

VIA CFTC Portal

7 June 2021

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

Dear Mr Kirkpatrick

NDF Contract in HKD/USD currency pair

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 Non-Deliverable Forward (“NDF”) Contracts in the USD/Hong Kong Dollar (HKD) currency pair for determination of whether mandatory clearing should apply.

Background

The ForexClear service currently clears NDFs on 25 currency pairs settled against USD¹. The service intends to expand the clearing eligibility to USD/HKD NDF Contracts with a maximum tenor of 2Y to meet Clearing Members’ demand. The planned launch date is 21 June 2021.

Factors for determination

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

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. Total average daily volumes for USD/HKD are USD \$233bn (Source: BIS Triennial FX Survey 2019); although it should be noted that the bulk of the volume on USD/HKD is currently traded as deliverable FX, with a small proportion being traded as non-deliverable, as further set out below. Expanding the clearing eligibility to non-deliverable contracts may help in increasing exposures and trading liquidity in this new currency pair.

The price data currently used in the ForexClear service is provided real-time directly by clearing members. 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.

¹ <https://www.lch.com/services/forexclear/what-we-clear>

The availability of the 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. LCH will continue to leverage this existing operational capability to clear the new NDF currency pair.

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 changes to the Product Specific Contract Terms and Eligibility Criteria Manuals (or referred to as “Product Manuals”) applicable to Clearing Members that are Futures Commission Merchants (“FCM Clearing Members”) and non FCM Clearing Members. The changes have been submitted for self-certification to the CFTC and made 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

The operational capability to manage the additional NDF currency pair is already in place in LCH.

LCH expects current ForexClear Clearing Members to start clearing the new currency pairs following the go-live date. A subset of existing Clearing Members will be ready on the go live date and plan to execute a few trades. More existing Clearing Members are expected to be ready in the near future where volumes/open interest in the additional currency pairs are expected to increase.

Based on the statistics of the latest Triennial Survey of the Bank for International Settlements, the daily average turnover of the new USD/HKD represents around 4% of the global FX market daily turnover, although only a very small proportion of this 4% is traded as Non-Deliverable Forwards. Therefore, allowing clearing of Non-Deliverable Forwards on these additional currency pairs 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

CME Clearing offers clearing of Cash Settled Forwards in HKD/USD. LCH is not aware of other competitors clearing NDFs on this currency pair.

Following the business launch, currently scheduled for 21 June 2021, the additional NDF currency pair will be subject to the ForexClear’s fee plan applicable to the non-deliverable segment of the service. The fees will differ according to the tariff chosen by Clearing Members.

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 NDF Contracts in USD-HKD currency pair 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)

The specifications of products eligible for clearing in the ForexClear service are set out in the LCH Product Manuals, which are publicly available on the LCH website ([link](#)). These will be updated with the specifications of the USD-HKD NDF Contract.

The participant eligibility standards for the new NDF Contract 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. In particular, there are no changes to the operational and risk management models. Initial Margin calculation, Variation Margin and settlement will all be in USD in line with the current NDF offering. The currency pair will be subject to the Liquidity Risk Margin (LRM) add-on and the Sovereign Risk Margin (SRM) add-on frameworks. The SRM add-on calculation will be calibrated accordingly to ensure it captures the specific risk associated with the HKD currency. In addition, ForexClear will be making updates and changes to the stress scenarios for the new currency pair, as per usual process for the extensions of product offering.

Under the LCH rules, the USD-HKD NDF currency pair will be considered a Non-EMTA NDF currency pair². As noted above, LCH will update the following sections of the Product Manuals accordingly:

- Contract terms
- Contract eligibility criteria
- Contract Templates

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 that LCH is required to make to the Product Manuals. Further, the updates to the Product Manuals have been submitted to the CFTC pursuant to §40.6(a).

² LCH eligible currencies whose contract templates are published by the Emerging Markets Trade Association (“EMTA”) are considered EMTA NDF currency pairs. For all other currencies, considered Non-EMTA NDF currency pairs, LCH sets out the respective Contract Templates in its Rulebook and these are referred to as “Non-EMTA NDF Contract Templates”.

Notice of this submission under CFTC regulation §39.5(b) was given to ForexClear Clearing Members on 5 May 2021 and a copy of this notice is provided at Appendix A. Furthermore, this submission is publicly available³.

LCH intends to launch these products with its Clearing Members and clients on, or after, 21 June 2021.

Please contact me if you have any questions.

Yours sincerely

P.P.



Julian Oliver
Chief Compliance Officer
LCH Limited

³ <https://www.lch.com/resources/rules-and-regulations/regulatory-responses>

Appendix A

Notice to Clearing Members regarding the 39.5 (b) submission on HKD/USD NDF

Memo

To	ForexClear Clearing Members
From	Loic Moreau, Head of In-Business Risk ForexClear
Date	5 May 2021
Subject	Submission on USD-HKD NDF currency pair for determination of clearing requirements

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 Non-Deliverable Forwards (“NDFs”) in the USD/Hong Kong Dollar (HKD) currency pair for determination of whether mandatory clearing should apply.

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

The ForexClear service currently clears NDFs on 25 currency pairs settled against USD⁴. The service intends to expand the clearing eligibility to USD/HKD NDF Contracts with a maximum tenor of 2Y to meet Clearing Members’ demand.

Factors for determination

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

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. Total average daily volumes for USD/HKD are USD \$233bn (Source: BIS Triennial FX Survey 2019); although it should be noted that the bulk of the volume on USD/HKD is currently traded as deliverable FX, with a small proportion being traded as non-deliverable, as further set out below. Expanding the clearing eligibility to non-deliverable contracts may help in increasing exposures and trading liquidity in this new currency pair.

The price data currently used in the ForexClear service is provided real-time directly by clearing members. 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.

⁴ <https://www.lch.com/services/forexclear/what-we-clear>

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. LCH will continue to leverage this existing operational capability to clear the new NDF currency pair.

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 changes to the Product Specific Contract Terms and Eligibility Criteria Manuals (or referred to as “Product Manuals”) applicable to Clearing Members that are Futures Commission Merchants (“FCM Clearing Members”) and non FCM Clearing Members. The changes will be submitted for self-certification to the CFTC and made 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

The operational capability to manage the additional NDF currency pair is already in place in LCH.

LCH expects current ForexClear Clearing Members to start clearing the new currency pairs following the go-live date. A subset of existing Clearing Members will be ready on the go live date and plan to execute a few trades. More existing Clearing Members are expected to be ready in the near future where volumes/open interest in the additional currency pairs are expected to increase.

Based on the statistics of the latest Triennial Survey of the Bank for International Settlements, the daily average turnover of the new USD/HKD represents around 4% of the global FX market daily turnover, although only a very small proportion of this 4% is traded as Non-Deliverable Forwards. Therefore, allowing clearing of Non-Deliverable Forwards on these additional currency pairs 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

CME Clearing offers clearing of Cash Settled Forwards in HKD/USD. LCH is not aware of other competitors clearing NDFs on these currency pair.

Following the business launch, currently scheduled for 21 June 2021, the additional NDF currency pair will be subject to the ForexClear’s fee plan applicable to the non-deliverable segment of the service. The fees will differ according to the tariff chosen by Clearing Members.

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 NDF Contracts in USD-HKD currency pair 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)

The specifications of products eligible for clearing in the ForexClear service are set out in the LCH Product Manuals, which are publicly available on the LCH website ([link](#)). These will be updated with the specifications of the USD-HKD NDF Contract.

The participant eligibility standards for the new NDF Contract 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. In particular, there are no changes to the operational and risk management models. Initial Margin calculation, Variation Margin and settlement will all be in USD in line with the current NDF offering. The currency pair will be subject to the Liquidity Risk Margin (LRM) add-on and the Sovereign Risk Margin (SRM) add-on frameworks. The SRM add-on calculation will be calibrated accordingly to ensure it captures the specific risk associated with the HKD currency. In addition, ForexClear will be making updates and changes to the stress scenarios for the new currency pair, as per usual process for the extensions of product offering.

Under the LCH rules, the USD-HKD NDF currency pair will be considered a Non-EMTA NDF currency pair⁵. As noted above, LCH will update the following sections of the Product Manuals accordingly:

- Contract terms
- Contract eligibility criteria
- Contract Templates

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 that LCH is required to make to the Product Manuals.

The updates to the Product Manuals will be submitted to the CFTC pursuant to §40.6(a) in time for the launch date expected to be June 21, 2021.

⁵ LCH eligible currencies whose contract templates are published by the Emerging Markets Trade Association ("EMTA") are considered EMTA NDF currency pairs. For all other currencies, considered Non-EMTA NDF currency pairs, LCH sets out the respective Contract Templates in its Rulebook and these are referred to as "Non-EMTA NDF Contract Templates".

Further information may form part of the full \$39.5 filing which will be publicly available on the LCH website.

Please do not hesitate to contact me regarding any questions raised by this submission.