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27 September 2012

Dear Sir and Madam:

This letter provides the response of LCH.Clearnet Group Limited ("LCH.Clearnet") to the Canadian Securities Administrators ("CSA") Derivatives Committee's ("Committee") Consultation Paper 91-406 Derivatives: OTC Central Counterparty Clearing ("Consultation Paper").

LCH.Clearnet is the world's leading clearing house group, 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, foreign exchange, freight, interest rate swaps, credit default swaps and bonds and repos. LCH.Clearnet works closely with market participants and exchanges to identify and develop clearing services for new asset classes.

LCH.Clearnet appreciates the opportunity to respond to the Consultation Paper. LCH.Clearnet commends the Committee for the sensible approach that it proposes to developing regulations that will allow Canada to achieve its G-20 commitments on the clearing of OTC derivatives. The approach described in the Consultation Paper recognizes the global nature of OTC derivatives and appropriately takes into account guidance from the Financial Stability Board and International Organization of Securities Commissions ("IOSCO") on the oversight of central counterparties ("CCPs"). We are especially pleased that the Consultation Paper identifies the recognition of foreign-based CCPs as a priority issue and recommends that regulators of a CCP develop a

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clear, co-operative oversight framework to deal with the regulation of CCPs that are subject to multi-jurisdictional regulation. LCH.Clearnet is committed to working with CSA as well as with both the Canadian buy and sell-side as requirements for clearing OTC derivatives develop.

### **Responses to specific questions raised in the Consultation Paper**

**Question 1. Do you consider that product characteristics of any OTC derivative asset classes make them eligible for CCP clearing based on the factors set out herein? If so what asset classes would you exclude, and for what reasons?**

LCH.Clearnet concurs in the Committee's recommendations on the process for determining which OTC derivatives to subject to mandatory clearing and on the back-loading of pre-existing transactions. These recommendations are consistent with the approaches being taken by the US Commodity Futures Trading Commission ("CFTC") as it implements the Dodd-Frank Act and by the European Securities and Markets Authority ("ESMA") as it implements the European Market Infrastructure Regulation ("EMIR"). In LCH.Clearnet's experience, many new participants choose to back-load pre-existing transactions. LCH.Clearnet asks the Committee not to restrict the voluntary back-loading of pre-existing transactions.

With regard to Question 1, the Consultation Paper correctly identifies the product characteristics that should be considered when determining whether an OTC derivative is eligible for mandatory CCP clearing. LCH.Clearnet believes that all OTC interest rate derivative products currently cleared by CCPs have product characteristics that are consistent with mandatory clearing.

LCH.Clearnet agrees with the Committee that international consistency is important in determining which derivatives should be subject to mandatory CCP clearing.

**Question 2. For which asset classes do you consider CCP clearing is inappropriate or not currently feasible based on the factors described herein, and for what reasons?**

LCH.Clearnet believes that all OTC derivative products currently cleared by CCPs should be evaluated against the product characteristics identified by the Committee to determine whether they should be required to be cleared. OTC interest rate derivatives that are currently cleared should be evaluated first followed by other asset classes.

**Question 3. What are the costs and risks involved in moving particular derivatives or classes of derivative transactions to CCP clearing that regulators should consider in determining if a derivative should be subject to a CCP clearing requirement?**

Implementing the Committee's recommendations on determining which OTC derivatives to subject to mandatory clearing will mitigate the costs and risks of moving derivative transactions to mandatory CCP clearing. These recommendations include an opportunity for public comment that will provide market participants with notice about which derivatives may be subject to mandatory clearing and time to plan for mandatory clearing. The Committee's recommendation that pre-existing transactions be exempt from mandatory clearing will also mitigate costs to market participants.

**Question 4. Does a deferred submission, be it measured in minutes, hours or days, engender significant counterparty or other risks that would make the imposition of a strict timeframe for submission to a CCP, and the acceptance by the CCP necessary?**

The Committee recommends that if a derivative that is subject to a clearing obligation is traded on a recognised trading venue, the counterparties (or the trading venue acting on behalf of the counterparties) must submit the trade as soon as possible, preferably via a fully automated process, which requires integration between the trading venue and the CCP's systems. LCH.Clearnet respectfully requests the Committee to take into consideration sufficient implementation times for any proposals that would enforce fully automated processes.

With regard to Question 4, LCH.Clearnet believes that the principal factor for consideration in the imposition of a strict timeframe for acceptance of trades to a CCP is prudent risk management. As a result, LCH.Clearnet welcomes the Committee's recognition that the acceptance of a trade should be subject to a review process, in order to eliminate any inappropriate risk to the CCP. Such review is not inconsistent with speedy acceptance by a CCP of trade for clearing but speed should not be favoured over prudent risk management.

**Question 5. The Committee asks whether an exemption from mandatory CCP clearing for intra-group transactions is appropriate, including a description of the risks that they could pose to the marketplace and the costs of migrating such transactions to a CCP.**

LCH.Clearnet agrees with the Committee that it is appropriate for certain intra-group transactions to be exempt from mandatory clearing. LCH.Clearnet believes this is an area where international consistency is necessary to ensure a level playing field and to limit regulatory arbitrage. Recent regulation in the EU excludes intra-group transactions from the mandatory clearing requirement, and there are regulatory proposals in the US to effect the same exclusion. LCH.Clearnet urges the Committee to align its recommendation on intra-group transactions with the approaches to such transactions in the EU and US.

**Question 6. Is it appropriate to ensure that Canadian market participants have meaningful input into operational decisions of a CCP operating in Canada?**

LCH.Clearnet concurs in the Committee's recommendation that market regulators provide for the recognition and regulation of CCPs, and that market regulators should have the ability to apply terms and conditions to the recognition or exemption from recognition of a CCP. LCH.Clearnet also agrees that the recent CPSS-IOSCO Principles for Financial Market Infrastructures provide an internationally applicable baseline for developing requirements applicable to CCPs recognised in Canada. The regulators in each jurisdiction in which a CCP operates have a legitimate interest in making sure that the CCP's operations address any particularities of that jurisdiction. However, there is a danger that CCPs that operate in multiple jurisdictions could be subject to duplicative or conflicting regulations. To avoid this situation, LCH.Clearnet strongly agrees with the Committee's observation that the regulators of a CCP, both domestic and foreign, should develop and commit to a clear, co-operative oversight framework to address the regulation of CCPs that are subject to multi-jurisdictional regulation. In this regard, LCH.Clearnet urges the Committee to ensure that any terms and conditions to recognition or exemption of a CCP are closely coordinated with those imposed by the CCP's home regulator and other regulators with an interest in the CCP's operation.

With regard to Question 6, LCH.Clearnet supports the principle that a CCP should provide a forum for the interests of relevant stakeholders from the different jurisdictions served by the CCP. LCH.Clearnet's Canadian User Group provides a forum for the communication on issues of particular importance to the Canadian market. These concerns are taken into account as LCH.Clearnet develops its Canadian product offering. However,



LCH.Clearnet believes that the Committee should not prescribe a particular method for input from Canadian market participants.

**Question 7. Do the Committee's proposals relating to corporate governance of a CCP address potential issues relating to conflicts of interest that may arise in the operation of a CCP? If not, what other measures would address such conflicts of interest?**

LCH.Clearnet believes the Committee's proposals relating to corporate governance are appropriate.

**Question 8. The Committee seeks public comment on the relevance of developing rules allowing for the access to CCPs regardless of trading venue. Is it of concern in the Canadian marketplace at this time or in the future?**

The development of non-discriminatory access provisions to CCPs, by both market participants and trading venues, is relevant in the context of the introduction of a clearing obligation for OTC derivatives. In order to ensure a fully functioning OTC derivatives market that operates consistent with the G-20 commitment, authorised CCPs should be able to clear transactions executed on any trading venue, and trading venues should be able to provide trade feeds to multiple authorised CCPs, notwithstanding the right of both to accept or reject such access.

**Question 9. The Committee asks for comment on the type of information that a CCP should provide and that should be made publicly available.**

LCH.Clearnet requests clarification on one of the Committee's recommendations on CCP risk management. Recommendation 9.3.8 states that "a CCP [must] have a chief risk officer who . . . reports to the CCP's board of directors or risk committee, as appropriate." LCH.Clearnet interprets this Recommendation as requiring a CCP's CRO to *make* reports to the Board or Risk Committee independently of senior management. We request that the Committee confirm whether LCH.Clearnet's interpretation is correct.

With regard to Question 9, LCH.Clearnet agrees with the Committee's recommendation on the type of information that a CCP should be required to provide to its market regulators. LCH.Clearnet asks that the CSA align its requirements on the format of this information with the requirements of the other regulators of the CCP. Some of the information provided to regulators is commercially sensitive; a CCP should not have to disclose this information to the public or to market participants. As a result, only a subset of the information provided to regulators should be required to be disclosed to the public and to market participants. Information appropriate for public disclosure includes the financial resource package available to a CCP in the event of a default, margin-setting methodology, clearing house fees, and the CCP's rules and procedures, including contract specifications. The margin requirements for each clearing member will, of course, be communicated to that clearing member.

**Question 10. Generally, the Committee has endeavoured to follow international recommendations in the development of the recommendations for Canada in this paper. Are there recommendations that are inappropriate for the Canadian market?**



This question requires a detailed knowledge of the Canadian market. Therefore, local stakeholders are best placed to respond.

**Question 11. Are there changes to the existing regulatory framework that would be desirable to accommodate a move to CCP clearing?**

LCH.Clearnet believes that the Committee's recommendations will accommodate a move to CCP clearing.

**Question 12. Do you consider that any changes need to be made to Canadian law to facilitate the efficiency of OTC derivatives clearing, either through a domestic or a foreign CCP? If so, what changes and for what reasons?**

From a legal perspective, LCH.Clearnet's primary goal in any jurisdiction is to ensure that LCH.Clearnet has sufficient comfort with respect to the actions LCH.Clearnet carries out in the event of a clearing member insolvency (i.e. the actions LCH.Clearnet carries out under LCH.Clearnet Default Rules). In this regard, LCH.Clearnet already has sufficient legal comfort under local law with respect to inter-dealer proprietary OTC derivatives positions. However, LCH.Clearnet believes that changes in law are necessary to provide sufficient certainty with respect to client clearing being offered by Canadian entities and in order to permit LCH.Clearnet to gain sufficient comfort that the porting of contracts and collateral would not be subject to challenge from an insolvency practitioner in Canada. Any uncertainty around a local insolvency practitioner's ability to restrict or impede LCH.Clearnet's actions or claw-back any payments or transfers is a material legal risk that would factor into our ability to satisfy both ourselves and our regulators that we can offer clearing for clients through members incorporated in Canada. LCH.Clearnet previously provided comments to the Department of Finance Canada on specific changes to the law in Canada that would support CCP clearing of OTC derivative transactions. LCH.Clearnet urges the Committee to work with Department of Finance Canada to secure approval of these suggested changes.

LCH.Clearnet appreciates the opportunity to comment on these important issues and would be pleased to enter into a further dialogue regarding these issues. Please do not hesitate to contact Lisa Rosen at +44 (0)207 426 7541 regarding any questions raised by this response letter.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Michael Davie', written in a cursive style.

**Michael Davie**  
On behalf of LCH.Clearnet Group Limited