

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

September 24, 2010

RE: “SEC Regulatory Initiatives Under the Dodd-Frank Act”

Dear Ms. Murphy,

LCH.Clearnet Group Limited (“LCH.Clearnet”) is pleased to respond to the request for comment by the Securities and Exchange Commission (the “SEC” or “Commission”) on “SEC Regulatory Initiatives Under the Dodd-Frank Act.”¹ LCH.Clearnet had urged for passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) because of the new law’s provisions in Title VII designed to reduce risk and increase transparency in the over-the-counter (“OTC”) derivatives market through mandated clearing. LCH.Clearnet believes this mandate is a major step in preventing another financial crisis from occurring.

LCH.Clearnet is the world’s leading independent clearinghouse group. It serves major international exchanges and platforms, as well as a range of OTC markets. It clears a broad range of asset classes, including cash equities, exchange-traded derivatives, energy, freight, interest rate swaps and euro- and British pound-denominated bonds and repos. LCH.Clearnet Limited currently clears more than 40% of the interest rate swap market representing trades with a total notional principal of over \$220 trillion in 14 currencies. Of that amount, approximately \$85 trillion is in U.S. dollars. LCH.Clearnet works closely with market participants and exchanges to identify and develop services for new asset classes. LCH.Clearnet was formed out of the merger of the London Clearing House Ltd and Clearnet SA and continues to operate two clearinghouses, LCH.Clearnet Limited in London² and LCH.Clearnet SA³ in Paris.

Mandatory Clearing of Security-Based Swaps, End-User Exception and Security-Based Swap Clearing Agencies

¹ See SEC Press Release No. 2010-135 (July 27, 2010).

² LCH.Clearnet Ltd is regulated by, *inter alia*, the Financial Services Authority of the United Kingdom and by the Commodity Futures Trading Commission (as a “Derivatives Clearing Organization”) of the United States.

³ LCH.Clearnet SA is regulated as a Credit Institution and Clearing House by a regulatory college consisting of, amongst others, the market regulators and central banks from the jurisdictions of: France, Netherlands, Belgium and Portugal. It is also regulated as a Recognised Overseas Clearing House by the UK Financial Services Authority.

Open Access

New Section 3C(a)(2) of the Securities Exchange Act of 1934 (the “Exchange Act”), enacted by Section 763 of the Dodd-Frank Act, requires that the rules of a security-based swap clearing agency prescribe that swaps submitted with the same terms and conditions are economically equivalent and may be offset with each other. LCH.Clearnet believes that full position offsets may not be feasible for all OTC derivatives, owing to their lack of homogeneity.⁴ LCH.Clearnet has found that the best way of accommodating less homogeneous OTC derivatives transactions within a CCP is to clear these transactions on a gross basis while establishing margin requirements on clients’ net risk positions. In such a way clearinghouses are able to minimize the economic impact of clearing for users, whilst reducing risks to the system and ensuring the financial integrity of the clearinghouse remains intact. LCH.Clearnet suggests that the Commission’s rules for the operation of security-based swap clearing agencies allow them to satisfy this “open access” requirement by providing economic offsets between open positions for margining purposes.

At the same time, LCH.Clearnet does not believe that the “open access” rule requires the abandonment of clearinghouse membership criteria. Instead, the Dodd-Frank Act requires that such criteria be transparent, appropriate, and enforced even-handedly. Membership criteria addressing financial size and sophistication remain important elements of prudent risk management, particularly in case of a default by a member.

Swap Submissions

New Section 3C(b)(2) of the Exchange Act, enacted by Section 763 of the Dodd-Frank Act, requires a security-based swap clearing agency to submit to the SEC each security-based swap, or category or class of security-based swaps, that it plans to accept for clearing. LCH.Clearnet is concerned that this provision could disadvantage non-US clearinghouses that have sought to register with the Commission as clearing agencies. Such clearinghouses would face potentially significant delays in launching new clearing services, as they typically would require “home country” regulatory approval to clear a swap, or category or class of swaps, before making a submission to the SEC. This would inhibit such entities’ abilities to compete with US clearinghouses and non-US clearinghouses that have instead chosen to operate pursuant to exemptive relief from the SEC, with a corresponding detriment to US market participants. LCH.Clearnet urges that the Commission, when considering the rules applicable to “swap submissions”, recognizes the global nature of clearing operations for OTC derivatives and the role of non-US regulators in approving security-based swaps for clearing by the clearinghouses they oversee.

Prevention of Evasion

New Section 3C(d), enacted by Section 763 of the Dodd-Frank Act, gives the SEC the power to prescribe rules, and issue interpretations of rules, to prevent evasions of the mandatory clearing requirement under the Dodd-Frank Act. Under this provision the SEC also has a duty to

⁴ On reviewing its OTC interest rate portfolio of 720,000 cleared swaps in December 2009, LCH.Clearnet found that 94% of the trades were not homogeneous.



investigate why a security-based swap has not been listed for clearing. LCH.Clearnet welcomes this provision and asks that in discharging its duty under this provision, the SEC be mindful of the ability of intellectual property owners to forestall clearing houses from accessing indexes. Refusal to grant index clearing licences could lead to the mandatory clearing requirement being evaded. LCH.Clearnet recognizes the rights of intellectual property holders, but does not believe that these private rights should be allowed to undermine or override the Act's requirements for central clearing of over-the-counter security-based swaps.

Governance and Conflict of Interest Controls

The SEC has invited public comment on "Governance and Conflict of Interest Controls for Clearing Agencies, Swap Execution Facilities and Exchanges." 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 ownership stakes in clearing agencies. OTC clearing agency shareholders who deal in OTC derivatives may have an interest in seeing that the clearinghouse does not clear the instruments in which they deal. Nor are conflicts of interest limited to swap dealer shareholders: an exchange may have an interest in seeing that a clearinghouse in which it is a shareholder not clear instruments traded on competing exchanges, while an end user may have an interest in seeing that a clearinghouse in which it is a shareholder keep margin requirements and other associated costs artificially low.

LCH.Clearnet has adopted a number of corporate governance safeguards that ensure that conflicts of interest do not affect the safety and soundness of its clearinghouses and its ability to serve markets by developing clearing services for new asset classes. These include limitations on voting rights by individual shareholders; independent board members; and objective and transparent clearinghouse membership criteria. LCH.Clearnet believes that such limitations can serve as a useful precedent for rulemaking by the Commission when it is establishing requirements to be made applicable to all clearing agencies. 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.

Such regulatory designations should be understood in the context of LCH.Clearnet's user-owned, user-governed model. LCH.Clearnet believes this model most effectively aligns the interests of the clearinghouse with those of its users. LCH.Clearnet's users have their own capital at stake in the clearinghouse and are fully involved in all risk decisions, avoiding any incentives to erode risk management standards in order to increase profitability or gain market share.



Perhaps most importantly, LCH.Clearnet's corporate charter 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 ensures that neither a single shareholder nor a small group of shareholders can dominate management of the 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 corporate end users.

LCH.Clearnet's board composition also ensures that operation of its clearinghouses serves the interest of its broad shareholder community. The LCH.Clearnet board is composed of exchange representatives, financial intermediaries and four "independent non-executive directors." LCH.Clearnet's Articles of Association set forth criteria for a director to be considered "independent," including whether the individual has been an employee of LCH.Clearnet during the preceding five years; receives remuneration from LCH.Clearnet apart from a director's fee; has close family ties with any LCH.Clearnet directors or senior management; or represents a significant shareholder.

LCH.Clearnet's even-handed application of transparent membership criteria also promotes clearinghouse operation free of 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 each clearinghouse's Risk Committee and board of directors. The criteria include minimum capital, operational, and in some cases rating criteria. 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. 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 or otherwise discriminate among clients or third-parties.

LCH.Clearnet believes Congress correctly rejected the aggregate limits on swap dealer ownership of clearing and trade execution facilities that were contained in the version of the Act passed by the House of Representatives (HR4173). 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 all bank holding companies or other specified entities.

Overly restrictive limits on swap dealer ownership would significantly hamper the development of derivatives clearinghouses. They would impede the ability of existing clearinghouses to grow and provide clearing services effectively in the global financial markets and remove market participants' incentive to participate in the creation and development of new clearinghouses. Restrictions on voting rights by individual shareholders, independent directors, and objective and transparent membership criteria would strike a better balance between mitigating conflicts of interest and ensure a competitive market for clearing services.

LCH.Clearnet appreciates the opportunity to comment on these important issues 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