

VIA CFTC PORTAL

June 28 2018

Mr Christopher Kirkpatrick
Commodity Futures Trading Commission
115 21st Street NW
Three Lafayette Centre
Washington DC 20581

LCH Limited Self Certification: Rule Changes allowing members to determine the index final for an Inflation Contract

Dear Mr Kirkpatrick

Pursuant to CFTC regulation §40.6(a), LCH Limited ("LCH"), a derivatives clearing organization registered with the Commodity Futures Trading Commission (the "CFTC"), is submitting for self-certification changes to its rules the effect of which will allow inflation trades where the final fixing is known at registration to be permitted as eligible trades.

Part I: Explanation and Analysis

LCH accepts inflation swaps for clearing in USD, EUR and GBP against 4 indices, UK RPI, EUR HICP, FRF CPI and USD CPI.

On an inflation swap, there are two fixings, one at the start and one at the end of the trade period with the payment being the ratio of the two. The inflation fix is defined with a lag of a number of months (which can vary from a period of c.2months to c.1year). The inflation fix for a month is published at some point during the following month.

Currently LCH does not accept trades in the month where the final fixing is due to be published. This restriction was put in place for operational reasons and there are no market risk or margin implications. This operational restriction is being lifted and the system should correctly handle a trade at any point up to final payment date. Inflation trades will thus be eligible even if the final inflation index level has been published.

The relevant sections of the LCH Procedures and product eligibility manual are being updated to reflect this change.

The rule changes will go live on, or after, July 16, 2018.

Part II: Description of Rule Changes

Section 1.8.13 and 1.8.14 in Procedures Section 2C (SwapClear Clearing Service) and section 2.1.8(o) and 2.1.8(p) of the FCM Procedure have been amended to support the possibility that the parties to an inflation swap may determine the index final rather than it solely being determined by LCH.

Section 2.1.3 of the SwapClear Product Specific Contract Terms and Eligibility Criteria Manual and section 2.1(c) of the FCM Product Specific Contract Terms and Eligibility Criteria Manual has been updated to remove the restriction noted in part I above.

The texts of the rule changes are attached hereto as:

- i. **Appendix I**, Procedures Section 2C (SwapClear)
- ii. **Appendix II**, FCM Procedures
- iii. **Appendix III**, SwapClear Product Specific Contracts Terms and Eligibility Criteria Manual
- iv. **Appendix IV**, FCM Product Specific Contracts Terms and Eligibility Criteria Manual

Part III: Core Principle Compliance

LCH has reviewed the changes against the requirements of the Core Principles and finds that they will continue to comply with all the requirements and standards therein.

Part IV: Public Information

LCH has posted a notice of pending certification with the CFTC and a copy of the submission on LCH's website at:

<http://www.lch.com/rules-regulations/proposed-rules-changes>

Part V: Opposing Views


There were no opposing views expressed to LCH by governing board or committee members, members of LCH or market participants that were not incorporated into the rule.

Certification

LCH hereby certifies to the Commodity Futures Trading Commission, pursuant to the procedures set forth in the Commission regulation § 40.6, that attached rule submission complies with the Commodity Exchange Act, as amended, and the regulations promulgated there under.

Should you have any questions please contact me at julian.oliver@lch.com.

Yours sincerely

PP. 

Julian Oliver
Chief Compliance Officer
LCH Limited

Appendix I
Procedures Section 2C (SwapClear)



LCH LIMITED

PROCEDURES SECTION 2C

SWAPCLEAR CLEARING SERVICE

(b) *Negative Interest Rate Method*

SCMs should note the provisions of section 3.3 of Part A of the Product Specific Contract Terms and Eligibility Criteria Manual as published on the Clearing House's website regarding the applicability of the Negative Interest Rate Method to a SwapClear Contract. SwapClear Clearing Members may, in the circumstances, wish to ensure that any trade submitted for registration follows that Negative interest Rate Method.

1.8.13 Calculation of Inflation Indices

(a) The Index level used for calculating the Floating Rate is determined according to the 2008 ISDA Inflation Definitions in respect of the following indices (or successor indices from time to time):

- (i) non-revised Index of Consumer Prices excluding Tobacco in the European Monetary Union;
- (ii) non-revised Index of Consumer Prices excluding Tobacco in France;
- (iii) non-revised Index of Consumer Prices excluding Tobacco in the United Kingdom; and
- (iv) non-revised Index of Consumer Prices for All Urban Consumer (CPI-U) before seasonal adjustment in the United States.

In the event an Index is not available to calculate the Index Final, the Clearing House will, in its sole discretion, determine a value for the Index Final.

~~1.8.14~~ Index Final

~~The Clearing House will calculate the Index Final by taking the relevant Index level for the applicable Reference Month. In the event of no Index being available the Clearing House will, at its sole discretion, determine a value for the Index level.~~

~~1.8.15~~ 1.8.14 Non-deliverable Interest Rate Swaps

The Clearing House will calculate all coupon payments for SwapClear Contracts that are non-deliverable interest rate swaps, including the Fixed Amount or Floating Amount payable under any such SwapClear Contract, in USD, and all amounts due or payable under such SwapClear Contracts must be paid in USD.

1.9 **Initial Margin**

The Clearing House will require SCMs to transfer Collateral in respect of their initial margin obligations, which are not discharged. This amount will be determined by the prevailing market conditions and the expected time to close out the portfolio. The

Appendix II
FCM Procedures



FCM PROCEDURES OF THE CLEARING HOUSE

LCH LIMITED

determined by the Clearing House in its sole discretion, the Clearing House will determine an alternative rate at its sole discretion. Each such rate will be provided in regular reports by the Clearing House to members.

(m) *Applying Floating Rate Options*

The Clearing House will determine the rate applicable on a Reset Date in respect of a SwapClear Contract as set out in paragraph (l) above. Such Rate will be applied to the appropriate floating legs and the coupon payments calculated.

The coupon payments will be adjusted to fall on actual Business Days according to the Calendar(s) and Business Day Convention specified.

(n) *Negative Interest Rate Method*

FCM Clearing Member should note the provisions of Section 3.2 of Part A of Schedule 1 to the FCM Product Specific Contract Terms And Eligibility Criteria Manual regarding the applicability of the Negative Interest Rate Method, to an FCM SwapClear Contract. FCM Clearing Members may, in the circumstances, wish to ensure that any trade submitted for registration follows that Negative interest Rate Method.

(o) *Calculation of Inflation Indices*

The Index level used for calculating the Floating Rate is determined according to the ~~2006–2008~~ ISDA Definitions in respect of the following indices (or successor indices from time to time):

- (i) non-revised Index of Consumer Prices excluding Tobacco in the European Monetary Union;
- (ii) non-revised Index of Consumer Prices excluding Tobacco in France;
- (iii) non-revised Retail Price Index All Items in the United Kingdom; and
- (iv) non-revised index of Consumer Prices for All Urban Consumers (CPI-U) before seasonal adjustment in the United States.

In the event an Index is not available to calculate the Index Final, the Clearing House will, in its sole discretion, determine a value for the Index Final.

~~(p) *Index Final*~~

~~The Clearing House shall calculate the Index Final by taking the relevant Index level for the applicable Reference Month. In the event~~

~~of no Index level being available the Clearing House shall, in its sole discretion, determine a value for the Index level.~~

~~(q)~~(p) *Non-deliverable Interest Rate Swaps*

The Clearing House will calculate all coupon payments for FCM SwapClear Contracts that are non-deliverable interest rate swaps, including the Fixed Amount or Floating Amount payable under any such FCM SwapClear Contract, in USD, and all amounts due or payable under such FCM SwapClear Contracts must be paid in USD.

2.1.9 *Initial Margin*

The Clearing House will require FCM Clearing Members to furnish it with Initial Margin. This amount will be determined by the prevailing market conditions and the expected time to close out the portfolio. The Portfolio Approach to Interest Rate Scenarios (PAIRS) will be used to calculate Initial Margin requirements for FCM SwapClear Contracts.

Separate Initial Margin calculations are performed for an FCM Clearing Member's house "H" and client "C" accounts and, within a "C" account, separately in respect of each FCM Client Sub-Account therein. No offset between the "C" and "H" accounts is permitted.

The Clearing House reserves the right to require additional amounts of Margin from a specific FCM Clearing Member or from all FCM Clearing Members in accordance with FCM Regulation 14 (*Margin and Collateral*).

(a) *Liquidity Multiplier*

Risk Management applies a liquidity multiplier based on Worst Case Loss (WCL) exceeding certain thresholds on the FCM Clearing Member's whole portfolio and individual currencies. The threshold amounts and multipliers are reviewed on an on-going basis. FCM Client accounts are treated as independent accounts for purposes of liquidity and will be called only in the event that the individual account exceeds the relevant threshold.

(b) *Intra-day Margin Calls*

In accordance with the Clearing House's FCM Regulations, the Clearing House is entitled to make additional margin calls for payment the same day (intra-day margin calls) where it is considered necessary. Intra-day margin calls can be called at any time throughout the Business Day. Intra-day margin calls will usually be made via the Protected Payments System (PPS) (see Section 2.1.10).

In certain circumstances the Clearing House may wish to make a call for additional funds after the closure of UK PPS facilities at 16:00 hours, London time. In this event the Clearing House will require payment of additional funds through PPS facilities in the USA (see Section 3.2.1). Members must ensure, in these circumstances, that

Appendix III
SwapClear Product Specific Contracts Terms and Eligibility Criteria Manual



**PRODUCT SPECIFIC CONTRACT TERMS AND ELIGIBILITY CRITERIA
MANUAL**

| <u>Day Count Fraction</u> | <u>MarkitWire/ FpML Code</u> | <u>Currency</u> |
|---------------------------------------------------------------------------------|----------------------------------|-----------------|
| | | SEK, CZK, HUF |
| <u>Fraction</u> | <u>SWIFT Code</u> | |
| Actual/365, Actual/Actual <i>(See Article 4.16(b) for definition)</i> | ACT/365 | |
| Actual/365 (Fixed) <i>(See Article 4.16(c) for definition)</i> | AFI/365 | |
| Actual/360 <i>(See Article 4.16(d) for definition)</i> | ACT/360 | |
| 30/360,360/360, Bond Basis <i>(See Article 4.16(e) for definition)</i> | 360/360 | |
| 30E/360 <i>(See Article 4.16(f) for definition)</i> | 30E/360 | |

2.1.2 Business Day Conventions

The Business Day Convention specified in the Economic Terms must be one of the following:

Following (see Article 4.12(i) of the ISDA 2000 Definitions and Article 4.12 (i) of the ISDA 2006 Definitions for definition)

Modified Following (see Article 4.12(ii) of the ISDA 2000 Definitions and Article 4.12(ii) of the ISDA 2006 Definitions for definition)

Preceding (see Article 4.12(iii) of the ISDA 2000 Definitions and Article 4.12(iii) of the ISDA 2006 Definitions for definition)

For inflation swaps and vanilla interest rate swaps with constant notional principal SwapClear does not support trades where a different business day convention is used for:

fixed period end dates and the termination date

float period end dates and the termination date

2.1.3 Minimum Residual Term of the Trade (Termination date – Today)

Trades in respect of vanilla interest rate swaps with constant notional principal and variable notional swaps and inflation swaps are subject to a minimum Residual Term on the day they are received by SwapClear.

Minimum Residual Term of trade:

Termination date - Today \geq 1 + currency settlement lag

where currency settlement lag is:

1 day for EUR, USD, GBP and CAD denominated trades

2 days for JPY, CHF, AUD, DKK, HKD, NZD, SEK, NOK, PLN, ZAR, SAD, HUF, CZK & MXN denominated trades

~~The Clearing House will accept inflation swaps for registration: (a) in the case of uninterpolated indices, up to the end of the month prior to the final Reference Month; and (b) in the case of interpolated indices, up to the end of the final Reference Month.~~

2.1.4 *Designated Maturity*

The Designated Maturity must be no less than one month and no more than twelve months. The Clearing House will, excepting stub periods, only accept a Designated Maturity that is a whole calendar month.

2.1.5 *Calculation Periods*

(See Article 4.13 of the ISDA 2000 Definitions and Article 4.13 of the ISDA 2006 Definitions for definition.)

For vanilla interest rate swaps with constant notional principal and variable notional swaps the Clearing House will only accept non standard Calculation Periods ("**stub periods**") at either the start or end of the contract. Transactions with stub periods at both the start and end of the transaction will not be eligible as SwapClear Transactions.

For variable notional swaps the stub rate should be detailed either as a percentage (i.e. 5.5 per cent.), an interpolation (i.e. 1 month/3 months) or as a designated maturity (i.e. 1 month). Stub Rates within the Final Stub are calculated via interpolation or as a designated maturity.

For interpolated coupons, payment dates must fall between the rolled dates, according to the Modified Following business day convention, of the specified designated maturities. Where this does not occur and extrapolation would be required, SwapClear will reject the trade.

The minimum stub period of a variable notional swap accepted by SwapClear is 1 + Currency Settlement Lag. The minimum stub rate tenor must be \geq 1 week for IRS and basis swap and \geq 1 month for zero coupon swaps.

SwapClear also calculates floating periods subject to IMM settlement dates as per ISDA definitions.

For Forward Rate Agreements non standard designated maturities are accepted subject to the following criteria:

Interpolated period:

The maturity date must fall between the rolled dates, according to the business day convention, of the specified designated tenors. Where this does not occur and extrapolation would be required, SwapClear will reject the trade.

SwapClear will interpolate based upon the closest indices for interpolation

Appendix IV
FCM Product Specific Contracts Terms and Eligibility Criteria Manual



FCM PRODUCT SPECIFIC CONTRACT TERMS AND ELIGIBILITY CRITERIA
MANUAL

| | |
|--------------------------------------|---------|
| 30E/360 | 30E/360 |
| (See Article 4.16(f) for definition) | |

(b) **Business Day Conventions**

The Business Day Convention specified in the Economic Terms must be one of the following:

- Following (see Article 4.12 (i) of the ISDA 2000 Definitions and Article 4.12 (i) of the ISDA 2006 Definitions for definition)
- Modified Following (see Article 4.12 (ii) of the ISDA 2000 Definitions and Article 4.12(ii) of the ISDA 2006 Definitions for definition)
- Preceding (see Article 4.12 (iii) of the ISDA 2000 Definitions and Article 4.12 (iii) of the ISDA 2006 Definitions for definition)

For inflation swaps and vanilla interest rate swaps with constant notional principal SwapClear does not support trades where a different business day convention is used for:

- (i) fixed period end dates and the termination date
- (ii) float period end dates and the termination date

(c) **Minimum Residual Term of the Trade (Termination date – Today)**

Trades in respect of vanilla interest rate swaps with constant notional principal and variable notional swaps [and inflation swaps](#) are subject to a minimum Residual Term on the day they are received by SwapClear.

- (i) Minimum Residual Term of trade:

$$\text{Termination date} - \text{Today} \geq 1 + \text{currency settlement lag}$$

where currency settlement lag is:

- 1 day for EUR, USD, GBP, CAD and MXN denominated trades
- 2 days for JPY, CHF, AUD, DKK, HKD, NZD, SEK, NOK, PLN, ZAR, SAD, HUF & CZK denominated trades

~~The Clearing House will accept FCM SwapClear Transactions that are inflation swaps for registration: (a) in the case of uninterpolated indices, up to the end of the month prior to the final Reference Month; and (b) in the case of interpolated indices, up to the end of the final Reference Month.~~

(d) **Designated Maturity**

The Designated Maturity must be no less than one month and no more than twelve months. The Clearing House will, excepting stub periods, only accept a Designated Maturity that is a whole calendar month.

