LCH.CLEARNET

18 January 2013

Ms. Melissa Jurgens
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington DC 20581

RE: Amendment to Previous Submission

Dear Ms. Jurgens:

After consulting with Commission staff, LCH.Clearnet Limited respectfully submits an amended cover letter to its self-certification of 18 October 2012. The new cover letter addresses updates to the LSOC model pursuant to industry and regulatory discussions, and does not alter any of the DCO's rules previously certified.

Due to another revision made to the same submission, the cover letter in question now appears on the Commission's website as "Exhibit B" to the aforementioned submission, and can be found at pages 5 -13. Please find the new cover letter attached together with a black-lined version of the changes.

Should you have any questions please contact me at the information below.

Yours sincerely,

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Via Electronic mail

Ms Sauntia Warfield
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

RE: Amendments to LCH.Clearnet Limited's Rules and Regulations in relation to the introduction of Legally Segregated, Operationally Commingled ("LSOC") Accounts, and with regards to Bunched Trade Registration for post registration allocation.

Dear Ms Warfield

LCH.Clearnet Limited ("LCH.Clearnet"), a derivatives clearing organization registered with the Commodity Futures Trading Commission (the "CFTC"), is submitting for self-certification, pursuant to CFTC Regulation §40.6, amendments to LCH.Clearnet's Rules and Regulations to reflect changes to the LCH.Clearnet SwapClear service. This submission is made in order to comply with Part 22 of the CFTC Rule[1], as well as to address CFTC Rule 1.35 regarding the allocation of bunched orders post registration.

Part I: Explanation and Analysis

The following changes to the SwapClear service are planned to take effect from November 5, 2012:

Introduction of Legally Segregated, Operationally Commingled ("LSOC") Accounts: In order to comply with CFTC Part 22 - Protection of Cleared Swaps Customer Contracts and Collateral - ("LSOC" rules), LCH.Clearnet will be introducing certain changes to its SwapClear service, and the associated account class offerings. LCH.Clearnet plans to release the LSOC model with effect from November 5, 2012[2]. LCH.Clearnet notes that its rules as submitted are intended to comply with Part 22 as currently constituted, and may require subsequent revision following expected guidance from the Commission relating to the manner in which FCM buffer may be held in a client account.

Bunched Order Trade Registration: In order to comply with CFTC Rule 1.35 regarding the execution of bunched orders by a fund manager for post registration allocation, LCH.Clearnet plans to implement changes with effect from November 5, 2012. (CFTC Rule

[1] Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336 (Feb. 7, 2012)
[2] Subject to the regulatory approval by the UK Financial Services Authority ("FSA")

1.35 became effective on 1 October 2012, an extension of time for compliance to market participants was granted by the CFTC until June 1, 2013).

Rationale for the Rule Amendments

1. "Legally Segregated, Operationally Commingled" ("LSOC")

1.1. Introduction

Part 22 describes the manner in which cleared swaps collateral must be treated prior to and after bankruptcy by both FCMs and DCOs. The model introduced by CFTC Regulation Part 22 permits client collateral of cleared swaps customers to be kept, pre-default, in one account at both the FCM and DCO level. However, in the event of an FCM default, a DCO will not have recourse to the collateral posted by one customer to cover losses suffered by another customer.

1.2 General LSOC Principles

1.2.1 The LSOC Segregation Calculation

CFTC Regulation 22.2(d), Limitations of Use, states that:

"No futures commission merchant shall use, or permit the use of, the Cleared Swaps Customer Collateral of one Cleared Swaps Customer to purchase, margin, or settle the Cleared Swaps...of, any person other than such Cleared Swaps Customer. "

As the rule does not allow for any period of time when individual treatment is not applied, it is the responsibility of the FCM to ensure that the information the DCO is relying upon is accurate. In order to comply, to the extent that the collateral a customer has provided to the FCM is less than the initial margin requirement of the DCO, an FCM will fund the remaining required margin from its own capital and not the excess collateral of any other customer.

In order to ensure customers are receiving the protections required by LSOC, an FCM must always ensure that the DCO has an accurate depiction of the disposition of customer funds in its possession to enable the DCO to segregate any customer collateral it holds and to enable it to ensure that the FCM is compliant with its obligation not "to permit" the collateral of one customer to margin another customer in accordance with CFTC Regulation 22.2.

1.2.2 Unallocated Excess

"Unallocated Excess" funds are those held by a DCO attributed to each FCM but not allocated to individual clients or to the FCM Buffer. In the event that a default occurs while the DCO is holding Unallocated Excess, the DCO may not use these funds to meet any losses, and will instead return them to the Bankruptcy Trustee of the defaulted FCM. ~~A DCO may not rely on this value in a default~~. ~~However, Unallocated Excess may belong to a customer with an increased requirement and a DCO may utilise Unallocated Excess as long as the FCM provides a certification that all or part of the Unallocated Excess may be used. However, LCH.Clearnet does not currently intend to support this functionality, as reflected in the rules attached hereto.~~

1.2.3 Variation Margin Is Not Required to Be Segregated

The protection against fellow customer risk granted by LSOC only applies to Cleared Swap Customer Collateral, and CFTC staff has informed LCH.Clearnet, along with other market participants, that it does not apply to unsettled Variation Margin. Cleared Swap Customer Collateral includes any property in the individual customer account belonging to that customer. Therefore, once Variation Margin is paid to an FCM's Cleared Swaps Customer Account, it receives the protections granted pursuant to Part 22. Although the CFTC regulation does not require LSOC protection to include unsettled Variation Margin, LCH.Cleranet will go beyond the minimum requirements of the rule by providing a legal segregation of unsettled Variation Margin gains following an FCM default. ~~As a DCO, LCH.Clearnet will continue to settle the variation margin gains and losses of an FCM's underlying customers on a net basis, before and after a default.~~

1.2.4. LSOC Protection is based on Post Haircut Value

The DCO is required to provide individual treatment to customer collateral at the DCO. The value that is legally segregated for each customer at the DCO is based on the post haircut value of customer collateral delivered to the DCO by an FCM on behalf of its customers. ~~The protection that Part 22 provides is based on the "value" of the initial margin requirement associated with the customer's portfolio of rights and obligations, as calculated by the DCO, and is segregated on this basis. All collateral delivered to the DCO is valued on a post haircut basis, regardless of whether it is required or excess collateral.~~

1.2.5. The FCMs Buffer May Be Commingled With Customer Funds

Part 22 provides that "any collateral deposited by a Futures Commission Merchant which is identified as such futures commission merchants own property may be used by the derivatives clearing organization...to margin, guarantee, or secure the cleared swaps of any or all cleared swaps customers". Because it is the responsibility of the FCM to identify the value of collateral that is the FCM's own contribution to the customer pool at the DCO, it is also the responsibility of the FCM to ensure that amount the DCO is relying upon, as the FCMs own value, is always accurate in accordance with CFTC Regulation 22.2.

As stated in FCM Regulation 10(h)(iv), LCH.Clearnet, LCH.Clearnet will allow an FCM to deposit its own funds into the Cleared Swaps Customer account at the DCO, but these funds must be separately identified to the DCO in order for them to be treated as such.

1.2.6 LSOC Without Excess

Part 22 requires that a DCO that intends~~ed~~ to accept excess customer funds from an FCM, to require a report from the FCM, at least daily, reflecting the value of the collateral ~~of the value~~ belonging to each individual customer. The "value of collateral required" arising from a customer's "portfolio of rights and obligations", or swap portfolio, is a customer's Initial Margin Requirement.

LCH.Clearnet does not intend to offer a 'with excess' model on 5 November 2012.

1.2.7 Establishing a Customer's Legally Segregated Value ("LSV")

~~Once~~ When an FCM meets its start of day margin obligation at LCH.Clearnet, LCH.Clearnet will adjust the legally segregated values of each customer to equal that customer's initial margin requirement, thereby protecting a customer's collateral value at LCH.Clearnet from being used to meet the obligations of any other customer in the event of a default. When margin calls are met intraday, LCH.Clearnet will assume that the margin being collected belongs to the customers generating the call and will therefore apply the called margin to the LSV of those customers with an indivudal margin deifict.

In accordance with Part 22, LCH.Clearnet will only use an individual customer's LSV to meet ~~any loss~~losses arising from that customer's own swap portfolio. ~~Once porting can be arranged, a customer may be transferred with its LSV.~~

1.2.8 The Treatment of "Excess" in "LSOC Without Excess"

As a result of the nature of clearing, funds may become excess without an explicit excess deposit. This will be evident in cases where a customer's margin requirement decreases or the value of the swaps customer collateral pool increases. In such cases, the DCO is limited in how it is able to treat this excess value. In a model where the DCO does not have collateral value reporting from the FCM, the DCO will be unaware of whether an FCM has met a margin call on behalf of a customer or if the customer has actually prefunded. As a result, when a customer's requirement decreases, creating excess, the DCO may not presume such excess to be FCM Buffer. Therefore, at the start of each day, the DCO ~~can~~ will ~~either~~ call an FCM for the aggregate amount by which any customer's new Initial Margin requirement is greater than the customer's LSV, and cannot be met by the FCM's Buffer. Once that call is met, the DCO will set each customer's LSV equal to each customer's initial margin requirement. The remaining excess will be deemed to be Unallocated Excess and ~~return all Unallocated Excess once the call is met~~be available for return to the FCM. ~~or the DCO can allow the FCM to provide a certification that stipulates how much of the Unallocated Excess can be used to offset the call. In the second instance the DCO could either return any remaining Unallocated Excess or hold it to be used along with future certifications.~~

~~LCH.Clearnet will not support the FCM certification method with effect from 5 November.~~ \

1.2.9 FCM Lodged Excess

Under Part 22, In LSOC Without Excess, an FCM is permitted to deposit excess funds with the DCO for the purposes of meeting any customer requirement in the future, so long as the funds only consist of the FCM's "Buffer" or residual interest.~~,~~ ~~and are characterized as "Unallocated Excess". Thus, these funds are required to be of no greater value than the FCM's capital contribution to its swaps customer segregation pool.~~

~~Unallocated Excess could only be used for the collateralisation of risk if the FCM provided a certification to the DCO that doing so would not create fellow customer risk. As reflected in the attached rules, LCH.Clearnet will allow FCMs to post FCM Buffer, but will not allow FCMs to post customer excess until the LSOC With Excess model is implemented.~~

1.2.10 Margining

Each time the DCO performs an Initial Margin Settlement with the FCM, or seeks to collateralize the increase in requirements of individual customers, the DCO will base its call on the aggregate amount by which a customer's requirements have gone up in aggregate. This amount may be reduced by the firm's buffer deposited at the DCO~~ as well as Unallocated Excess accompanied by FCM certification~~.

The variation margin settlement each day will be handled separately from the initial margin Settlement described above. By separating the two, the DCO will ensure that it is not offsetting a decrease in customer IM requirements with a Net variation margin loss across all customers. ~~LCH.Clearnet will separate initial margin and variation margin settlement in a model where it does not receive customer specific excess reporting from the FCM.~~

1.3 "Bunched Order" Trade Registration

CFTC Rule 1.35 requires that bunched orders submitted by a fund manager or other relevant entity be allocated to the ultimate customer as soon as practicable after execution and sufficiently before the end of the day on which the swap is executed to ensure that clearing records can identify the ultimate customer for each trade. LCH.Clearnet will initially register bunched orders as one trade for clearing as a single bunched order, and will then allocate the transaction among participating customer accounts for clearing purposes post acceptance/registration. Until allocation, the registered bunched orders will sit in a suspense sub-account at the clearinghouse within the account of the applicable FCM at the DCO. FCM Regulation 5(o) has been introduced in LCH Clearnet's Rulebook to make provision for this bunched order allocation process.

LCH.Clearnet has developed the following process to address bunched orders, as reflected in the attached Rulebook provisions:

- The bunched order is sent for clearing by the account manager and executing broker.
- FCM agrees to clear the account manager's side of the trade on behalf of that account manager.
- Once accepted by the FCM, the standard trade registration process will run over the bunched order(s), and it/they will be cleared once all liabilities are covered.
- Each cleared bunched order will be booked into a 'suspense' account. The account manager then executes a further transaction with the client to which it wishes to allocate part of the bunched order.
- An offsetting trade between the account manager and the client reduces the notional value of the bunched order and results in an allocation to the relevant client.

Part II: Amendments to the Rules & Regulations of LCH.Clearnet

1. Amendments to FCM Regulations (at Exhibit A1)

Certain changes have been made to LCH.Clearnet's FCM regulations in order to incorporate the requirements of Part 22 and CFTC Rule 1.35 including:

The Definitions will be amended to include a description of

- Account Manager,
- Executing Party,

- Allocating Transaction,
- Applied FCM Buffer,
- Cleared Swap,
- Cleared Swaps
- Account Class,
- FCM Buffer,
- FCM Client Sub-Account Balance,
- FCM OTC Client Segregated Sub-Account,
- Permitted Depository,
- Unallocated FCM Collateral,
- Unallocated FCM SwapClear Transaction,
- Unallocated FCM SwapClear Contract,
- Unallocated Excess,
- FCM Client Sub-Account Balance, Permitted Depository ,
- Unallocated Excess Sub-Account.
- Excess Margin,
- FCM Approved Trade Source system,
- FCM Client, LCH Approved Outsourcing Party,
- LCH OTC Client Segregated Depository Account,
- Executing Party, FCM Client.

Regulation 4 requires that each FCM Clearing Member keeps books and records identifying all information regarding its Affiliates, FCM Clients for which it provides SwapClear Clearing Services, and regarding trades made on its own behalf through its Proprietary Account.

Regulation 4.d will be amended to include the requirement that books and records must also include all FCM Contracts and Account Assets maintained in each FCM OTC Client Segregated Sub-Account for the Relevant Client.

This demand is mirrored on the side of LCH.Clearnet, by the addition of **Regulation 4.f** which requires LCH.Clearnet to establish and maintain on its books and records an FCM OTC Client Segregated Sub-Account and an FCM Buffer sub-account, in the name of each FCM Client of an FCM Clearing Member. The Client Sub-Account and FCM Buffer Sub-Account will be sub-accounts of the FCM Omnibus OTC Client Account maintained for the FCM Clearing Member. LCH.Clearnet will also be required to reflect on its books all FCM SwapClear Contracts and associated Account Assets held on behalf of FCM Clients. LCH.Clearnet however, will have no responsibility to ensure that the information provided by the FCM Clearing Member regarding FCM Contracts and Account Assets held by itself are correct.

Ancillary changes were made in **Regulations 4.e and 4.g** to accommodate for the introduction of Part 22 of the CFTC Regulations.

Regulation 4.h will be amended to contain the ‘waterfall’ for how initial margin increases are met across sub-accounts and the FCM Clearing Member’s Proprietary Account, as well as details in case LCH.Clearnet increases the Required Margin of FCM SwapClear contracts of an FCM Client and the order in which the margin increase shall be met.

FCM Clearing Members are required to inform the Clearing House of all FCM SwapClear Contracts and Account Assets held by such Clearing Member for each of its FCM Clients.

Regulation 4.i will be amended to include the duty of the FCM Clearing Member to instruct LCH.Clearnet as to the FCM SwapClear Contracts and Assets reflected in each corresponding FCM SwapClear OTC Client Segregated Sub-Account.

Under **Regulation 4.j** FCM Clearing Members will not be allowed to withdraw any amounts from their FCM Omnibus OTC Client Account or Proprietary Account, if this would cause the Margin Requirements not to be met. The regulation has been amended to include the prohibition of FCM Clearing Members to withdraw amounts from their Proprietary Accounts where there is insufficient margin in an FCM Client Sub-Account, and an insufficient amount of FCM Buffer available to offset such a deficiency in the Required Margin.

Ancillary changes were made to **Regulations 4.e and 4.g** to include provisions for the introduction of Part 22 of CFTC Rules regarding the holding of Collateral.

Regulation 5.o contains the new mechanism for the execution of a 'bunched order' by an Account Manager Executing Party and subsequent allocation of such bunched order through the registration of further transactions.

Regulation 6.c introduces rule changes to cater for the introduction of Part 22 of the CFTC Regulations and its effect on accounts (including the required level of segregation). In particular, the new regulation requires that LCH.Clearnet must treat the value of all Account Assets received on behalf of a Client as belonging to that Client, and therefore cannot be used to margin, guarantee or secure Contracts or Obligations of other Clients or of the Clearing Member. Furthermore, LCH.Clearnet will not be allowed to combine or consolidate the balances of several FCM Omnibus OTC Client Accounts belonging to the same FCM Clearing Member.

The rules regarding the provisions for the transfer of the portfolio of an FCM Client will be amended to cater for the introduction of FCM OTC Client Segregated Sub-Accounts. **Regulation 9.b, 9.c and 9.i** will be amended to cater for the introduction of sub-accounts.

Regulation 10.h addresses how LCH.Clearnet deals with excess attributable to an account (both proprietary accounts and client sub-accounts). It includes a restriction on FCM Clearing Members providing excess to LCH.Clearnet (in the LSOC without excess model). The provision also details how excess is swept to an Unallocated Excess Account at the end of each day.

Regulations 10.j and 10.n will be amended to include Client Segregated Sub-Accounts.
Ancillary changes were made to **Regulations 10.o and 10.p**.

Regulation 16 will be amended to include the right of LCH.Clearnet to convert monies standing to the debit or credit of an FCM Clearing Member's accounts (including FCM OTC Client Segregated Depository Accounts and FCM Omnibus OTC Client Accounts) into any currency it thinks fit, at reasonable rates. **Regulation.29** will be amended and updated to provide for changes introduced by Part 22 of the CFTC Regulations.

2 Amendments to the FCM Procedures (at Exhibit A2)

Rule 2.15.4 of the Procedures details how, in the event that LCH.Clearnet determines that an FCM Client will be liquidated, hedging and liquidation costs are allocated to such FCM Clients. It provides supplementary procedures (in addition to the Default Rules and other applicable provisions in the Rulebook) that will apply upon the default of an FCM Clearing Member.

Rule 4.10 of the Procedures will be amended to contain provisions detailing how, when Unallocated Excess has been created, it may be released to an FCM Clearing Member. The rule change will address how Unallocated Excess or FCM Clearing Buffer may be returned to the FCM Clearing Member.

3 Amendments to the Default Rules (at Exhibit A3)

The Default Rules were amended in order to accommodate the introduction of LSOC accounts:

Rule 8 (d) has been amended to expand the provisions to cater for the fact that proprietary assets of a clearing member may be used to make good a shortfall across all sub-accounts, rather than across the general omnibus account.

Rule 8.e. has been amended to cater for the fact that there is a separate net sum for each sub-account rather than across the (former) omnibus client account as a whole.

Rule 8 (penultimate paragraph): Provisions have been included to explain that Unallocated Excess may not be used by LCH.Clearnet in making good any losses that it suffers. Unallocated Excess must be returned to the clearing member's bankruptcy official (use of such excess may mean a breach of Part 22)

Rule 8 (final paragraph) As part of the SwapClear Default Management Process, LCH.Clearnet hedges the contracts of clients that are not ported to an alternative clearing member. The reference in this paragraph cross refers to the new section in the FCM Procedures which sets out how hedging and liquidation costs are apportioned.

Rule 9 will be amended to cater for corresponding changes for the introduction of multiple net sums for multiple sub-accounts.

Rule 9.A.a deals with the transfer of FCM Contracts between FCM Clearing Members in case of a default, and the credit of individual clients' variation margin credits post default to the transferee FCM Clearing Member.

Rule 9.A.b deals with the transfer of FCM Contracts between FCM Clearing Members in case of a default, and the credit of individual clients' variation margin payments post default directly to the client

Rule 9.c.i contains provisions to limit the return of post default variation margin credits where a sum is due to LCH.Clearnet with respect to the relevant client.

Rule 9.c.ii deals with rights of LCH.Clearnet to set off any payments or credits in regards to Variation Margin owed by LCH.Clearnet against excess liquidation costs applicable to the relevant client, where an FCM Client's FCM SwapClear Contracts are liquidated.

Rule 9.d Each FCM Client of a defaulter is made a third-party beneficiary of rule 9A. This clause is designed to ensure that individual clients' post default variation margin payments are enforceable.

Changes will be made in **Rules 10.a, 10.i, 10.b and 10.c** to cater for the introduction of multiple sub-accounts.

Part III: Compliance with CFTC Regulation 39.13(g)(8)(i)

No Rule amendements will be made in relation to CFTC Regulation 39.13(g)(8)(i) for the SwapClear service. LCH.Clearnet's SwapClear service is already compliant with CFTC Regulation 39.13(g)(8)(i) as SwapClear clients are margined on a gross basis which is reflected at Regulation 4 (h) of the FCM Regulations.

Part IV: Certification by LCH.Clearnet

LCH.Clearnet certifies to the CFTC, in accordance with CFTC Regulation §40.6, that the amended rules, comply with the Commodity Exchange Act and the CFTC Regulations promulgated thereunder. In addition, LCH.Clearnet certifies that LCH.Clearnet has posted a notice of pending certification with the CFTC and a copy of the submission on LCH.Clearnet's website at
http://www.lchclearnet.com/rules_and_regulations/ltd/proposed_rules.asp
A signed certification is attached to this submission as Exhibit B.

Part V: Compliance with Core Principles

LCH.Clearnet will continue to comply with all Core Principles following the introduction of these proposed amendments into the LCH.Clearnet Rulebook. LCH.Clearnet has concluded that its compliance with Core Principles would not be adversely affected by these changes. Finally, the rule changes as a result of CFTC regulation coming into effect on November 8, 2012 will ensure continued compliance with the Core Principles and in particular with Core Principle E.

Part VI: Opposing Views

There were no opposing views expressed to LCH.Clearnet by governing board or committee members, members of LCH.Clearnet or market participants that were not incorporated into the rule.

Should you have any questions regarding this submission please contact me on +44-207-426-7285 or at jay.iyer@lchclearnet.com.

Yours sincerely

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Jay Iyer
Chief Compliance Officer
LCH.Clearnet Limited