

## SUBMISSION COVER SHEET

**IMPORTANT:** Check box if Confidential Treatment is requested

Registered Entity Identifier Code (optional): \_\_\_\_\_

Organization: \_\_\_\_\_

Filing as a:        **DCM**        **SEF**        **DCO**        **SDR**    Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): \_\_\_\_\_ Filing Description:

**SPECIFY FILING TYPE**                      Please note only ONE choice allowed per Submission.

**Organization Rules and Rule Amendments**

Certification	§ 40.6(a)
Approval	§ 40.5(a)
Notification	§ 40.6(d)
Advance Notice of SIDCO Rule Change	§ 40.10(a)
SIDCO Emergency Rule Change	§ 40.10(h)

Rule Numbers: \_\_\_\_\_

**New Product**                                      Please note only ONE product per Submission.

Certification	§ 40.2(a)
Certification Security Futures	§ 41.23(a)
Certification Swap Class	§ 40.2(d)
Approval	§ 40.3(a)
Approval Security Futures	§ 41.23(b)
Novel Derivative Product Notification	§ 40.12(a)
Swap Submission	§ 39.5

Official Product Name: \_\_\_\_\_

**Product Terms and Conditions (product related Rules and Rule Amendments)**

Certification	§ 40.6(a)
Certification Made Available to Trade Determination	§ 40.6(a)
Certification Security Futures	§ 41.24(a)
Delisting (No Open Interest)	§ 40.6(a)
Approval	§ 40.5(a)
Approval Made Available to Trade Determination	§ 40.5(a)
Approval Security Futures	§ 41.24(b)
Approval Amendments to enumerated agricultural products	§ 40.4(a), § 40.5(a)
“Non-Material Agricultural Rule Change”	§ 40.4(b)(5)
Notification	§ 40.6(d)

Official Name(s) of Product(s) Affected: \_\_\_\_\_

Rule Numbers: \_\_\_\_\_

Mr Christopher Kirkpatrick  
Commodity Futures Trading Commission  
1155 21st Street NW  
Three Lafayette Centre  
Washington DC 20581

12 November 2015

Dear Mr Kirkpatrick

### **Australian Dollar Overnight Index Swaps**

Pursuant to CFTC regulation §39.5(b), LCH.Clearnet Limited (“LCH.Clearnet”), a derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission (the “CFTC”), is submitting Australian Dollar Index Swaps (“AUD OIS”) for determination of whether mandatory clearing should apply.

There is currently no mandate in place for any interest rate swaps in AUD, however the Australian Securities & Investments Commission (“ASIC”) has recently held a public consultation<sup>1</sup> in which it proposed the mandatory clearing of certain AUD IRS, including OIS, by certain categories of Australian and foreign entities, to come into effect in April 2016. From a systemic risk standpoint and for all concerned (market participants, regulators, market infrastructure providers and CCPs) we strongly recommend that any consideration for clearing obligations in any currency looks to maintain a consistent view on all products between all relevant regulators.

#### Background

LCH.Clearnet is launching AUD OIS as part of its SwapClear service, as extensions to its current product offering on December 7<sup>th</sup>, 2015. LCH.Clearnet is eligible to accept these swaps and would be able to maintain compliance in the event that these swaps were required to be cleared.

AUD OIS is a standard swap with one leg paying fixed, and the other leg paying the AONIA rate. The fixed rate of the trade may either be annual, or zero coupon in date structure. The floating rate is tied to AUD-AONIA-OIS-COMPOUND as per ISDA definition.

#### Factors for determination

#### ***The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data***

The 2013 BIS Triennial Survey<sup>2</sup> shows a doubling of daily turnover in AUD to \$76billion, overtaking Japanese Yen, and making AUD the 4<sup>th</sup> largest IRS market in terms of notional traded. On an assumed 250 business days a year, this gives an estimated notional trade per annum of \$19trillion. These figures<sup>3</sup> are broadly in line with an independent survey executed by the Australian Financial Markets Association<sup>3</sup>

<sup>1</sup> <http://download.asic.gov.au/media/3252197/cp231-published-28-may-2015.pdf>

<sup>2</sup> <http://www.bis.org/publ/rpfx13ir.pdf>

<sup>3</sup> <http://www.afma.com.au/data/afmr/2014%20afmr.pdf>

who estimated a total notional of swaps in AUD of AUD18trillion, of which approximately 40% are OIS contracts.

LCH.Clearnet has cleared AUD 2,885billion notional in AUD LIBOR swaps, year to date, with US persons. For USD swaps LCH.Clearnet finds that clearing volume in OIS is about 80% of that of LIBOR and therefore LCH.Clearnet forecasts full year clearing in AUD OIS by US persons, allowing for a graduated take up of the new product, will be circa AUD 2trillion notional per year.

Pricing data for AUD AONIA is readily available from conventional sources, e.g. Bloomberg and Reuters. LCH.Clearnet already sources and uses an AUD AONIA curved for the discounting of all currently eligible AUD swap products. The curve construction and sourcing will remain unchanged, but now used for projection of the index rate as well as for general discounting.

***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***

LCH.Clearnet already has a well-developed rule framework and support infrastructure for clearing interest rate swaps. LCH.Clearnet intends to leverage this existing operational capability when extending its offering to cover AUD OIS.

In order to prepare for the launch of AUD OIS, LCH.Clearnet will perform testing to ensure that is able to clear these products in a manner which is consistent with the terms on which AUD OIS is traded.

Further to this, LCH.Clearnet has consulted its Clearing Members on a number of minor rule changes which will be made in order to support the clearing of AUD OIS. The LCH.Clearnet rule changes will be certified with the CFTC and are available on the LCH.Clearnet website.

***The effect on mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract***

In general, we recommend a delay between a new product with additional risk factors (e.g. such as OIS swaps in specific currencies) becoming eligible for clearing and it being considered for clearing obligation. There are a number of arguments in support of this approach, which apply in general:

1. As a result of current participant exemptions, the clearing obligation would apply to certain market participants but exempt others. A clearing obligation could therefore create asymmetries, with those parties who are exempt from clearing forcing their counterparties into a mismatched cleared book relative to the portfolio-wide balance they maintain. If clearing is not mandated they retain the flexibility to clear only the trades which help them manage their counterparty risk;
2. For any newly cleared product, the CCP's default management protocols, processes and technology will have been modified to allow clearing of the new product. Although extensive testing will have taken place, this is not substitute for running the service with a live book of cleared trades for a period of time to fully ensure the robustness of the setup and to stimulate improvement wherever necessary; and
3. The CCP's risk management framework will have been calibrated to handle expected volume of activity. Actual positions may be larger and more concentrated than research indicates. A mandatory clearing obligation would limit the amount of control the CCP has to restrict large sized risks from being cleared.

***The effect on competition, including appropriate fees and charges applied to clearing***

AUD AONIA swaps are cleared out to 3 years by Australian Securities Exchange (“ASX”). At LCH.Clearnet the same product will be portfolio margined with other currencies and indices which will in most cases offer a margin offset for the product when compared to the margin on a standalone basis. LCH.Clearnet expects to clear a portion of the market; despite the fact it is already offered.

LCH.Clearnet’s fees for AUD OIS will be in line with the fees charged for existing currencies in the service.

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

The level of legal certainty around the clearing of AUD OIS is in all material respects the same as that of the IRS already cleared by LCH.Clearnet.

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 recently provided an updated an updated opinion on the treatment of cleared swaps customer funds to the CFTC.

Further Information (§39.5(b)(iii-viii))

Product terms of AUD OIS are market standard and follow the 2008 ISDA Derivatives Definitions<sup>4</sup>.

Participant eligibility standards for AUD OIS are the same as for existing SwapClear Clearing Members.

There are no additional price sources required as prices are readily available from the price sources already used by LCH.Clearnet.

No major risk management changes are necessary for LCH.Clearnet to offer AUD OIS clearing; however minor adjustments will be made for each as follows:

- AUD is already included in the SwapClear liquidity survey, and liquidity add-ons will be charged based on the estimates provided by Clearing Members and according to the current methodology for AUD OIS ;
- Historical and hypothetical stress testing scenarios have been added to the scenario framework used for default fund sizing to capture AUD OIS focussed scenarios.

LCH.Clearnet will make a number of minor changes to its Rulebook to enable clearing of AUD OIS, in the following sections:

- FCM Procedures
- Procedures Section 2C (SwapClear)
- FCM Product Manual
- SCM Product Manual

The rule changes will be submitted to the CFTC pursuant to §40.6(a), following consultation with LCH.Clearnet Clearing Members.

LCH.Clearnet engages it’s Clearing Members in the design and testing of new products at an early stage, through regular meetings and working groups. Clearing Members have been formally consulted on the changes which LCH.Clearnet is required to make to its Rulebook. Clearing Member feedback has been

---

<sup>4</sup> <http://www.isda.org/publications/pdf/2008-inflation-defs.pdf>



incorporated into the final changes. Notice of this submission was given to SwapClear Clearing Members on November 4, 2015, a copy of this notice is provided at **Appendix A**. Furthermore, this submission is publicly available at:

<http://www.lchclearnet.com/rules-regulations/regulatory-responses>

LCH.Clearnet intends to launch these products with its Clearing Members and clients on December 7<sup>th</sup>, 2015.

Should you have questions please contact me at [daniel.maguire@lchclearnet.com](mailto:daniel.maguire@lchclearnet.com).

Yours sincerely

A handwritten signature in blue ink, appearing to read "Daniel J Maguire", with a long horizontal flourish extending to the right.

**Daniel J Maguire**  
**Global Head of SwapClear and Listed Rates**  
LCH.Clearnet Limited

cc. Parisa Abadi

**Appendix A**  
**Notice of this submission provided to SwapClear Clearing Members**

LCH.Clearnet Ltd: SwapClear

4th November 2015

---

**To** SwapClear Clearing Members

---

**From** David Horner, Head of SwapClear Business Risk

---

**Subject** **AUD OIS submission for determination of clearing requirements**

---

Pursuant to CFTC regulation §39.5(b), LCH.Clearnet Limited (“LCH.Clearnet”), a derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission (the “CFTC”), is submitting Australian Dollar Index Swaps (“AUD OIS”) for determination of whether mandatory clearing should apply. As described in more detail below, LCH.Clearnet will recommend a delay between these new products being launched and any decision to make clearing mandatory.

There is currently no mandate in place for any interest rate swaps in AUD, however the Australian Securities & Investments Commission (“ASIC”) has recently held a public consultation<sup>[1]</sup> in which it proposed the mandatory clearing of certain AUD IRS, including OIS, by certain categories of Australian and foreign entities, to come into effect in April 2016. From a systemic risk standpoint and for all concerned (market participants, regulators, market infrastructure providers and CCPs) we strongly recommend that any consideration for clearing obligations in any currency looks to maintain a consistent view on all products between all relevant regulators.

As per CFTC regulation §39.5(b)(viii), LCH.Clearnet is required to notify members of its submission. This note does not constitute a notification that the products are live for clearing. A notice announcing the live data and arrangements for the formal product launch will be published separately.

***The existence of significant outstanding notional exposures, trading liquidity, and***

---

<sup>[1]</sup> <http://download.asic.gov.au/media/3252197/cp231-published-28-may-2015.pdf>

### ***adequate pricing data***

The 2013 BIS Triennial Survey<sup>[2]</sup> shows a doubling of daily turnover in AUD to \$76billion, overtaking Japanese Yen, and making AUD the 4<sup>th</sup> largest IRS market in terms of notional traded. On an assumed 250 business days a year, this gives an estimated notional trade per annum of \$19trillion. These figures are broadly in line with an independent survey executed by the Australian Financial Markets Association<sup>[3]</sup> who estimated a total notional of swaps in AUD of AUD18trillion, of which approximately 40% are OIS contracts.

Pricing data for AUD AONIA is readily available from conventional sources, e.g. Bloomberg and Reuters. LCH.Clearnet already sources and uses an AUD AONIA curve for the discounting of all currently eligible AUD swap products. The curve construction and sourcing will remain unchanged, but now used for projection of the index rate as well as for general discounting.

### ***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***

LCH.Clearnet already has a well-developed rule framework and support infrastructure for clearing interest rate swaps. LCH.Clearnet intends to leverage this existing operational capability when extending its offering to cover AUD OIS.

LCH.Clearnet has consulted its Clearing Members on a number of minor rule changes which will be made in order to support the clearing of AUD OIS. The LCH.Clearnet rule changes will be certified with the CFTC and are available on the LCH.Clearnet website.

### ***The effect on mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract***

In general, we recommend a delay between a new product with additional risk factors (e.g. such as OIS swaps in specific currencies) becoming eligible for clearing and it being considered for clearing obligation. There are a number of arguments in support of this approach:

1. As a result of current participant exemptions, the clearing obligation would apply to certain market participants but exempt others. A clearing obligation could therefore create asymmetries, with those parties who are exempt from clearing forcing their counterparties into a mismatched cleared book relative to the portfolio-wide balance they maintain. If clearing is not mandated they retain the

<sup>[2]</sup> <http://www.bis.org/publ/rpfx13ir.pdf>

<sup>[3]</sup> <http://www.afma.com.au/data/afmr/2014%20afmr.pdf>



flexibility to clear only the trades which help them manage their counterparty risk;

2. For any newly cleared product, the CCP's default management protocols, processes and technology will have been modified to allow clearing of the new product. Although extensive testing will have taken place, this is not substitute for running the service with a live book of cleared trades for a period of time to fully ensure the robustness of the setup and to stimulate improvement wherever necessary; and
3. The CCP's risk management framework will have been calibrated to handle expected volume of activity. Actual positions may be larger and more concentrated than research indicates. A mandatory clearing obligation would limit the amount of control the CCP has to restrict large sized risks from being cleared.

***The effect on competition, including appropriate fees and charges applied to clearing***

AUD AONIA swaps are cleared out to 3 years by Australian Securities Exchange ("ASX"). At LCH.Clearnet the same product will be portfolio margined with other currencies and indices which will in most cases offer a margin offset for the product when compared to the margin on a standalone basis. LCH.Clearnet expects to clear a portion of the market; despite the fact it is already offered.

LCH.Clearnet's fees for AUD OIS will be in line with the fees charged for existing currencies in the service.

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

The level of legal certainty around the clearing of AUD OIS is in all material respects the same as that of the IRS already cleared by LCH.Clearnet.

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 recently provided an updated an updated opinion on the treatment of cleared swaps customer funds to the CFTC.

Product terms of AUD OIS are market standard and follow the 2008 ISDA Derivatives Definitions<sup>[4]</sup>.

Participant eligibility standards for AUD OIS are the same as for existing SwapClear Clearing Members.

<sup>[4]</sup> <http://www.isda.org/publications/pdf/2008-inflation-defs.pdf>

There are no additional price sources required as prices are readily available from the price sources already used by LCH.Clearnet.

No major risk management changes are necessary for LCH.Clearnet to offer AUD OIS clearing; however minor adjustments will be made for each as follows:

- AUD is already included in the SwapClear liquidity survey, and liquidity add-ons will be charged based on the estimates provided by Clearing Members and according to the current methodology ;
- Historical and hypothetical stress testing scenarios have been added to the scenario framework used for default fund sizing to capture both AUD OIS focussed scenarios.

LCH.Clearnet will make a number of minor changes to its Rulebook to enable clearing of AUD OIS, in the following sections:

- FCM Procedures
- Procedures Section 2C (SwapClear)
- FCM Product Manual
- SCM Product Manual

The rule changes will be submitted to the CFTC pursuant to §40.6(a), following consultation with LCH.Clearnet Clearing Members.

LCH.Clearnet engages it's Clearing Members in the design and testing of new products at an early stage, through regular meetings and working groups. Clearing Members have been formally consulted on the changes which LCH.Clearnet is required to make to its Rulebook. Clearing Member feedback has been incorporated into the final changes.

Further information will form part of the full §39.5 filing which will be publically available on the LCH.Clearnet website.

LCH.Clearnet looks forward to working with Clearing Members and the CFTC in the determination of clearing requirements. Please do not hesitate to contact me regarding any questions raised by this information.

Regards

David Horner  
Head of SwapClear Business Risk