



June 15, 2023

VIA EMAIL

**Securities and Exchange Commission
100 F Street NE
Washington, DC 20549**

Re: Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule with Respect to U.S. Treasury Securities; RIN 3235-AN09; File No S7-23-22

The London Stock Exchange Group (LSEG) is pleased to file a supplementary response to the request for comment on the Securities and Exchange Commission's (SEC) Proposed Rule on Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule with Respect to U.S. Treasury Securities¹.

LSEG is a leading global financial markets infrastructure and data provider. It has majority ownership of the global central counterparty clearing house (CCP), LCH Group (LCH) that has two licensed CCP subsidiaries – LCH Ltd and LCH SA². LCH offers clearing services for a diverse range of asset classes, including repo and cash bond clearing in U.K. and European sovereign markets. LCH receives collateral from its clearing members as margin, accepting a wide range of eligible currencies and securities, including U.S. dollar cash and U.S. Treasury securities. Regulation carefully prescribes the risk management and placement of cash collateral, appropriately limiting CCP's balances held unsecured at commercial banks. LCH therefore restricts investment of cash margin to central bank deposit accounts (where available), reverse repo agreements, government bonds, and an appropriately limited amount at commercial banks.

LCH Ltd provides important clearing services to U.S. markets and U.S. customers. As a registered Derivatives Clearing Organization it is overseen directly by the Commodity Futures Trading Commission (CFTC) and is fully compliant with the Dodd Frank Act. LCH Ltd holds a significant amount of U.S. dollar cash that is invested in the U.S. Treasury market, both outright and via reverse repo. LCH Ltd is uniquely impacted by this proposal as compared to other CCPs as, despite holding a significant amount of USD collateral, it does not hold an account at a Federal Reserve Bank. If LCH Ltd had access to such an account it would be an important risk management tool, reducing reliance on U.S. Treasury markets and thus reducing systemic risk.

In line with LSEG's comment letter submitted in December 2022, LSEG commends the SEC's consideration of ways to increase central clearing and settlement of U.S. Treasury securities with the objective of improving the safety, efficiency, and transparency of the market. However, there are some additional considerations LSEG wishes to raise with regard to this proposal. Specifically, CCPs would face significant challenges if their investment

¹ [Proposed rule: Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities](#)

² LCH SA has been registered with the SEC since 2017 and with the CFTC since 2013. LCH Ltd has been registered with the CFTC since 2001.

activity in U.S. Treasury securities are covered by the proposed rule. Many of these challenges are outside of a CCP's control as they stem from existing regulations and market structure. LCH therefore requests that the SEC consider a CCP exemption until such time these challenges are addressed and CCPs can safely clear these trades under the SEC's proposal.

The specific issues for consideration are outlined below:

Financial stability

The proposed rule could create contagion risk by increasing linkages between CCPs. This risk would crystallize if a CCP clearing its investment trades contributed to the mutualized financial resources of another CCP via its default fund or was otherwise exposed to loss in the event of a member default of the other CCP. In this scenario, the CCP clearing its investment trades with the other CCP could be exposed to its default waterfall and suffer losses due to the failure of an unrelated clearing member. This could affect its viability, causing contagion to its members, the markets it clears, and potentially to the wider market. There is also a second order contagion risk as the CCP clearing its investment trades would have exposure to the other CCP's clearing members, but not have the information to assess them from a credit risk perspective. For this reason, linkages between interoperating³ CCPs typically adopt conservative risk management features; the CCPs do not contribute to each other's default funds, and the initial margin exchanged is carefully ring-fenced to avoid inter-CCP credit exposures.

Regulatory divergence

Regulation under both U.S. and European regulatory frameworks recognize the potential financial stability risks of inter-CCP linkages and prohibit them from accepting the counterparty credit risk of another CCP. However, under existing U.S. Treasury clearing models where default fund contributions would be expected from a CCP participant, it would not be possible for a CCP to participate in clearing without being directly or indirectly exposed to the other CCP.

One such conflict arises under the Commodity Exchange Act where, to minimize systemic risk, there is a requirement that "[. . .] under no circumstances shall a derivatives clearing organization be compelled to accept the counterparty credit risk of another clearing organization". Furthermore, in Europe, regulators have specifically stated that interoperating CCPs are not permitted to contribute to each other's default funds to avoid exposure to the default waterfall⁴. The proposals in EU EMIR 3.0 go further in explicitly requiring CCPs to have membership criteria that "[. . .] ensure that CCPs [. . .] cannot be clearing members, directly or indirectly, of the CCP".

Operational challenges

A clearing model tailored to meet CCPs' bespoke collateral management requirements would need to be developed before they could operationally clear investment trades. An important component of a CCP's collateral management framework is its ability to manage liquidity risks, including meeting daily liquidity needs and remaining ready to meet the obligations of a defaulted clearing member at short notice. To accommodate this, existing investments need to mature as early as possible in the day and new investment trades need to be made as late

³ Interoperating CCPs are CCPs with an interoperability arrangement, which is a link that allows market participants to trade on the same trading venue but clear at a CCP of their choice.

⁴ Please see the 'ESMA Guidelines and Recommendations for establishing consistent, efficient and effective assessments of interoperability arrangements': [esma_guidelines_u_recommendations_on_interoperability_arrangements - as approved by bos 20130314.pdf](https://www.esma.europa.eu/press-news/esma-press/2013/0314) ([europa.eu](https://www.esma.europa.eu/))

as possible in the day. Under existing models of clearing, maturities do not occur until mid-afternoon, EST. Equally, any model where the CCP has direct intraday exposure to a commercial bank until novation to clearing would also be outside the CCP's risk appetite and pose challenges to the operating model. As a result, further clearing models would need to be developed that support the needs of CCPs within the wider structures of the market.

Conclusion

While we remain supportive of the SEC's initiative overall, and open in principle to the clearing of CCP investments in U.S. Treasury Securities, LCH has significant concerns about the consequences of the proposed rule if these factors are not satisfactorily addressed. Given the financial stability, regulatory, and operational issues, LCH requests that the final rule include a provision exempting CCP investment activity from a requirement to clear, until such time it is possible to do so without increasing CCPs' liquidity, credit risks or financial stability risks more broadly.

Sincerely,



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