LCH.CLEARNET

February 29, 2012

VIA ELECTRONIC SUBMISSION TO: SECRETARY@CFTC.GOV

Mr. David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: CFTC Division of Clearing and Risk letter dated February 1, 2012, Requesting Submission of DCO Recommendations for the Mandatory Clearing Requirement.

Dear Mr. Stawick:

LCH.Clearnet Limited ("LCH.Clearnet") is pleased to respond to the February 1, 2012 letter of Sarah Josephson, Deputy Director—Product Review, Division of Clearing and Risk, regarding the review of swaps for mandatory clearing under Section 723 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank" or "the Act"), and in accordance with 17 C.F.R. § 39.5 of the Commission's regulations. One of the primary goals of the Act is to lower systemic risk by authorizing the Commission to mandate clearing of standardized swaps. LCH.Clearnet strongly supports the Act and the policy goals of Section 723.

LCH.Clearnet is submitting all of the freight and commodity swaps that it accepted for clearing as of February 1, 2012, for mandatory clearing determinations—detailed product information for these swaps is attached.[1] This letter also includes the information required by 17 C.F.R. § 39.5 for the freight and commodity swaps that LCH.Clearnet clears. LCH.Clearnet voluntarily agrees to extend the deadline for a mandatory clearing determination on pre-enactment swaps until such time as the Commission has completed the review process outlined in § 39.5(b).

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[1] LCH.Clearnet submitted the interest rate swaps that it clears in a separate letter.

LCH.Clearnet also clears OTC energy contracts traded on Nodal Exchange. Nodal is currently an ECM and has not yet decided whether it will register with the Commission as a designated contract market ("DCM") or as a swap execution facility. Until the Commission finalizes its rules on the definition of a swap and on Core Principles for DCMs, it is uncertain whether these OTC energy contracts cleared on LCH.Clearnet from Nodal Exchange are futures or swaps. If these contracts are ultimately determined to be swaps, LCH.Clearnet will submit them to the Commission for a mandatory clearing determination under § 39.5(b).

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LCH.Clearnet's EnClear Service

LCH.Clearnet's EnClear service provides an independent clearing service for the registration of OTC Forward Freight Agreements (FFAs) as well as OTC commodity swaps such as Coal, Iron Ore and Fertilizer. All of these swaps are cash settled on a monthly basis. Globally based chartering companies, ship owners, producers, and trading companies are increasingly managing their risk through cleared trading solutions. Approved Brokers have open and equal access to the service and can register their OTC brokered trades with LCH.Clearnet for clearing through a clearing member of LCH.Clearnet. The freight service was launched in September 2005. The other products were launched in subsequent years.

Information Related to the Five Factors

The Commission regulations implementing Section 723(a)(3) of Dodd-Frank require a DCO to submit "information that will assist the Commission in making a quantitative and qualitative assessment" of five factors. The following responses conform to the information requirements of § 39.5(b)(ii):

A. "The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data"

When considering the eligibility of a new product for clearing, the central question addressed by LCH.Clearnet is whether we have the right risk management, operations, default management, and technology in place to be able to dispose of positions in that new product in a default scenario. It is extremely imprudent for any DCO to clear a product without possessing a high degree of confidence that it can exit a position in that product during a default.

LCH.Clearnet considers numerous characteristics before clearing a new product and before making a submission to its regulators. One of the most important characteristics is liquidity, of which there are many components in the OTC derivatives market. The degree of homogeneity in the traditional listed futures market allows liquidity to be captured by traded contract volume, and even here the disparity between front and back month volumes can be marked.

The Freight Market has around 400 participants, with relatively equal splits between buyers and sellers. Trading liquidity varies from day to day. However, liquidity is certainly sufficient for clearing and risk management. The monthly average volume in 2011 was 73,500 lots, made up of an average of 75,000 trades. The cleared market is highly liquid as 95% of the freight contracts are already cleared; therefore it is the bilateral market that that is thin from a liquidity perspective.

The price data LCH.Clearnet uses is collated and distributed by the Baltic Exchange, an organisation that specialises in index formation and price dissemination. The price curves we receive for this market are therefore considered to be highly reliable.

For default management, LCH.Clearnet has an arrangement with several freight brokers to assist in closing out positions. We believe that liquidity is sufficient to close out positions at any time in a successful manner and without moving the market significantly

B. "The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded"

In developing a clearing service, LCH.Clearnet ensures that the swaps it clears are economically equivalent to the swaps with the same underlying attributes in the uncleared world. The freight swaps cleared at LCH.Clearnet today are done so under a rule framework and operational infrastructure accepted by its Clearing Members as well as the largest market participants.

C. "The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract"

When appropriate clearable swaps are mandated for clearing, the inevitable result will be a less disparate marketplace from a risk perspective. Mandatory clearing will also remove a large portion of the interconnectedness of current OTC markets that leads to systemic risk. However, it is important to acknowledge that central clearing, by its very nature, concentrates risk in a handful of entities. Thus, DCOs that clear swaps must have gold standard risk, default, operational, legal, liquidity, technology standards and processes, and regulatory oversight to ensure that the DCO does not itself pose a greater systemic risk than the systemic risk it is alleviating.

D. "The effect on competition, including appropriate fees and charges applied to clearing"

We believe that the Commission should use the clearing mandate to spur competition between DCOs, and to encourage DCOs to be innovative in developing the capability to safely clear new types of swaps and ways to collateralise those swaps. However, it is important for the Commission to recognize the potential pitfalls of rushing new clearing products and services to market in the name of competitiveness. We suggest that the Commission remain vigilant in permitting new products to be cleared only when the DCO has appropriate processes, procedures, risk management, and default procedures in place for these products.

E. "The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property"

LCH.Clearnet is in the process of drafting rules to implement an FCM model for US customer clearing.

Insofar as legal certainty in the event of the insolvency of the DCO is concerned, LCH.Clearnet would be wound up under English law and has provided opinions to the Commission on this point.

Further information requested under § 39.5(b)(iii) - (vii) is publicly available in LCH.Clearnet Limited's rulebook, or has been made available to the Commission in a separate submission.[2]

Extraterritoriality

Currently, five clearinghouses around the world clear freight swaps. Two of those clearinghouses, SGX AsiaClear and NOS Clearing ASA, are not registered with the CFTC as DCOs. We are concerned that, if the freight swaps cleared by the EnClear service are subject to mandatory clearing while those cleared on our competitors are not, business may move away from EnClear. For this reason, it is vitally important for the Commission to coordinate and cooperate with its regulatory counterparts around the world. A disjointed regulatory mandate could bifurcate existing liquidity pools and create thinner and therefore riskier liquidity pools to the detriment of all participants, and the overarching goal of systemic risk reduction.

[2] All such information is also available to market participants who have previously signed NDAs.

Conclusion

LCH.Clearnet looks forward to working with the Commission and the Division of Clearing and Risk as the CFTC makes mandatory clearing determinations. Please do not hesitate to contact Lisa Rosen at +44 20 7426 7541 regarding any questions raised by this letter.

Yours sincerely,

Ian Axe
Chief Executive Officer

CC: Ananda K. Radhakrishnan
Sarah Josephson
Erik Remmler
Brian O'Keefe

Attachment