

VIA CFTC PORTAL

1 December 2021

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

LCH Limited Self-Certification: Treatment of Client Accounts in the Default Management Process

Dear Mr. Kirkpatrick,

Pursuant to Commodity Futures Trading Commission (“CFTC”) Regulation §40.6(a), LCH Limited (“LCH”), a derivatives clearing organization registered with the CFTC, is submitting for self-certification revisions to its rules related to the attribution of: (i) market profits or losses in a client default management account (“DMA”), and (ii) auction losses during the management of a clearing member default.

Part I: Explanation and Analysis

In the event of a default of a clearing member, LCH seeks to protect associated client accounts through the activation of porting processes whereby they will be transferred to a back-up clearing member, under either the US or the international client clearing models, as applicable. However, where a client is unable to port, for example due to a lack of back-up clearing members or if the client requests to be closed out, its positions will be liquidated and the relevant client account becomes subject to the default management process, separately from the default management of the respective defaulting clearing member.

Under the current LCH Rulebook, multiple clients subject to the default management process may be aggregated into one or more DMAs to improve the efficiency of hedging and minimize operational complexity¹. The proposed rule changes maintain this flexibility, but clarify the allocation of market profits or losses experienced in the DMA, and alters the methodology used for the attribution of auction losses.

In order to provide for a consistent and clear approach to the usage of DMAs, LCH plans to revise its rules, specifically the LCH Procedures (Section 2C SwapClear Clearing Service and Section 2I ForexClear Clearing Service) that cover client clearing under the international client clearing model and the LCH FCM Procedures that cover client clearing under the US client clearing model (jointly the “Procedures”).

Part II: Description of Rule Changes

The changes described below are applied consistently across the Procedures. With respect to the LCH Procedures (Section 2C SwapClear Clearing Service) and LCH FCM Procedures, the revisions replace the current process in an effort to achieve greater clarity and equity. In the LCH Procedures (Section 2I ForexClear Clearing Service) the changes will now be added as clients are starting to actively clear under the international model via the ForexClear service.

¹ Client accounts can only be aggregated with others that are under the same defaulting clearing member and therefore by definition, only those under the same clearing model, US or international.

Where two or more clients are aggregated into a single DMA, profits or losses incurred by the combined account are allocated to the individual clients pro rata based upon relative margin liability. However, the Rulebook is currently not explicit about the specific point of measurement of this liability. The proposed revisions explicitly state that the point of measurement is the last good margin call prior to the default.² LCH believes this is the appropriate timing as the last good margin call was the last time a client could have influenced their positions and, therefore, the margin computation. The proposed allocation of profits or losses utilizes the ratio of relative margin liability for all profit or loss incurred by the DMA from (and including) the day when the aggregation occurred. The proposed revisions do not reflect a change in the spirit or implementation of the rules, but merely clarify the process.

The proposed revisions introduce a new method for the allocation of auction losses incurred during the default management process. Under the current rules, allocation is linked to notional and position direction, but this can give rise to non-equitable attributions. The identical treatment of different products with different tenors may also be problematic. For example, an FRA and a long-dated swap are currently given equal weight. The revised method again uses the last good margin call prior to the default for clients in the auction to allocate losses, providing for fairer attributions.

These changes provide for the consistent use of initial margin as a basis for allocation related to DMAs and auctions and therefore create a coherent and similar approach across the allocation process. The proposed changes are intended to make the process more clear both internally and to members and clients, while removing potential ambiguity associated with the current rules.

The changes to the rules are included as **Appendices I - III** in black line form. The changes will be effective not earlier than 16 December 2021.

Part III: Core Principle Compliance

LCH reviewed the proposed rule changes against the requirements of the Core Principles and finds it will continue to comply with all requirements and standards set forth therein. Specifically, this rule change has potential relevance to Core Principles D (Risk Management) and G (Default Rules and Procedures).

LCH believes the changes described in this filing will not impact LCH's ongoing compliance with the objectives of Core Principle D. The revisions related to treatment of client accounts in default management will not require changes to LCH's risk management framework, margin methodology, or margin requirements. As explained above, LCH will use client initial margin requirements as the basis for allocating gains and/or losses during default management. However, this will not alter the methodology for the calculation of client or clearing member initial margin requirements. LCH considered its risk management requirements and believes the changes related to the allocation of gains and/or losses in DMAs and auctions will not impact LCH's ongoing compliance with Core Principle D. The changes have been reviewed and approved internally via the LCH risk governance process.

Additionally, LCH believes the changes described in this filing enhance its compliance with the objectives of Core Principle G, including that LCH have rules and procedures designed to allow for the efficient, fair, and safe management of events during which clearing members become insolvent or default on obligations to LCH. In revising its process for the management of client funds during a clearing member default, LCH considered efficiency, fairness and safety. With the proposed changes, LCH intends to increase fairness by clarifying that the last good margin call will be used when determining the allocation of gains and losses in DMAs. Furthermore, allocating auction losses to clients based upon margin requirements rather than notional and

² Please see definition of: "Pre-Default TMR," "Pre-Default TMR Ratio," "Pre-Merger TMR," and "Pre-Merger TMR Ratio."

position direction avoids potential unfair attributions, even to the point that gains are possible in the allocation of a loss. LCH believes the proposed changes maintain the existing levels of efficiency and safety and that overall, the proposed revisions enhance its compliance with the requirements of Core Principle G.

LCH believes these changes are consistent with the requirements of Core Principle D on Risk Management under CFTC regulation §39.13, and Core Principle G on Default Rules and Procedures under CFTC regulation §39.16.

Part IV: Public Information

LCH has posted a notice of pending certification with the CFTC and a copy of the submission on LCH's website at: <https://www.lch.com/resources/rulebooks/proposed-rule-changes>.

Part V: Opposing Views

There were no opposing views expressed to LCH by governing board or committee members, members of LCH or market participants.

Certification

LCH hereby certifies to the CFTC, pursuant to the procedures set forth in CFTC Regulation §40.6, that the attached submission complies with the Commodity Exchange Act, as amended, and the regulations promulgated thereunder.

Should you have any questions please contact me at julian.oliver@lseg.com.

Yours sincerely,



Julian Oliver
Chief Compliance Officer
LCH Limited

Appendix I
LCH Procedures (Section 2C SwapClear Clearing Service)
Changed Pages

Appendix II
LCH Procedures (Section 2I ForexClear Clearing Service)
Changed Pages

Appendix III
LCH FCM Procedures
Changed Pages