

Mr Christopher Kirkpatrick  
Commodity Futures Trading Commission  
1155 21st Street NW  
Three Lafayette Centre  
Washington DC 20581

8<sup>th</sup> September 2016

Dear Mr Kirkpatrick

**Variable Notional Swaps (“VNS”) denominated in AUD, CAD and JPY**

Pursuant to CFTC regulation §39.5(b), LCH.Clearnet Limited (“LCH”), a derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission (the “CFTC”), is submitting Variable Notional Swaps (“VNS”) denominated in AUD, CAD and JPY for determination of whether mandatory clearing should apply.

**Background**

VNS are interest rate swaps (“IRS”) in which the notional of the trade can vary through the life of the trade, and between the two legs of the swap. The profile of the VNS is fixed at the inception of the trade and is generally designed to match a specific client’s financing requirements. VNS are currently cleared by SwapClear in the following currencies and indices:

- Euro (EUR) EURIBOR
- UK Sterling (GBP) LIBOR
- US Dollar (USD) LIBOR

In response to Clearing Members’ and clients’ feedback, LCH now intends to increase the eligibility of the VNS product to include:

- Japanese Yen (JPY) LIBOR
- Canadian Dollar (CAD) BA-CDOR
- Australian Dollar (AUD) BBR-BBSW

The tenor of the VNS will not exceed the maximum tenor of the IRS currently eligible for clearing in SwapClear. Further, SwapClear has not introduced changes to its risk management or operations in order to launch these products.

**Factors for determination**

***The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data***

The volumes traded and cleared in the VNS product are relatively small in comparison with those of the vanilla IRS market. Using publicly available information on SwapClear volumes, the VNS products in the currencies currently eligible for clearing represent about 1% of the vanilla IRS market. It is expected that the volume ratios would be similar for VNS in the three additional currencies.

Data to value VNS in AUD, CAD and JPY is readily available from conventional price sources, e.g. Bloomberg and Reuters. VNS trades consist of a fixed versus floating leg; VNS are priced as the sum of the discounted cash flows of both legs, using the same methodology as for IRS.

***The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded***

LCH already has a well-developed rule framework and support infrastructure for clearing IRS. LCH intends to leverage this existing operational capability when extending its offering to cover VNS in AUD, CAD and JPY.

In order to prepare for the launch of VNS in AUD, CAD and JPY, LCH will perform testing to ensure that is able to clear these products in a manner which is consistent with the terms on which they are traded.

Further to this, LCH has notified its Clearing Members of a number of minor rule changes which will be made in order to support the clearing of VNS in the three specified currencies. The rule changes will be certified with the CFTC and be made available on the LCH website.

***The effect on mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract***

The US and EU have already implemented a clearing mandate for VNS products, LCH is aware that Canada has also proposed a clearing mandate of this product.

The product does not introduce any novel risks to LCH, as the operational capability to manage the product, albeit in other currencies, is already in place. Expanding the clearing offering of VNS in currencies other than EUR, GBP and USD will reduce current market asymmetries and will allow participants to manage a larger proportion of their risk via a CCP. LCH expects the majority of current SwapClear Clearing Members to start clearing VNS in the additional three currencies, once the service is live.

Further, in the event of a default, VNS products would be managed in conjunction with other products using portfolio level macro hedges to remove the primary risk of the defaulter ahead of an auction. The introduction of VNS products has no impact on the LCH's ability to manage defaults or the Clearing Members' ability to bid in an auction in a default scenario.

***The effect on competition, including appropriate fees and charges applied to clearing***

CME Clearing and Eurex Clearing already support VNS in the currencies which each CCP clears. LCH would expect to clear a proportion of the VNS products traded in the market that closely matches the proportion it clears in the vanilla IRS market.

LCH's fees and charges for VNS in AUD, CAD and JPY will be in line with those charged for existing currency VNS contracts.

***The existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds and property***

The level of legal certainty around the clearing of VNS in AUD, CAD & JPY is in all material respects the same as that of the IRS already cleared by LCH.

Insofar as legal certainty in the event of the insolvency of the DCO is concerned, LCH would be wound up under English law.

Further Information (§39.5(b)(iii-viii))

VNS swaps are by definition less standardised than vanilla IRS, but their bespoke nature is only applicable to a small set of parameters of the trade, such as notional schedules, fixed rates and floating spreads. The trades are executed under the market standard 2008 ISDA Derivatives Definitions<sup>1</sup> and are covered by the Financial products Markup Language (FpML) standard, which is a protocol used for sharing information on derivatives and other products.

The participant eligibility standards for VNS in AUD, CAD & JPY are the same as those for existing SwapClear Clearing Members.

There are no additional price sources required as the products can be valued using prices that are readily available from the price sources already used by LCH.

No material revisions or adjustments to the existing risk models/parameters and/or liquidity risk management framework are required for LCH to offer clearing of VNS in AUD, CAD & JPY.

LCH will make a number of minor changes to its Rulebook to enable clearing of VNS in AUD, CAD & JPY, in the following sections:

- Product Specific Contract Terms and Eligibility Criteria Manual
- FCM Specific Contract Terms and Eligibility Criteria Manual

The rule changes will be submitted to the CFTC pursuant to §40.6(a), following consultation with LCH Clearing Members.

LCH engages its Clearing Members in the design and testing of new products at an early stage, through regular meetings and working groups. Clearing Members have been formally notified on the changes which LCH is required to make to its Rulebook.

Notice of this submission under CFTC regulation §39.5(b) was given to SwapClear Clearing Members on 26<sup>th</sup> August 2016 and a copy of this notice is provided at **Appendix A**. Furthermore, this submission is publicly available at: <http://www.lchclearnet.com/rules-regulations/regulatory-responses>

LCH intends to launch these products with its Clearing Members and clients no earlier than 12<sup>th</sup> September 2016.

Should you have questions please contact me at [Daniel.Maguire@lch.com](mailto:Daniel.Maguire@lch.com).

Yours sincerely

**Daniel J Maguire**



**Global Head of Rates & FX Derivatives**  
LCH.Clearnet Limited

cc. Parisa Abadi

<sup>1</sup> <http://www.isda.org/publications/pdf/2008-inflation-defs.pdf>

**Appendix A**

**Notice of this submission provided to SwapClear Clearing Members**

---

To	SwapClear Clearing Members
From	David Horner, Head of SwapClear Business Risk
Date	26 August 2016
Subject	<b>VNS in AUD/CAD/JPY submission for determination of clearing requirements</b>

---

Pursuant to CFTC regulation §39.5(b), LCH.Clearnet Limited (“LCH”), a derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission (the “CFTC”), is submitting Variable Notional Swaps (“VNS”) denominated in AUD, CAD and JPY for determination of whether mandatory clearing should apply. VNS are currently cleared by SwapClear in EUR, GBP and USD.

As per CFTC regulation §39.5(b)(viii), LCH is required to notify members of its submission. This note does not constitute a notification that the products are live for clearing. A notice announcing the live data and arrangements for the formal product launch will be published separately.

***The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data***

The volumes traded and cleared in the VNS product are relatively small in comparison with those of the vanilla IRS market. Using publicly available information on SwapClear volumes, the VNS products in the currencies currently eligible for clearing represent about 1% of the vanilla IRS market. It is expected that the volume ratios would be similar for VNS in the three additional currencies.

Data to value VNS in AUD, CAD and JPY is readily available from conventional price sources, e.g. Bloomberg and Reuters. VNS trades consist of a fixed versus floating leg; VNS are priced as the sum of the discounted cash flows of both legs, using the same methodology as for IRS.

***The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded***

LCH already has a well-developed rule framework and support infrastructure for clearing IRS. LCH intends to leverage this existing operational capability when extending its offering to cover VNS in AUD, CAD and JPY.

In order to prepare for the launch of VNS in AUD, CAD and JPY, LCH will perform testing to ensure that is able to clear these products in a manner which is consistent with the terms on which they are traded.

Further to this, LCH has notified its Clearing Members of a number of minor rule changes which will be made in order to support the clearing of VNS in the three specified currencies. The rule changes will be certified with the CFTC and be made available on the LCH website.

***The effect on mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract***

The US and EU have already implemented a clearing mandate for VNS products, LCH is aware that Canada has also proposed a clearing mandate of this product.

The product does not introduce any novel risks to LCH, as the operational capability to manage the product, albeit in other currencies, is already in place. Expanding the clearing offering of VNS in currencies other than EUR, GBP and USD will reduce current market asymmetries and will allow participants to manage a larger proportion of their risk via a CCP. LCH expects the majority of current SwapClear Clearing Members to start clearing VNS in the additional three currencies, once the service is live.

Further, in the event of a default, VNS products would be managed in conjunction with other products using portfolio level macro hedges to remove the primary risk of the defaulter ahead of an auction. The introduction of VNS products has no impact on the LCH's ability to manage defaults or the Clearing Members' ability to bid in an auction in a default scenario.

***The effect on competition, including appropriate fees and charges applied to clearing***

CME Clearing and Eurex Clearing already support VNS in the currencies which each CCP clears. LCH would expect to clear a proportion of the VNS products traded in the market that closely matches the proportion it clears in the vanilla IRS market.

LCH's fees and charges for VNS in AUD, CAD and JPY will be in line with those charged for existing currency VNS contracts.

***The existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds and property***

The level of legal certainty around the clearing of VNS in AUD, CAD & JPY is in all material respects the same as that of the IRS already cleared by LCH.

Insofar as legal certainty in the event of the insolvency of the DCO is concerned, LCH would be wound up under English law.

**Further Information (§39.5(b)(iii-viii))**

VNS swaps are by definition less standardised than vanilla IRS, but their bespoke nature is only applicable to a small set of parameters of the trade, such as notional schedules, fixed rates and floating spreads. The trades are executed under the market standard 2008 ISDA Derivatives Definitions<sup>1</sup> and are covered by the Financial products Markup Language (FpML) standard, which is a protocol used for sharing information on derivatives and other products.

The participant eligibility standards for VNS in AUD, CAD & JPY are the same as those for existing SwapClear Clearing Members.

There are no additional price sources required as the products can be valued using prices that are readily available from the price sources already used by LCH.

No material revisions or adjustments to the existing risk models/parameters and/or liquidity risk management framework are required for LCH to offer clearing of VNS in AUD, CAD & JPY.

LCH will make a number of minor changes to its Rulebook to enable clearing of VNS in AUD, CAD & JPY, in the following sections:

- Product Specific Contract Terms and Eligibility Criteria Manual

---

<sup>1</sup> <http://www.isda.org/publications/pdf/2008-inflation-defs.pdf>

- FCM Specific Contract Terms and Eligibility Criteria Manual

The rule changes will be submitted to the CFTC pursuant to §40.6(a), following consultation with LCH Clearing Members.

LCH engages its Clearing Members in the design and testing of new products at an early stage, through regular meetings and working groups. Clearing Members have been formally notified on the changes which LCH is required to make to its Rulebook.

Further information will form part of the full §39.5 filing which will be publically available on the LCH website.

LCH looks forward to working with Clearing Members and the CFTC in the determination of clearing requirements. Please do not hesitate to contact me regarding any questions raised by this information.

Regards

David Horner  
**Head of SwapClear Business Risk**