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

28 April 2011

Dear Ms. Murphy,

RIN 3235-AK74: 17 CFR Part 242 - "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")

The LCH.Clearnet Group ("LCH.Clearnet" or "the Group") is pleased to add further comment to the letters it has already submitted to the Securities and Exchange Commission ("Commission").

LCH.Clearnet 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.

We appreciate the open manner in which the Commission has consulted with market participants and other interested parties during the rulemaking process, and to the consideration it has given this important rulemaking in particular. LCH.Clearnet is grateful for the opportunity to provide additional commentary on this Proposing Release, further to its earlier submissions[1] on this matter.

In its release of Tuesday March 8, 2011, the Commission seeks further comment on the Proposing Release in light of its other more recent proposed rulemakings that concern conflicts of interest at security-based swap clearing agencies. LCH.Clearnet welcomes this opportunity to share such comments with the Commission.

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[1] http://www.sec.gov/comments/s7-27-10/s72710-11.pdf; http://www.sec.gov/comments/s7-27-10/s72710-85.pdf. http://www.sec.gov/comments/s7-27-10/s72710-85.pdf

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In its original Proposing Release dated Tuesday October 26, 2010, the Commission identified three key areas in which it believes a conflict of interest of participants who exercise undue control or influence over a security based swap clearing agency could adversely affect the central clearing of security-based swaps.

Each of these is addressed below, together with references to other of the Commission's proposed rulemakings that in our view address and seek to mitigate the same conflicts.

(1) **Limiting access:** The Commission stated that participants could limit access to the security-based swap clearing agency, either by restricting direct participation in the security-based swap clearing agency or restricting indirect access by controlling the ability of non-participants to enter into correspondent clearing arrangements.

In the Group's view this conflict has been addressed in the Commission's proposed rulemaking on *Clearing Agency Standards for Operation and Governance* [17 CFR Part 240, RIN 3235-AL13]. Broadly, under the Commission's proposed rules a clearing agency would be obliged to:

- provide persons who do not perform dealer or security based swap dealer services with the opportunity to obtain membership of the clearing agency to clear securities for itself or on behalf of others [§240.17Ad-22(b)(5)];
- set membership standards that neither require a participant to maintain a portfolio of any minimum size nor require that participants maintain a minimum transaction volume [§240.17Ad-22(b)(6)]; and
- provide that a person with net capital of $50 million or greater can become a participant, although the clearing agency can set higher standards if necessary [§240.17Ad-22(b)(7)].

In this regard, the following are of particular interest:

§240.17Ad-22, Standards for clearing agencies

"(b) A clearing agency that performs central counterparty services shall establish, implement, maintain and enforce written policies and procedures reasonably designed to:

(5) Provide the opportunity for a person that does not perform any dealer or security-based swap dealer services to obtain membership at the clearing agency to clear securities for itself or on behalf of other persons.

(6) Have membership standards that do not require that participants maintain a portfolio of any minimum size or that participants maintain a minimum transaction volume.

(7) Provide a person that maintains net capital equal to or greater than $50 million with the ability to obtain membership at the clearing agency, with any net capital requirements being scalable so that they are proportional to the risks posed by the participant's activities to the clearing agency; provided, however, that the clearing agency may provide for a higher net capital requirement as a condition for membership at the clearing agency if the clearing agency demonstrates to the Commission that such a requirement is necessary to mitigate risks that could not otherwise be effectively managed by other measures and the Commission approves the higher net capital requirement as part of a rule filing or clearing agency registration application."

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(2) Scope of products: participants could limit the scope of products eligible for clearing at the security-based swap clearing agency, particularly if there is a strong economic incentive to keep a product traded in the OTC market for security based swaps.

In the Group's view this conflict has been addressed in the Commission's proposed rulemaking on *Clearing Agency Standards for Operation and Governance* [17 CFR Part 240, RIN 3235-AL13]. Broadly, under the Commission's proposed rules a clearing agency would be obliged to:

- have clear and transparent governance arrangements; and
- enforce written policies and procedures designed to address potential conflicts of interest.

In this regard, the following are of particular interest:

§240.17Ad-22, Standards for clearing agencies

(d) Each clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable: ...

(8) Have governance arrangements that are clear and transparent to fulfill the public interest requirements in section 17A of the Act applicable to clearing agencies, to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency's risk management procedures.

(9) Provide market participants with sufficient information for them to identify and evaluate the risks and costs associated with using its services.

§240.17Ad–25 Clearing agency procedures to identify and address conflicts of interest.

Each clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to identify and address existing or potential conflicts of interest. Such policies and procedures must also be reasonably designed to minimize conflicts of interest in decision making by the clearing agency.

§240.17Ad–26 Standards for board or board committee members.

(a) Each clearing agency shall establish governance standards for its board members and board committee members.

(b) Such standards shall address at least the following areas:

(1) A clear articulation of the roles and responsibilities of directors serving on the clearing agency's board and any board committees;

(2) Director qualifications providing criteria for expertise in the securities industry, clearance and settlement of securities transactions, and financial risk management;

(3) Disqualifying factors concerning serious legal misconduct, including violations of the Federal securities laws; and

(4) Policies and procedures for the periodic review by the board or a board committee of the performance of its individual members.

(3) **Risk controls:** participants could use their influence to lower risk management controls of a security-based swap clearing agency in order to reduce the amount of collateral and liquidity resources they would have to expend as margin or guaranty fund to expend as margin or guaranty fund to the security-based swap clearing agency.

LCH.Clearnet would humbly submit that the issues that the Commission has outlined above have been addressed to a certain extent in its proposed rulemaking on *Clearing Agency Standards for Operation and Governance* [17 CFR Part 240, RIN 3235-AL13]. Broadly, under the Commission's proposed rules a clearing agency would be obliged to:

- measure its exposures to its participants daily and limit its and other participants exposures to potential losses from the default of a participant [§240.17Ad-22(b)(1)];
- use margin requirements to limit credit exposures to participants, including a monthly review of models for calculating margin [§240.17Ad-22(b)(2)];
- maintain sufficient financial resources to withstand the default of the participant to which it has largest exposure in extreme but plausible market conditions provided that a securities based swaps clearing agency maintains sufficient financial resources to withstand the default of the two participants to which it has the largest exposures in extreme but plausible market conditions [§240.17Ad-22(b)(4)];
- perform an independent annual model validation to evaluate the performance of the clearing agency's margin models [§240.17Ad-22(b)(5)]; and
- provide that a person with net capital of $50 million or greater can become a participant although the CCP can set higher standards if necessary [§240.17Ad-22(b)(7)]; and
- publish and disseminate all prices with respect to security-based swaps [§ 240.17Aj–1].

In this regard, the following are of particular interest:

§240.17Ad-22, Standards for clearing agencies

"(b) A clearing agency that performs central counterparty services shall establish, implement, maintain and enforce written policies and procedures reasonably designed to:

(3) Maintain sufficient financial resources to withstand, at a minimum, a default by the participant to which it has the largest exposure in extreme but plausible market conditions; provided that a security-based swap clearing agency shall maintain sufficient financial resources to withstand, at a minimum, a default by the two participants to which it has the largest exposures in extreme but plausible market conditions.

(7) Provide a person that maintains net capital equal to or greater than $50 million with the ability to obtain membership at the clearing agency, with any net capital requirements being scalable so that they are proportional to the risks posed by the participant's activities to the clearing agency; provided, however, that the clearing agency may provide for a higher net capital requirement as a condition for membership at the clearing agency if the clearing agency demonstrates to the Commission that such a requirement is necessary to mitigate risks that could not otherwise be effectively managed by other measures and the Commission approves the higher net capital requirement as part of a rule filing or clearing agency registration application."

§ 240.17Aj–1 Dissemination of pricing and valuation information by security-based swap clearing agencies that perform services as a central counterparty.

Each security-based swap clearing agency that performs services as a central counterparty shall make available to the public, on terms that are fair and reasonable and not unreasonably discriminatory, all end-of- day settlement prices and any other prices with respect to security-based swaps that the clearing agency may establish to calculate mark-to-market margin requirements for its participants and any other pricing or valuation information with respect to security- based swaps as is published or distributed by the clearing agency to is participants.

As we stated in our earlier submissions, LCH.Clearnet has long recognized that potential conflicts of interest may arise from the ownership of clearing agencies. For this reason, the Group 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 LCH.Clearnet 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 Group believes it is appropriate that the Commission should adopt rules and standards for security-based swap clearing agencies and important that the Commission establishes a process for the registration of security-based swap clearing agencies. We would, however, submit that the standards set out by the Commission in its proposed rulemakings that we refer to earlier in this letter, together with such self-imposed standards as those adopted by LCH.Clearnet should be sufficient to mitigate address potential conflicts of interest. Additionally, we believe that these standards will more appropriately address potential conflicts of interest than the rules originally set out in the Commission's Proposing Release dated Tuesday October 26, 2010[2]. Finally, we believe such standards will better allow for the international harmonization of standards for clearinghouses than those originally proposed by the Commission. In this regard we would respectfully observe that in Europe, where we have been closely tracking the European Market Infrastructure Regulation's ("EMIR's") progress through the European legislature, there have been no proposals to attempt to limit clearinghouse ownership or voting rights by groups of entities – either from the European Commission, the European Parliament, or the European Council. Indeed, the restrictions on the ownership of shares and voting interests of the type proposed by the Commission would likely be deemed contrary to the fundamental freedoms set out in the primary EU Treaty (the Treaty on the Functioning of the European Union, "TFEU"), in particular, those protecting the freedom of establishment and the free movement of capital.[3]

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2 RIN 3235-AK74: 17 CFR Part 242 - "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".

3 The provisions of the TFEU relating to free movement of capital provide that "all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited." The EU's Supreme Court (the European Court of Justice, "ECJ") has consistently found that, for these purposes, capital movements include "direct investment in the form of participation in an undertaking by way of shareholding or the acquisition of securities on the capital market ... [and] ... the possibility of participating effectively in the management of a company or in its control." The free movement of capital and freedom of establishment are fundamental tenets of the TFEU, and any exceptions to these rules would needs therefore to be justified by overarching public policy requirements. Moreover, the TFEU sets out that "only the Council, acting in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament, adopt measures which constitute a step backwards in Union law as regards the liberalisation of the movement of capital to or from third countries." Accordingly, such an amendment would require unanimity amongst Member States.

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LCH.Clearnet looks forward to extending its clearing services further into the U.S. marketplace, and hopes to in due course, and subject to the Commission's approval, to register one or more of its clearinghouses as a security-based swaps clearing agency, thereby offering the safeguards of its proven structures to a wider audience.

LCH.Clearnet recognizes the hard work undertaken by the Commission in order to develop these proposed rules and values its thoughtful approach in this task. We appreciate the opportunity to comment on these important issues, and would be pleased to enter into a further dialogue with the Commission and its staff on the matters raised in this letter. Please do not hesitate to contact Simon Wheatley at +44 (0)20 7426 7622 regarding any questions raised by this letter, or to discuss these comments in greater detail.

Yours sincerely,

Ian Axe
Chief Executive Officer