

*Via electronic submission*

April 30, 2020

Ms. Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

**Re: Use of Derivatives by Registered Investment Companies and Business Development Companies; File No. S7-24-15**

Dear Ms. Countryman:

LCH Ltd and LCH SA (together “LCH”) welcome the opportunity to respond to this request for comment from the Securities and Exchange Commission (“SEC” or “Commission”) regarding the Use of Derivatives by Registered Investment Companies and Business Development Companies (“Proposal”).<sup>1</sup> We commend the SEC on this initiative to address many of the comments received in response to the 2015 previous proposal and propose this updated approach to funds’ use of derivatives.<sup>2</sup>

LCH is an international, multi-asset class group of clearing houses, or central counterparties (“CCPs”), that manage risk of many diverse portfolios of cleared derivatives.<sup>3</sup> LCH has supported regulatory reform enhancements to the global structure governing derivatives markets that have resulted in a comprehensive, stronger, and more robust risk management framework for CCPs, clearing members, and end-users of derivatives.

Our U.S. end-user clients include a diverse range of funds under the SEC’s supervision. Derivatives remain an important tool risk management tool for these market participants and for the overall health and liquidity of the U.S. financial markets. For example, the U.S. interest rate swap market allows banks, funds, and other financial institutions to manage fluctuations in

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<sup>1</sup> SEC, “Use of Derivatives by Registered Investment Companies and Business Development Companies,” 85 FR 4446, available at <https://www.govinfo.gov/content/pkg/FR-2020-01-24/pdf/2020-00040.pdf>.

<sup>2</sup> SEC, “Use of Derivatives by Registered Investment Companies and Business Development Companies,” 80 FR 80884, available at <https://www.govinfo.gov/content/pkg/FR-2015-12-28/pdf/2015-31704.pdf>.

<sup>3</sup> LCH Ltd and LCH SA are registered Derivatives Clearing Organizations (“DCO”) supervised by the CFTC under the Commodity Exchange Act and Commission Regulations. LCH SA is also registered with the Securities and Exchange Commission as a Clearing Agency. LCH Group is the leading multi-asset class and multi-national group of clearing houses, serving major international exchanges and platforms as well as a broad range of asset classes including securities, exchange-traded derivatives, foreign exchange derivatives, interest rate swaps, credit default swaps, and euro and sterling denominated bonds and repos. LCH Group Limited is majority owned by the London Stock Exchange Group (“LSEG”), a diversified international exchange group.

interest rates, which translates into direct benefits for end users, U.S. consumers, and the broader U.S. economy.<sup>4</sup>

LCH previously submitted comments in response to the SEC's initial proposal. We shared concerns with the asset management and derivatives industries and recommended that the Commission:

- (1) apply a risk-based framework that recognizes the leverage and risk in a fund's portfolio, rather than total notional amount of the derivatives positions in a fund's portfolio; and
- (2) align the scope of "qualifying coverage assets" with similar assets permitted to meet collateral requirements within the broader global derivatives framework.<sup>5</sup>

As noted below, we commend the SEC for addressing these concerns. Although we do not provide comment on many of the specific components of the proposed Derivatives Risk Management Program, as risk managers, we believe the broader changes strike the correct balance for our customers and the broader financial markets.

## **Comments**

### *Use of Value-at-Risk Based Limit*

LCH supports the SEC's proposal to use a value-at-risk ("VaR") based limit rather than a notional based limit to address a funds' leverage and risk. VaR is a better risk measure than notional amount because it incorporates significant, identifiable market risk factors associated with a fund's investments.

LCH commends the SEC's efforts to harmonize their rules across major jurisdictions, particularly the EU, on certain aspects of this Proposal.<sup>6</sup> As the SEC indicates, the EU's related UCITS framework limits a funds derivatives overall risk exposure to 200% of its net asset value or an absolute VaR limit of 20% over a 20-day holding period based on a confidence interval of 99%.<sup>7</sup> We believe this has served as a sound requirement for UCITS funds.

### *Removal of Asset Segregation Requirement*

LCH supports the SEC's proposal to remove the asset segregation requirement and related "qualifying coverage assets" requirement. As noted in the Proposal, the definition in the 2015 proposal was complex and created uncertainty for funds falling in scope of the proposal.<sup>8</sup> We

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<sup>4</sup> See Daniel J. Maguire Written Testimony before the House Agriculture Subcommittee on Commodities Exchanges, Energy, and Credit, June 26, 2019, available at <https://agriculture.house.gov/uploadedfiles/hhrg-116-ag22-wstate-maguired-20190626.pdf>.

<sup>5</sup> See LCH.Clearnet comment letter at 2.

<sup>6</sup> 80 FR 80884 at 4457, 4464, 4469-70.

<sup>7</sup> See European Securities and Markets Authority (formerly Committee of European Securities Regulators), Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS, CESR/10-788 (July 28, 2010), at 12, available at [https://www.esma.europa.eu/sites/default/files/library/2015/11/10\\_788.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/10_788.pdf).

<sup>8</sup> *Id.* at 4490.

believe that margin requirements for cleared derivative transactions play an important role in risk management and, as the Commission notes, the additional Derivatives Risk Management Program requirements make the asset segregation requirement unnecessary.

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LCH appreciates the opportunity to comment on this Proposal.

Sincerely,

A handwritten signature in black ink, appearing to read "Jonathan Jachym". The signature is fluid and cursive, with the first name "Jonathan" and last name "Jachym" clearly distinguishable.

Jonathan Jachym  
Head of Government Relations and Regulatory Strategy, Americas  
London Stock Exchange Group