

November 5, 2010

Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**RE: SEC Rel. No. 34-63107, File No. S7-27-10, “Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC”**

Dear Ms. Murphy,

The LCH.Clearnet Group (“LCH.Clearnet”) is pleased to respond to the request for comment by the Securities and Exchange Commission (the “SEC” or “Commission”) on the “Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC.”<sup>1</sup>

LCH.Clearnet appreciates the careful thought and consideration that the Commission has given to the rulemaking process and the open way in which it has consulted with market participants and other interested parties. LCH.Clearnet strongly supports the policy goals underpinned both by the Proposing Release and the statutory provisions contained in Section 765 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

Section 765 of the Dodd-Frank Act requires the Commission to adopt rules mitigating conflicts of interest with respect to any clearing agency that clears Security-Based Swaps. These rules may include numerical limits on the control of, or the voting rights with respect to, such a clearing agency by one of several specified market participants. These participants include a Security-Based Swap dealer, a major Security-Based Swap participant, and a large bank holding company or non-bank financial company regulated by the Federal Reserve.

LCH.Clearnet has long recognized that potential conflicts of interest may arise from such firms’ ownership stakes in clearing agencies. Clearinghouse shareholders who deal in over-the-counter (“OTC”) derivatives may have an interest in seeing that the clearinghouse does not clear the instruments in which they deal – although LCH.Clearnet’s substantial OTC derivatives clearing book plainly evidences the contrary. Such conflicts of interest are not limited to derivatives dealer shareholders: exchanges may also have an interest in seeing that a clearinghouse

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<sup>1</sup> SEC Rel. No. 34-63107, File No. S7-27-10, “Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC” (the “Proposing Release”).

in which they are shareholders does not clear instruments traded on competing exchanges or in the OTC market, while end users may have an interest in seeing that a clearing agency in which they are shareholders keep margin requirements and other associated costs artificially low.

LCH.Clearnet has adopted a number of corporate governance safeguards that ensure that such conflicts of interest do not affect the safety and soundness of its clearinghouses. These safeguards ensure that the Group is able to serve markets, innovate and develop clearing services for new asset classes, sometimes for competing exchange partners. The Group's safeguards include limitations on voting rights by individual shareholders; independent board membership requirements; and objective and transparent clearinghouse membership criteria.

The effectiveness of the governance safeguards adopted by LCH.Clearnet has been demonstrably proven. Since 1999, when it first rolled out its innovative interest rate swap and repurchase agreement clearing services, the Group has consistently strived to expand its range of cleared OTC products, pioneering a large range of successful and proven OTC services. As well as offering a range of OTC cleared services to the European repo, and global energy, commodity, freight and emissions markets, LCH.Clearnet currently clears more than 40 percent of the global interest rate swap market through its SwapClear service, representing trades with a total notional principal of over \$220 trillion in 14 currencies.<sup>2</sup> Of that amount, approximately \$85 trillion is in U.S. dollars. There are currently 33 members of LCH.Clearnet's SwapClear service. In December 2009 the service was extended to facilitate client clearing and since then a wide range of end customers have used the service, ahead of an explicit regulatory obligation to do so.

LCH.Clearnet's application of transparent but onerous membership criteria promotes the operation of its clearinghouses in a manner that is free from conflicts of interest. To ensure the safe and sound operation of its clearinghouses, LCH.Clearnet employs membership eligibility criteria for each market that it clears. The criteria are approved by the Group's Risk Committees and Board of Directors and include transparent and objective minimum capital requirements, operational standards, and in some cases credit ratings. Members must separately satisfy the criteria for each different clearing service they wish to join. A clearing member may provide access to the clearing service for all of its clients; LCH.Clearnet does not set any criteria regarding the access to clearing by clients of clearing members or otherwise discriminate among clients or third-parties.

For OTC derivative markets, LCH.Clearnet Limited has additional objective criteria to establish whether a clearing member is able to participate in the default management arrangements that are critical to the stability of the service and the clearinghouse. All of these criteria are completely transparent and available on the clearinghouse's website. The resilience of SwapClear's default management process was demonstrated in September 2008 when it successfully handled Lehman Brothers' \$9 trillion interest rate swap default. The highly effective default management process ensured that over 60,000 trades were hedged and auctioned off to other clearing members in a timely fashion and that the default was managed well within the margin held and with no recourse to the default fund.

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<sup>2</sup> From Q1 2011 the range of currencies cleared will be extended from 14 to 20, to include IRS denominated in HUF, CZK, KRW, MXN, BRL and SGD. This extension will enable over 95 percent of the global IRS market to be cleared through SwapClear.

Following are LCH.Clearnet's comments with respect to certain specific proposed rule provisions contained in the Proposing Release.

**242.701 Mitigation of conflicts of interest of Security-Based Swap clearing agencies**

(a) Limits on voting interest

LCH.Clearnet supports proposed Rule 242.701(a)1(i-ii), prohibiting any Security-Based Swap clearing agency participant, either alone or together with its related persons, from directly voting or causing the vote of any interest in the Security-Based Swap clearing agency that exceeds 20 percent of the voting power of such clearing agency. Ensuring that no individual entity is able to unduly influence the management and or operation of a clearing agency is an important policy goal that is upheld by LCH.Clearnet.

LCH.Clearnet is nonetheless concerned by the proposed provisions contained at 242.701(a)1(ii-iv), which provide that participants should not collectively own or vote on more than 40 percent of any class of securities or other ownership interest. LCH.Clearnet believes that Congress correctly rejected any collective or aggregate limits on clearing agency participants' ownership of clearing and trade execution facilities in the Dodd-Frank Act. As enacted, Section 765 of the Dodd-Frank Act gives the SEC discretionary authority to limit the control of, or the voting rights with respect to, a clearing agency by an individual bank holding company or other specified entity. It does not authorize the SEC to limit aggregate ownership of a clearing agency by bank holding companies or other specified entities.

(b) Limits on voting interests

LCH.Clearnet commends the Commission for proposing five percent as an appropriate threshold at which to set a limitation on voting interests as outlined under proposed Rule 242.701(b). LCH.Clearnet would nonetheless observe that a voting limitation such as that proposed by the Commission and outlined above would more appropriately be applied to all kinds of shareholders, rather than solely to clearing agency participants.

LCH.Clearnet's corporate charter already prohibits any shareholder from exercising votes representing more than five percent of the shares in issue, even if a shareholder actually holds a number of shares amounting to more than five percent of the total number of shares in issue. This measure has effectively ensured that neither a single shareholder nor a small group of shareholders – whatever their origin or collective interests - has been able to dominate management of LCH.Clearnet's clearinghouses and determine their policies, such as which asset classes will be cleared. Instead, the management and policies of the clearinghouses must respect the broad interests of all shareholders, including exchanges, financial intermediary users, and end users.



LCH.Clearnet also believes that a limitation on voting interests is itself sufficient to ensure that conflicts of interests can be sensibly addressed. LCH.Clearnet therefore encourages the SEC to discard the additional “ownership limitation” proposal as it believes it is unnecessary and unduly restrictive. Hardwiring ownership limitations into the Commission’s rules may restrict the ability and incentive of participants to invest in new clearing agencies and may thereby inadvertently hamper the development of OTC derivatives clearing.

Restrictive ownership limits may also impede the ability of existing clearinghouses to grow and provide clearing services effectively in the global financial markets. LCH.Clearnet believes that restrictions on voting rights by individual shareholders, a fair representation requirement for Board composition and objective and transparent membership criteria would strike a better balance between mitigating conflicts of interest and ensuring a competitive market for clearing services.

(c) Composition of Boards

LCH.Clearnet believes that the Boards of Security-Based Swap clearing agencies should include Independent Directors. Nonetheless it is concerned by the provision at proposed Rule 242.701(b)(3), requiring that “the majority” of the Board members should be Independent Directors.

The LCH.Clearnet Board currently has four independent members (representing approximately 25 percent of the Board). Additionally, the LCH.Clearnet Board is composed of a balanced mix of exchange representatives and financial intermediaries. This wide spectrum of diverse representation ensures that the Board is balanced, and well-positioned to serve the interest of LCH.Clearnet’s entire shareholder and user community and to operate the clearinghouses accordingly.

LCH.Clearnet believes that it is of key importance to ensure that the participants who have capital at stake in the clearinghouse are fully involved in all Board decisions, avoiding any incentives by other stakeholders to erode risk management standards in order to increase profitability or gain market share. It is also critical that clearing agency Boards be furnished with a sufficiency of the necessary risk and market expertise to ensure that their operations are managed in accordance with the responsibilities and in support of the objectives laid out under the Act. Former Security-Based Swap dealers who are no longer actively engaged in the business, and who might qualify as Independent Directors under the Agency’s definition, will bring a wealth of useful knowledge and experience to the table. LCH.Clearnet would nonetheless observe that it is critical in these fast-changing markets that the balance of expertise come from the active Security-Based Swap dealer community.

LCH.Clearnet would therefore recommend that the SEC either adopt a 25 percent Independent Director representation requirement or, alternatively, enforce a “fair representation” requirement on clearing agency Board compositions.

LCH.Clearnet believes that the Boards of clearing agencies would be better able to preserve the safeguards required under the Dodd-Frank Act and serve the interests of all constituencies were they to be subject to either this 25 percent limit or to a more flexible “fair representation” requirement. Such a rule could require clearing agencies to ensure that both independent viewpoints, as well as those of clearing agency participants and exchanges or Security-Based Swap execution facilities had a voice in Board level decisions. LCH.Clearnet believes that the more flexible, but equally objective and transparent Board composition criteria outlined immediately above would strike a better balance between mitigating conflicts of interest and ensuring a competitive market for clearing services.

(d) Nominating Committee

LCH.Clearnet believes that the requirements contained in the proposed Rule 242.701(a)(4) and 242.701(b)(4), that a Security-Based Swap clearing agency’s Nominating Committee be comprised of “a majority” of Independent Directors, is too onerous and does not believe that such requirement would have a sufficiently positive effect on mitigating conflicts of interest as would justify its imposition.

Rather, LCH.Clearnet believes that it is important that those serving on the Nominating Committee have a detailed knowledge of the market in which the clearinghouse operates. LCH.Clearnet believes that it is important that there is input from Independent Directors on the Nominating Committee and therefore recommends that the Nominating Committee have a threshold of 25 percent Independent Directors.

(e) Other Committees of the Board

With respect to proposed Rule 242.701(a)(5) and 242.701(b)(5), LCH.Clearnet believes that the composition of any other Committees of the Board should reflect the composition of the Board as a whole. Again, however, LCH.Clearnet would recommend that a “fair representation” requirement should be sufficient to ensure that the Committees of the Board are balanced and able to serve the interests of LCH.Clearnet’s entire shareholder and user community, as well as the financial markets more generally.

LCH.Clearnet supported the Dodd-Frank Act because of the new law’s provisions in Title VII designed to reduce risk and increase transparency in the OTC derivatives market through mandated clearing. LCH.Clearnet believes this mandate is a major step toward preventing another financial crisis from occurring and supports the Commission as it progresses with its important task of writing the rules required to implement the statutory provisions required under the Act. At the same time, and as many Security-Based Swap clearing agencies will also seek registration with the Commodity Futures Trading Commission (“CFTC”) as “Derivatives Clearing Organizations,” LCH.Clearnet urges the Commission to work with the CFTC to establish consistent regulations for these two regulatory designations.

LCH.Clearnet appreciates the opportunity to comment on these important rule proposals and would be pleased to enter into a further dialogue with the Commission and its staff. Please contact Simon Wheatley at (+44) 207 426 7622 regarding any questions raised by this letter or to discuss these comments in greater detail.

Sincerely yours,



Roger Liddell  
Chief Executive