



Securities Industry Association

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OFFICE OF THE SECRETARIAT

October 8, 1998

Jean A. Webb  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

## COMMENT

COMMODITY FUTURES  
TRADING COMMISSION  
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Re: Petition by London Clearing House Limited for  
Exemption Under Commodity Exchange Act Section 4(c)(1)

Dear Ms. Webb:

The OTC Derivative Products Committee (the "Committee") of the Securities Industry Association (the "SIA")<sup>1</sup> is submitting this letter in response to the Commodity Futures Trading Commission's (the "Commission" or "CFTC") request for public comment<sup>2</sup> with respect to the captioned petition for relief by the London Clearing House Limited ("LCH") in connection with LCH's proposed "SwapClear" swap clearing activities.

The Committee recommends that the Commission grant the LCH petition for relief. The Committee further urges the Commission to clarify, consistent with the

<sup>1</sup> SIA is the leading proponent of capital markets, bringing together the shared interests of nearly 800 securities firms throughout North America. SIA members - including investment banks, brokers-dealers, specialists, and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the United States, SIA members collectively account for approximately 90%, or \$100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans. (More information about the SIA is available on its home page: <http://www.sia.com>.)

<sup>2</sup> 63 Fed. Reg. 36657 (July 7, 1998).

original promulgation of Part 35 of the Commission's regulations, that the requested exemptive relief is granted to the extent, and without any determination that, any swap transaction submitted for clearance by LCH constitutes a futures contract or commodity option subject to the Commission's jurisdiction. In this connection, the Committee acknowledges that the Commission may wish to limit the scope of the swap transactions that are eligible for the requested exemptive relief. Accordingly, the Committee recommends that the Commission limit the relief to transactions that satisfy the requirements of Rule 35.2(a), (b) and (d).

The Committee bases its recommendation on several considerations:

First, the evolution of clearing mechanisms to reduce the inter-counterparty credit exposure associated with individually negotiated swap transactions<sup>3</sup> is an important and positive development. As the Commission appreciates, credit risk is the principal economic risk factor associated with financial transactions such as OTC derivative instruments. The availability of viable clearing mechanisms provides credit enhancement that mitigates credit risk and reduces credit concentrations that otherwise may deplete available sources of liquidity. Greater liquidity and reduced credit concentration are highly desirable objectives for any market or form of economic activity.

Thus, approval of the LCH petition would have significant positive practical benefits.

Second, as the Committee understands the petition, LCH's activities will be overseen by and subject to comprehensive regulation by the United Kingdom Financial Services Authority under the United Kingdom Financial Services Act 1986 ("FSAct"). Thus, any practical concerns regarding the need for prudential oversight are already addressed. Moreover, the counterparties that may participate in the contemplated SwapClear arrangements must be wholesale market participants under the FSAct. This category of participants is generally more restrictive than the Commission's "eligible swap participant" category and encompasses institutions that have the sophistication and capacity to evaluate intelligently the financial integrity of SwapClear and the adequacy of its regulatory oversight.

Thus, there is no reason for the Commission to decline to defer to SwapClear's local regulator and, accordingly, additional Commission oversight of SwapClear's activities is not necessary.

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<sup>3</sup> In this regard, the Committee notes that the existence of qualification criteria and parameters for the admission of individual transactions for clearance does *not* mean that such transactions are not individually negotiated or that a cohesive market in fungible transactions is necessarily created thereby. It is thus not necessary for the Commission to decide how it would respond to petitions involving the proposed clearance of standardized and fungible swaps in order to respond affirmatively to the LCH petition.

Third, the Commission has not been granted by Congress authority to oversee the operations of a clearing house such as LCH. As a general matter, the Commission has not been granted authority to regulate clearing houses except in the limited context of the Commission's oversight of the futures clearing activities of boards of trade designated as contract markets. Although legislation has in the past been proposed that would have granted such authority to the Commission,<sup>4</sup> such legislation has never been enacted. Additionally, LCH is a non-U.S. entity acting and subject to regulation outside the United States. Given the policy underpinnings of Commodity Exchange Act Section 4(b),<sup>5</sup> it would not be consistent with that provision for the Commission to assert jurisdiction over LCH. Finally, the Committee does not believe that the Commission has, or has been authorized by Congress to exercise, jurisdiction over individually negotiated swap transactions, whether or not they are subject to clearing arrangements.

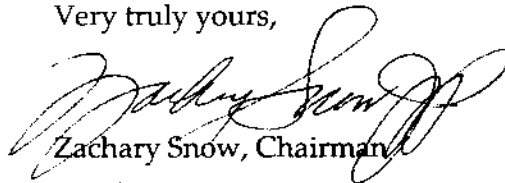
As a result, the Committee does not believe that the Commission has been granted the statutory authority to regulate LCH or the firms participating in SwapClear.

For the foregoing reasons, the Committee recommends that the Commission grant the petition of LCH without imposing CFTC regulatory oversight or asserting jurisdiction over the contemplated activity.

\* \* \*

If you have any questions or would like further information regarding this letter, please feel free to contact the undersigned (tel. 212-816-0821) or Gerard J. Quinn, Staff Adviser to the Committee (tel. 212-618-0507) or Edward J. Rosen, of Cleary, Gottlieb, Steen & Hamilton, counsel to the Committee (tel. 212-225-2820).

Very truly yours,



Zachary Snow, Chairman

OTC Derivative Products Committee

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<sup>4</sup> See S. 2837, 93rd Cong. 1st Sess., Section 205, 206 (Dec. 20, 1973).

<sup>5</sup> As the Commission is aware, very generally, CEA Section 4(b) prohibits the Commission from regulating foreign markets -- even where U.S. persons participate in such markets.