



Kevin M. O'Neill  
Deputy Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

27 May 2014

Dear Mr. O'Neill:

**Re: File No. S7-03-14, Standards for Covered Clearing Agencies**

LCH.Clearnet Group Limited (“LCH.Clearnet” or “The Group”) is pleased to respond to the request for comment on the Securities and Exchange Commission’s (“the SEC” or “Commission”) proposed rules on Standards for Covered Clearing Agencies (“proposed rules” or “proposal”).<sup>1</sup>

The Commission proposes to amend its existing regulations to establish additional requirements for risk management, operations and governance of registered clearing agencies that meet the definition of “covered clearing agency.” Covered clearing agencies would include registered clearing agencies that provide central counterparty services for security-based swaps or are involved in activities that the Commission determines to have a more complex risk profile and for which the Commodity Futures Trading Commission is not the “supervisory agency” for the registered clearing agency as that term is defined in the Clearing Supervision Act.<sup>2</sup> The proposed rules are intended to be in line with the Principles for Financial Market Infrastructures (“PFMIs”) adopted by the Committee on Payments and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions (“CPSS-IOSCO”).<sup>3</sup> Adherence to the proposed rules would facilitate the ability of covered clearing agencies to be considered qualified central counterparties (“QCCPs”) within the meaning of the Basel Committee on Bank Supervision (“BCBS”) bank capital rules. In 2012, BCBS published interim rules governing capital changes arising from bank exposure to CCPs related to OTC derivatives, exchange traded derivatives, and securities financing transactions.<sup>4</sup> Under these interim rules, the capital treatment for bank clearing member exposures to QCCPs is

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<sup>1</sup> 79 FR 16866 (March 26, 2014).

<sup>2</sup> The Clearing Supervision Act was adopted as Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

<sup>3</sup> Principles for Financial Market Infrastructures, (April 2012), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD377.pdf>.

<sup>4</sup> Capital Requirements for Bank Exposures to Central Counterparties (July 2012), available at [www.bis.org/publ/bcbs227.pdf](http://www.bis.org/publ/bcbs227.pdf).

significantly lower than the capital treatment for exposures to non-qualified CCPs. Bank regulators in the US and Europe began to apply these interim rules on January 1, 2014.<sup>5</sup>

The Group supports the Commission's proposal to adopt heightened regulatory standards that are consistent with the PFMI and that would facilitate the ability of covered clearing agencies to be considered QCCPs. However, LCH.Clearnet has concerns about some of the proposed rules and requests clarifications of other proposed rules.

### LCH.Clearnet Overview

The LCH.Clearnet Group is the leading multi-asset class and multi-national clearinghouse, 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, foreign exchange derivatives, interest rate swaps, credit default swaps, and euro and sterling 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.<sup>6</sup>

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<sup>5</sup> In July 2013, the Board of Governors of the Federal Reserve and the Office of the Comptroller of the Currency adopted final capital rules applicable to bank exposures to CCPs. The final rules are available at <http://www.occ.gov/news-issuances/news-releases/2013/2013-110a.pdf>.

In July 2013, the Capital Requirement Regulation setting capital rules for bank exposures to CCPs entered into force. <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0001:0337:EN:PDF>.

<sup>6</sup> The Group consists of three operating subsidiaries: LCH.Clearnet SA, LCH.Clearnet Limited, and LCH.Clearnet LLC.

LCH.Clearnet SA is regulated as a credit institution by a regulatory college of the market regulators and central banks of France, the Netherlands, Belgium and Portugal, and is supervised as a Recognised Overseas Clearing House by the Bank of England, and is registered with the Commodity Futures Trading Commission ("CFTC") as derivatives clearing organization ("DCO"). LCH.Clearnet SA clears single-name and index CDS contracts through its CDSClear service. LCH.Clearnet SA is planning to submit an application to the Commission for registration as a clearing agency.

LCH.Clearnet Limited is supervised as a Recognised Clearing House by the Bank of England and is registered with the CFTC as a DCO.

LCH.Clearnet Limited and LCH.Clearnet SA are subject to the European Markets Infrastructure Regulation ("EMIR"). On May 23, 2014, the European Securities and Markets Authority announced the authorization of LCH.Clearnet SA under EMIR. Final action on LCH.Clearnet Limited's application is expected in the first half of 2014.

LCH.Clearnet LLC is registered with the CFTC as a DCO.

LCH.Clearnet Group Limited 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.<sup>7</sup>

### Comments on Specific Proposed Rules

LCH.Clearnet has comments on a number of the provisions of the proposed rules. As an initial matter, LCH.Clearnet requests that the Commission clarify how it intends to apply the rules to applications for registration as a clearing agency that are pending when the rules are finalized.

### **Proposed Rule 240.17Ad-22(e)—Scope**

LCH.Clearnet SA provides central counterparty services for security-based swaps placing it within the proposed definition of “covered clearing agency.” The proposed rules would apply to LCH.Clearnet SA if becomes registered with the Commission as a clearing agency. LCH.Clearnet SA is currently regulated as a credit institution by a regulatory college of the market regulators and central banks of France, the Netherlands, Belgium and Portugal, and is authorized under EMIR shortly. EMIR’s regulation of central counterparties (“CCPs”) is consistent with the PFMLs.

In the proposed rules on cross-border security-based swap activities, the Commission stated that it might consider proposing rules that are specific to foreign-based CCPs registered with the Commission as clearing agencies where international consistency on some regulatory standards suggests that such a targeted regulatory approach might be warranted.<sup>8</sup> Consistent with this statement, LCH.Clearnet urges the Commission to exclude foreign-based registered clearing agencies that clear security-based swaps and are also regulated in their home jurisdictions under a regime that is consistent with the PFMLs from the definition of “covered clearing agency.” This approach would minimize duplicative requirements on this limited type of registered clearing agency while ensuring that all registered clearing agencies that clear security-based swaps are regulated in a manner that is consistent with the PFMLs. This approach would also be consistent with the Commission’s proposal to exclude from the definition of “covered clearing agency” registered clearing agencies that: (1) are dually registered as DCOs; (2) are designated as systemically important under

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<sup>7</sup> LSEG is headquartered in London, United Kingdom with significant operations in Europe, North America and Asia, and operates a broad range of international equity, fixed income and derivatives markets, including: London Stock Exchange; Borsa Italiana; MTS, and Turquoise; post trade and risk management, including CC&G, the Rome headquartered CCP and Monte Titoli, the European settlement business; and is majority owner of the leading multi-asset global CCP, LCH.Clearnet Group. LSEG operates the EMIR authorised trade repository, UnaVista, and offers an extensive range of real-time and reference data products, including Sedol, Proquote and RNS, as well as access to over 200,000 international equity, bond and alternative asset class indices, through the world leading index provider, FTSE International. LSEG is also a leading developer of high performance trading platforms and capital markets software. In addition to the LSEG’s own markets, over 30 other organisations and exchanges around the world use the LSEG’s MillenniumIT trading, surveillance and post trade technology.

<sup>8</sup> See, Cross-Border Security-Based Swap Activities, 78 FR 30968, 31039 (May 23, 2013).

the Clearing Supervision Act; and, (3) have the CFTC as their supervisory agency under the Clearing Supervision Act.

### **Proposed Rule 240.17Ad-22(e)—Role of Written Policies and Procedures**

LCH.Clearnet supports the Commission's proposal to require covered clearing agencies to develop policies and procedures to fulfil the requirements of Rule 17Ad-22(e). This approach provides covered clearing agencies with sufficient flexibility to bring to bear their market experience and institutional knowledge to develop appropriate written policies and procedures to comply with the proposed rules. However, as the Commission acknowledges in the preamble to the proposed rules, it is inappropriate to require a covered clearing agency to disclose all of its policies and procedures.<sup>9</sup> Some policies and procedures may include commercially sensitive information. It would be helpful for the language of the final rules to explicitly reflect this reality.

### **Proposed Rule 240.17Ad-22(e)(2)—Governance**

The Commission seeks comment on whether it should require a covered clearing agency's policies and procedures to provide for public disclosure of the major decisions of the board of directors. LCH.Clearnet does not object to disclosure of major *determinative* decisions of the board of directors. However, LCH.Clearnet believes that the publication of Board resolutions prior to a determinative decision would be confusing and potentially misleading or market-moving (especially for a clearing house that is part of a listed group). Such disclosure is also likely to serve as a deterrent to open discussions amongst Board members.

### **Proposed Rule 240.17Ad-22(e)(7)(iv)—Liquidity Providers**

Proposed Rule 240.17Ad-22(e)(7)(iv) requires a covered clearing agency to have in place policies and procedures to undertake due diligence of its liquidity providers. The Banque de France is currently the only liquidity provider for LCH.Clearnet SA. LCH.Clearnet does not believe that it is appropriate to require a covered clearing agency to do due diligence on a central bank acting as a liquidity provider. LCH.Clearnet requests that the final rules clarify that the requirements under Rule 240.17Ad-22(e)(7)(iv) do not apply where a central bank is a liquidity provider of the covered clearing agency.

### **Proposed Rule 240.17Ad-22(e)(12)—Exchange of Value Settlement Systems**

The Commission seeks comment on whether there are circumstances when ensuring that the settlement of an obligation is final if and only if the settlement of the corresponding obligation is final is not feasible or practicable. One such situation occurs when the settlement of a CDS contract occurs following a credit event. In this case, there may be some non-delivery versus payment obligations to be settled, such as loans. LCH.Clearnet SA's CDS Clearing Supplement describes a

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<sup>9</sup> 79 FR at 16877-78.



procedure for this situation in order to secure the settlement. LCH.Clearnet believes that the final rules should encompass this situation.

#### **Proposed Rule 240.17Ad-22(e)(14)—Segregation and Portability**

LCH.Clearnet reads proposed Rule 17Ad-22(e)(14) as permitting a covered clearing agency that clears security-based swaps to comply with the proposed rule's segregation requirement by offering either the legally segregated, operationally commingled ("LSOC") structure mandated by the CFTC for cleared swaps or the individual segregated account structure required to be offered to customers under EMIR. LCH.Clearnet welcomes this flexibility since LCH.Clearnet SA already is required to offer both types of accounts.

#### **Proposed Rule 240.17Ad-22(e)(19)—Tiered Participation Agreements**

LCH.Clearnet does not believe that the Commission has provided sufficient guidance regarding who would be "indirect participants" of a covered clearing agency. As a result, LCH.Clearnet cannot ascertain whether it is correctly reading the proposed rules as requiring the covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage the material risks posed to the covered clearing agency by the clients of its clearing members. LCH.Clearnet does not believe that it is appropriate for a covered clearing agency to undertake due diligence of the clients of its clearing members for a number of reasons. The covered clearing agency has no direct, contractual relationship to these clients. Performing due diligence on what may be a very large number of clients could be very burdensome for the covered clearing agency. Clients may object to due diligence inquiries from a covered clearing agency and choose to move their business to another CCP that is not required to perform such due diligence. LCH.Clearnet believes that a covered clearing agency can reasonably rely on the due diligence that its clearing members do on their clients and should not have to perform its own due diligence on these indirect participants.

#### Conclusion

LCH.Clearnet appreciates the opportunity to share our views on the Commission's proposed rules to establish standards for the operation and governance of covered clearing agencies. Please do not hesitate to contact me at 202-347-4049 regarding any questions raised by this letter or to discuss these comments in greater detail.

Yours sincerely

A handwritten signature in black ink that reads "Susan Milligan" followed by a horizontal line.

Susan Milligan  
Head of US Public Affairs