October 3, 2014)

foreign exchange derivatives, interest rate swaps, credit default swaps 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. LCH.Clearnet is majority owned by the London Stock Exchange Group, a diversified international exchange group that sits at the heart of the world's financial community.

LCH.Clearnet position:

As a multi-asset class and international clearing house we have been responsible for deploying prudent risk management techniques across both OTC and exchange traded derivatives for many years. This experience gives us a unique viewpoint on this subject. We have invaluable experience in model design, collateral management and the operational processes of calling, collecting and settling initial margin and variation margin.

LCH.Clearnet continues to be fully supportive of the G20 commitment to promote financial stability and reduce systemic risk in the OTC derivatives markets through the increased use of central counterparties. We recognise that clearing is not suitable for all products; however, where possible, standardised OTC derivatives should be cleared by a central counterparty. The benefits of CCP clearing have been recognised over many years in the OTC markets and any regulation should look to build upon the CCP model. Given the importance of the G20 objectives, we believe it is imperative that international regulatory and capital rules do not, whether directly or indirectly, disincentive the use of central clearing for the promotion of financial stability.

LCH.Clearnet believes that due consideration should be given to the following areas in the context of margin requirements for non-centrally cleared derivatives:

- Commensurate Margin
- International consistency
- Regulatory certainty

The above aspects are discussed further below.

Commensurate Margin

CCP margin models are subject to rigorous quantitative and qualitative regulatory requirements, and are maintained in compliance with such regulations. Further, CCPs employ extensive stress testing and, as a result, collect additional resources such as a default fund. These resources strengthen the protection afforded by clearing but are not without cost to participants. Critically, these extra resources are not present in a non-centrally cleared environment. LCH.Clearnet recognises that the margin requirements for non-centrally cleared contracts necessarily differ from those within a CCP framework; however we believe these differences should not disincentivise the use of CCPs. Should a CCP be authorised to offer a clearing service for a

³ LCH.Clearnet Group Limited consists of three operating entities: LCH.Clearnet Limited, the UK entity, LCH.Clearnet SA, the Continental European entity, and LCH.Clearnet LLC, the US entity. Link to Legal and Regulatory Structure of the Group:
http://www.lchclearnet.com/about_us/corporate_governance/legal_and_regulatory_structure.asp

specified asset class, this should be seen as recognition by the CCP's regulators and policy makers that centrally clearing this asset class will further promote financial stability and reduce systemic risk. In such cases, and in order to promote and incentivise the reduction of systemic risk, the overall capital and funding costs associated with centrally clearing these products should never be more than that required to hold the equivalent contracts in a non-centrally cleared environment.

International consistency

Significant divergence between major jurisdictions, resulting from the transposition of the BCBS IOSCO framework, can have unintended consequences for the OTC derivatives market. Disparities in Initial Margin and Variation Margin calculations, eligible collateral and collection requirements for margin will all have an impact on a participant's funding costs and the pricing of derivatives contracts. Without international consistency the true value of a derivative contract may differ between regulatory regimes. This may give rise to regulatory arbitrage and bifurcation of the global liquidity pool. Consequently, a harmonised approach between regulators is essential to ensuring the OTC derivatives markets continue to operate efficiently.

Regulatory Certainty

The need for regulatory certainty should be a primary consideration for regulators. With the first participants set to exchange Initial Margin in September 2016, according to the BCBS-IOSCO final standards⁴, the market must be given sufficient certainty of the rules to allow for implementation. Where changes to the rules are envisaged, they should be well communicated to the market to promote certainty, maintain international consistency and minimise implementation costs for participants. We support the early communication of final rules to allow participants adequate time for implementation in advance of September 2016. Any delay to the implementation dates, must be internationally coordinated to ensure the effective functioning of the OTC derivatives market.

Additional comments

We fully support the requirement of daily exchange of margins as a core component of the margin framework for non cleared swaps. Timely exchange of both Initial and Variation margins is vital in achieving the genuine systemic risk reduction to which these measures are directed. LCH.Clearnet operates clearing services that support a number of large global marketplaces, and we calculate, call and collect margin with a frequency no less than daily (and often, more frequently).

We also note that the use, when calculating bilateral margin, of a 99% confidence level over a liquidation period of 10 days differs from current CCP margin requirements. Without accounting for factors such as key periods of historical volatility, bilateral margins may be lower than those required by a CCP for cleared trades and we question whether this is consistent with G20 goals. Should additional factors be introduced which lead to more robust standards, we ask for consistent implementation across jurisdictions.

⁴ BCBS-IOSCO (March, 2015) <http://www.bis.org/bcbs/publ/d317.pdf>

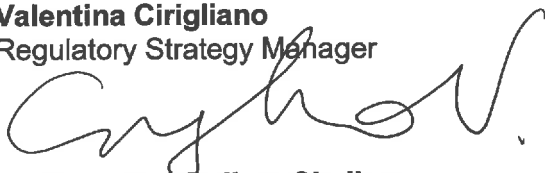
Conclusion

CCP margin models have been developed over time under rigorous regulatory oversight. LCH.Clearnet recognises that the margin requirements for non-centrally cleared contracts may differ; however we believe these differences should only reinforce the G20 aim that “Non-centrally cleared derivatives contracts should be subject to higher capital requirements” and the BIS aim that these margin rules should promote central clearing.

We trust that our comments will assist the CFTC in the development of the final requirements on margins for uncleared swaps as well as their cross-border application. Should you have any questions on this response, please contact myself at Valentina.Cirigliano@lchclearnet.com or Corentine Poilvet-Clediere at Corentine.Poilvet-Clediere@lchclearnet.com.

Yours sincerely,

Valentina Cirigliano
Regulatory Strategy Manager



cc: **Corentine Poilvet-Clediere**
Head of Post Trade Regulatory Strategy