

VIA CFTC Portal

May 23, 2019

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

Dear Mr Kirkpatrick

**Submission under CFTC Regulation 39.5 (b) – FX Forwards (ForexClear)**

Pursuant to CFTC regulation §39.5(b), LCH Limited (“LCH”), a derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission (the “CFTC”), is submitting FX Forwards in eight currency pairs (AUD/USD; EUR/USD; EUR/CHF; EUR/GBP; EUR/JPY; GBP/USD; USD/CHF; USD/JPY) for determination of whether mandatory clearing should apply, at the request of the CFTC. LCH appreciates that in 2012 the Secretary of the Treasury determined that foreign exchange forwards are exempt from mandatory clearing under Dodd-Frank.

Background

In May 2018, via the ForexClear service, LCH launched clearing of European Plain Vanilla FX Options in the eight currency pairs mentioned above and FX Forwards and Spots as associated hedge trades. LCH now intends to allow the Clearing Members to clear FX Forwards and Spots in their own right. The FX Forwards Contracts, which are the subject of this submission, will be eligible for clearing in the same currencies pairs as for FX Options, and the eligible maximum remaining time to maturity is 2 calendar years.

LCH will continue to retain full responsibility for the ‘clearing to settlement’ process, with some settlement aspects being undertaken in conjunction with CLS<sup>1</sup>. Further, the current Settlement Position Limits set at Clearing Member level in respect to FX Options Contracts will also apply to the FX Forwards Contracts and any excess above the relevant settlement exposures will be addressed via the current enforced Settlement Reduction Process two days prior to settlement date, as for FX Options.

Factors for determination

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

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<sup>1</sup> CLS Bank International, the global utility for eliminating settlement risk in FX transactions.

The FX market is fast paced, global and well established with a clear product set. The majority of FX transactions are short dated and volume has grown considerably over the last ten years. Table 1 shows FX Forwards average daily volumes for cleared currency pairs (Source: BIS Triennial FX Survey 2016).

Table 1

(USD millions)	AUD/USD	EUR/USD	EUR/CHF	EUR/GBP	EUR/JPY	GBP/USD	USD/CHF	USD/JPY	Total
<b>Forwards</b>	27,886	116,176	5,161	16,052	14,438	60.492	20,127	115,102	<b>315,102</b>

The price data currently used in the ForexClear service is provided real-time directly by clearing members. Price data for Major Currency pairs is sourced in the same way. Price data includes FX spot rates and swap points for specified tenors as well as implied volatility points for specified tenors and deltas for all currency pairs.

***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 has a well-developed rule framework and support infrastructure for clearing FX transactions, including FX Forwards which are already actively cleared as hedges of FX Option Contracts. LCH will continue to leverage this existing operational capability to clear outright FX Forwards.

In order to prepare for the launch of this product, LCH has been performing testing, including capacity testing.

Further to this, LCH have notified its Clearing Members of a number of minor changes to the LCH Rulebook, mainly in the General Regulations to allow ForexClear Clearing Members to clear FX Forwards other than just as hedges of FX Option Contracts. The changes have been submitted for self certification to the CFTC and are available on the LCH 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***

LCH actively clears FX Forwards as hedges of FX Option Contracts via the ForexClear service, therefore the operational capability to manage the product is already in place.

LCH expects current ForexClear Clearing Members to start clearing outright FX Forwards following the go-live date. The anticipated volumes will largely be driven by existing volumes/open interest in the eligible currency pairs and more generally by the number of Clearing Members in the ForexClear deliverable service.

Based on the statistics of the latest Triennial Survey of the Bank for International Settlements, the daily average turnover in FX Forward and Spots in the relevant eight currency pairs represents 20% of the global market daily turnover. The FX market has a diverse set of participants but the top 7

banks are involved in 62% of all FX business, whilst the top 10 banks cover 80% of it. The market share of the ForexClear Clearing Members represents less than 20% of the average daily turnover. Therefore, allowing clearing of FX Forwards other than as FX Option hedges is unlikely to have a significant impact on the risk profile or total resources held by the ForexClear service. As such, the systemic risk profile of LCH remains unchanged as a result of the new product offering.

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

LCH is not aware of competitors clearing FX Forwards at present.

Following the launch, scheduled for end of May/beginning of June 2019, outright FX Forwards will be the subject to the current fee plan applicable to the ForexClear deliverable service. The fees will differ according to the tariff chosen by Clearing Members (i.e. Bronze or Silver) and may consist of an annual charge and a charge based on the clearing activity.

LCH will also impose a fee as part of the automated settlement reduction process, levied against Clearing Members who are in breach of relevant settlement limits at end of day two days prior to the Settlement Date. This is already in place for FX Option Contracts and will equally apply to FX Forwards Contracts.

***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 FX Forwards Contracts is in all material respects the same as that of the products already cleared in the ForexClear service at LCH.

Insofar as legal certainty in the event of the insolvency of the DCO is concerned, LCH would be wound up under English law.

***Further information §39.5(b)(iii-viii)***

Product specifications are set out in the ForexClear Deliverable Forward Contract Terms (Part F of the LCH Product Specific Contract Terms and Eligibility Criteria Manual), which are publicly available on the LCH website ([link](#)).

The participant eligibility standards for FX Forwards are the same as those for existing ForexClear Clearing Members.

As noted above, the market data is provided real-time directly by Clearing Members.

There are no material changes within the service as FX forwards are already actively cleared within ForexClear as FX Options hedges. In particular, there are no risk management changes required (FX Forwards Contracts will be valued and margined alongside FX Options and hedges) and there will also be no changes to the existing settlement management framework. In particular, there are no changes to the current Settlement Position Limits at Clearing Member level and any excess above the relevant settlement exposures will be addressed via the enforced Settlement Reduction Process two days prior to settlement date, as for FX Options.

Further, an additional flow will be added in the trade registration process to identify the purpose of the trade (i.e. whether or not it is related to the hedging of the FX Option portfolio) and allow ForexClear to appropriately manage the hedges vs non-hedges trade flow.

LCH will make a number of minor changes to its Rulebook, as follows:

- **General Regulations** - Regulation 98 currently includes the restrictions for ForexClear Clearing Members to clear FX Forwards and Spot only as hedges of FX Option Contracts. As such restriction will no longer apply, the wording under Regulation 98 and references to it in Regulation 91 will be removed. Minor updates will be made in other sections to Further, to refer to outright FX Forwards as eligible clearing.
- **Procedures Section 21 (ForexClear Clearing Service)** - these will include a new section 1.22 (ForexClear Spot Transactions and ForexClear Deliverable Forward Transactions – Reporting of Hedge Transactions) requiring ForexClear Clearing Members to submit to LCH a report of the FX Forwards transactions submitted for clearing as hedges to FX Option Contracts. This requirement will allow the clearing service to appropriately manage the flow of FX Forwards and Spots transactions being submitted for clearing by distinguishing hedges vs non-hedges trades.

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

LCH engages its 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 notified of the changes which LCH is required to make to its Rulebook.

Notice of this submission under CFTC regulation §39.5(b) was given to ForexClear Clearing Members on 21 May, 2019 and a copy of this notice is provided at Appendix A. Furthermore, this submission is publicly available at: <http://www.lch.com/rules-regulations/regulatory-responses>

LCH intends to launch these products with its Clearing Members and clients no earlier than May 28, 2019.

Should you have questions please contact me at [julian.oliver@lch.com](mailto:julian.oliver@lch.com).

Yours sincerely



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