

**VIA ELECTRONIC EMAIL**

31 July 2020

**Mr Christopher Kirkpatrick  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street NW  
Three Lafayette Centre  
Washington DC 20581**

Dear Mr Kirkpatrick,

Pursuant to CFTC regulation 39.5(b), LCH SA (“**LCH**”), a derivatives clearing organization registered (“**DCO**”) with the Commodity Futures Trading Commission (the “**CFTC**”), is making the present submission for determination of whether mandatory clearing should apply.

iTraxx MSCI ESG Screened Europe Index initiative

LCH intends to add to the list of eligible instruments iTraxx MSCI ESG Screened Europe indices from series 33 onwards on 5Y tenor, denominated in EUR.

**Eligibility to clear swaps and ability to maintain compliance under a mandatory clearing determination**

LCH is launching iTraxx MSCI ESG Screened Europe indices as part of its CDSClear service, as an extension to its current product offering on the second half of August 2020 subject to any relevant regulatory review or approval process duly completed. Under CFTC regulation §39.5(a)(1), LCH is eligible to clear these swaps and will be able to maintain compliance with section 5b(c)2 of the Act in the event.

**Factors for determination**

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

This index is a sub-index of the iTraxx Europe Main index CDS. A combination of the following datasets from MSCI ESG Research is used to determine the composition of the iTraxx MSCI ESG Screened Europe Index.

- MSCI ESG Business Involvement Screening Research
- MSCI ESG Climate Change Metrics
- MSCI ESG Controversies
- MSCI ESG Ratings

The MSCI ESG Research data as of the last Business Day of the month prior to the month in which Roll Date occurs will be used. This index is constituted of those iTraxx Europe Main index that successfully pass the screening.

While the iTraxx MSCI ESG Screened Europe index is a new instrument, it is a sub-index of the iTraxx Europe Main index CDS, which is heavily traded. Series 33 is the first index launched and was made available to trade for the first time on June 22, 2020, the delay between the creation date of March 20<sup>th</sup> and the first trading date was due to the COVID-19 pandemic, and we do expect liquidity to build up rapidly.

Since June 22, 2020, we have seen the index consistently priced by four different banks, we were able to observe quotes of 55.5bps (versus 67bps on iTraxx Europe Main), with a bid/ask spread of 3.5bps (versus 0.5bps on iTraxx Europe Main, the spread is expected to narrow as trading picks up. Two trades for a total notional of 47 million were executed bilaterally.

Pricing data is available from Markit and other standard price sources. However, to ensure that LCH always has access to the best prices, even on illiquid products, we have implemented a process whereby members of the CDSClear service (with open interest in a product) contribute prices on a daily basis. These prices are aggregated to create our settlement prices.

**The availability of rule framework, capacity, operational expertise 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 already has a well-developed rule framework and support infrastructure for clearing CDS indices. LCH intends to leverage this existing operational capability when extending its offering to cover iTraxx MSCI ESG screened Europe indices.

In order to prepare for the launch of iTraxx MSCI ESG Screened Europe indices, LCH has performed testing to ensure that it is able to clear iTraxx MSCI ESG Screened Europe indices in a manner that is consistent with the terms on which iTraxx MSCI ESG Screened Europe indices contracts are traded.

As for the other CDS indices currently cleared through LCH, the clearing documentation applicable to the CDS cleared contract is based on the market standard documentation.

**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**

The CCP's default management protocols, processes and technology are modified to allow clearing of the new product.

The CCP's risk management framework has been calibrated to handle an expected volume of activity.

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

To the best of our knowledge, iTraxx MSCI ESG Screened Europe indices are not yet offered to clearing by any other CCP neither in the US nor in Europe, although it is likely to be in the short term, and therefore LCH's early engagement in offering clearing on this instrument will foster competition on this market and could down the line lead the European authorities to submit the iTraxx MSCI ESG Screened Europe indices to mandatory clearing.

The fees applicable to the clearing of iTraxx MSCI ESG Screened Europe indices will be the same as the fees applicable to other European indices cleared on the platform as denominated in EUR<sup>1</sup>. The current fees for Euro denominated products have been certified with the CFTC<sup>2</sup>.

**The existence of reasonable legal certainty in the event of 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**

The level of legal certainty around the clearing of iTraxx MSCI ESG Screened Europe indices is the same as that of any other CDS currently cleared by LCH.

Insofar as legal certainty in the event of the insolvency of the DCO is concerned, LCH would be wound up under French law and has provided opinions on the treatment of cleared swaps customer funds as part of its DCO registration in 2013.

**Product specifications, including copies of any standardized legal documentation, generally accepted contract terms, standard practices for managing any life cycle events associated with the swap, and the extent to which the swap is electronically confirmable.**

The clearing documentation applicable to iTraxx MSCI ESG Screened Europe indices is based on the market standard iTraxx Europe Untranchured Transactions Standard Terms Supplement published by Markit. This covers the standardized legal documentation and generally accepted contract terms.

Standard practices for managing any life cycle events are based on the credit events as defined under the 2014 ISDA Credit Derivatives Definitions as applicable, and as determined by the ISDA EMEA Determination Committee.

Only standardized CDS are eligible to clearing and as a result, they are all electronically confirmable.

**Participant eligibility standards, if different from the derivatives clearing organization's general participant eligibility standards**

The participant eligibility standards have not been modified.

**Pricing sources, models, and procedures, demonstrating an ability to obtain sufficient price data to measure credit exposures in a timely and accurate manner, including any agreements with clearing members to provide price data and copies of executed agreements with third party price vendors, and information about any price reference index used, such as the name of the index, the source that calculates it, the methodology used to calculate the price reference index and when and where it is published publicly**

LCH will continue using a price contribution process as described under Section 5.18 of the CDS Clearing Procedures. All members are required to contribute on contracts on which they have open interest.

**Risk management procedures including measurement and monitoring of credit exposures, initial and variation margin methodology, methodologies for stress testing and back testing, settlement procedures, and default management procedures**

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<sup>1</sup> <https://www.lch.com/index.php/services/cdsclear/fees>

<sup>2</sup> [https://www.lch.com/sites/default/files/media/files/LCH\\_CDSClear\\_Fee%20changes\\_Sel%20Cert\\_Modified\\_Formal\\_16Dec2019.pdf](https://www.lch.com/sites/default/files/media/files/LCH_CDSClear_Fee%20changes_Sel%20Cert_Modified_Formal_16Dec2019.pdf)  
[https://www.lch.com/system/files/media\\_root/LCH\\_CDSClear\\_Client%20Fee%20Incentive%20scheme\\_CFTC%20SelfCertification\\_Formal\\_17%20Oct%202018.pdf](https://www.lch.com/system/files/media_root/LCH_CDSClear_Client%20Fee%20Incentive%20scheme_CFTC%20SelfCertification_Formal_17%20Oct%202018.pdf)

Risk parameters have been adjusted, as reflected in its Reference Guide: CDS Margin Framework to take into account the introduction of the iTraxx MSCI ESG Screened Europe indices:

- (i) removing references to specific indices in the document and replacing them with a generic reference to an index,
- (ii) removing the fixed 24% value and changing the spread shock formula for it to be applicable more generically to both iTraxx Main index and any of its sub index including financial Single Names.

**Applicable rules, manuals, policies or procedures**

No changes.

**A description of the manner in which the derivatives clearing organization has provided notice of the submission to its members and a summary of any views on the submission expressed by the members**

Clearing members have also been informed via the notice attached in Appendix.

No specific comments have been expressed by the clearing members.

Yours sincerely



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**APPENDIX**

**Notice of the submission to CDSClear members**

# Memo

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To	Clearing Members
From	CDSClear
Date	29 June 2020
Subject	<b>CFTC Clearing Mandate Determination for iTraxx MSCI ESG Screened Europe Index CDS</b>

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## **Introduction**

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[https://www.lch.com/system/files/media\\_root/LCH\\_CDSClear\\_Client%20Fee%20Incentive%20scheme\\_CFTC%20SelfCertification\\_Formal\\_17%20Oct%202018.pdf](https://www.lch.com/system/files/media_root/LCH_CDSClear_Client%20Fee%20Incentive%20scheme_CFTC%20SelfCertification_Formal_17%20Oct%202018.pdf)



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