

Financial Services Board
Republic of South Africa

By email: Michael.Kabai@fsb.co.za ; Kgomotso.molefe@fsb.co.za

8 April 2016

Dear Sirs,

Comments on the proposed directive on implementing interoperable and cooperative arrangements between Market Infrastructures

LCH.Clearnet Group Limited (“LCH.Clearnet” or “The Group”) is pleased to provide comments to the Financial Services Board (“FSB”) concerning the proposed directive on implementing interoperable and cooperative arrangements between Market Infrastructures (“MIs”) under the Financial Markets Act, 2012.

The Group strongly supports the FSB’s goal of defining the framework for the implementation of interoperability arrangements between MIs, thus ensuring that the South African financial markets are fair, efficient, transparent and supportive of the stability of the broader financial system.

This comment letter provides LCH.Clearnet’s view on the overall approach of the FSB on this key topic to promote either:

- (i) competition, when the cooperative arrangements are derived from open access; or
- (ii) optimisation of collateral usage to better serve our clearing members and clients, when the arrangement is an interoperability arrangement.

For these purposes, we understand “open access” to mean arrangements which allow access to trading, clearing and settlement infrastructures on a non-discriminatory and transparent basis. By contrast, interoperability involves two or more clearing houses entering into a voluntary agreement that enables cross-system execution of transactions (i.e. a counterparty using one CCP is able to execute a trade with a counterparty who uses a different CCP).

LCH.Clearnet Overview

LCH.Clearnet¹ is a leading multi-asset class and international clearing house, serving major international exchanges and platforms as well as a range of OTC markets. It clears a broad range

¹ 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>

of asset classes including securities, exchange-traded derivatives, commodities, energy, freight, 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 (“LSEG”), a diversified international exchange group that sits at the heart of the world’s financial community.

LCH.Clearnet position

To ensure that we continue to provide market leading risk management and clearing solutions across the world, LCH.Clearnet remains committed to comply with the highest international regulatory standards across jurisdictions. LCH.Clearnet is authorised as a central counterparty to offer services and activities in the Union in accordance with the European Markets Infrastructure Regulation² (“EMIR”) and registered as a Derivatives Clearing Organization (DCO) with the Commodity Futures Trading Commission (CFTC) in the USA. We are also regulated in Australia, Quebec, Ontario, Norway and Singapore, and have applied for recognition or licensing in a number of other jurisdictions. As a multi-asset class and international clearing house, we have established over the years numerous links and cooperative relationships with other market infrastructures, across jurisdictions and activities, including exchanges, execution venues, central securities depositories and other clearing houses. This experience, together with our international presence, gives us a unique viewpoint on this subject.

LCH.Clearnet is fully supportive of the FSB’s approach to align the South African supervisory oversight arrangements and practices with international best practice and standards. Significant divergence between jurisdictions could give rise to regulatory arbitrage and have adverse consequences. We therefore strongly believe that a harmonised approach between regulators and across jurisdictions is essential for the reliable and optimal functioning of both South African domestic markets and the international financial markets that South Africa accesses. It is fundamental there is seamless regulatory oversight across jurisdictions to ensure the most efficient access.

Specific Comments

- **Open access**

LCH.Clearnet supports the FSB’s proposal for open access between MIs. LCH.Clearnet and LSEG strongly support the concept of open access as essential to delivering fair markets, protection and choice for global investors, and promoting the international and domestic competitiveness of the South African financial markets. As such, we fully agree with the FSB’s view that access between most types of MIs should be based on reciprocity and made available on a transparent and non-discriminatory basis.

- **Interoperability**

However, we would like to express our concern around the drafting of section 3 of the proposed Directive: this section states that “A MI must conclude an interoperability

² Regulation (EU) No 648/2012 of the European Parliament and the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

arrangement(s) with another MI". We consider that this drafting could be construed as a mandatory requirement for clearing houses to establish interoperability arrangements between themselves. This is a concern as we firmly believe that interoperability arrangements should be concluded on a voluntary basis. Interoperability arrangements will most likely be requested by clearing members or clients of a central clearing counterparty ("CCP") where they are seeking to support trading relationships with the widest possible range of counterparties and to benefit from collateral efficiencies through increased contract fungibility and netting possibilities. Such agreements need to be contractual, customised, based on members and clients' needs, and will require additional financial resources to cover the CCP's exposure from the possible failure of the other linked CCP.

In addition, ensuring that interoperability remains a voluntary option for CCPs will more closely align the South African rules with the European framework, which will facilitate relationships between South African domestic and European based CCPs, their clearing members and their clients. Interoperability arrangements, as defined under Article 2 of EMIR, cover specific relationships between two or more CCPs. Under EMIR, interoperability arrangements remain voluntary, as they generally require that each CCP becomes a member of, and counterparty to, the other CCP, and their complexity may not make them appropriate for all products and services³. For example, it would be particularly challenging to establish interoperability arrangements for products with long maturity dates, such as 50-year interest rate swaps, both due to the lack of precedent globally and the potential contagion risks. For these reasons, we believe that interoperability arrangements should remain voluntary and not be mandated under any circumstances.

We hope that our comments will assist the FSB in the development of the implementation of interoperability arrangements in South Africa. Should you have any questions on the response or wish to discuss it in detail, please do not hesitate to contact me at Natalie.Caldwell@lchclearnet.com, Jean-Philippe Collin at Jean-Philippe.Collin@lchclearnet.com or Corentine Polivet-Clediere at Corentine.Poilvet-Clediere@lchclearnet.com.

Yours sincerely,

N. Caldwell

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³ This complexity was recently pointed out by the European Systemic Risk Board in its [report to the European Commission on the systemic risk implications of CCP interoperability arrangements](#), published in January 2016.