LSEG

CPMI-IOSCO discussion paper on client clearing: access and portability

LSEG RESPONSE TO CPMI-IOSCO DISCUSSION PAPER ON CLIENT CLEARING: ACCESS AND PORTABILITY

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Introduction

LSEG (London Stock Exchange Group) is a diversified global financial markets infrastructure and data business, headquartered in London, with significant operations in Europe, North America, and Asia. With extensive experience, deep knowledge and worldwide presence across financial markets, we enable businesses and economies around the world to fund innovation, manage risk and create jobs. At LSEG, we help to drive financial stability, empower economies and enable customers to create sustainable growth through three business divisions: data and analytics, capital markets and post-trade.

LSEG has majority ownership of the multi-asset global central counterparty clearing house ("CCP") operator, LCH Group ("LCH"). LCH has two licensed CCP subsidiaries – LCH Ltd in the UK and LCH S.A. in France. Both are leading multi-asset class and international clearing houses, serving major international exchanges and platforms as well as a range of OTC markets. They clear a broad range of asset classes, including securities, exchange-traded derivatives, commodities, foreign exchange derivatives, interest rate swaps, credit default swaps, Euro and Sterling denominated bonds and repos.

Executive summary

LSEG welcomes the opportunity to respond to CPMI-IOSCO discussion paper on client clearing: access and portability. We would like to make the following key observations:

- We agree with the observations in the discussion paper that the direct and sponsored access models are designed for and generally used more by larger and/or more sophisticated clients. However, there are different models available in markets to cater for participants' individual requirements depending on their engagement and activity within that market.

- LCH's Sponsored Clearing model available in RepoClear can help address challenges in liquidity management and operational capability that clients have identified as potential barriers to accessing central clearing facilities as well as risk mutualisation at the CCP. The sponsored members are able to use the operational services of the sponsoring agent such as to post or collect Variation Margin (VM) directly whilst still benefiting from all other functionalities offered to direct members.

- We believe that from a regulatory perspective, initiatives aimed at promoting the use of sponsored clearing arrangements could result in the greater uptake of such access models. For example, a more streamlined regulatory approval process to allow new fund types to onboard to the CCP, would be welcomed by the clearing community. Also, changes to the accounting standards for sponsor firms similar to the US, whereby default fund contributions provided by sponsors do not have an impact on the balance sheet of sponsor firms, would also pave the way for a more uptake of those models.
- Regarding risk transmission from participants using direct and sponsored access models, the EMIR framework provides all the necessary tools and procedures to enable CCPs and regulators to manage effectively risk undertaken by CCPs and the broader ecosystem. These standards will apply to any type of membership. At LCH, we consistently implement the highest standards available in all jurisdictions we operate in. This consistency enables us to operate in the safest and most effective and transparent way for both market participants and supervisory authorities.

- Sponsored models are new types of models which require time to mature. In our opinion emphasis must be placed on further familiarising clients and regulators on (i) how the different models work, (ii) on the roles and responsibilities of each participant and (iii) on regulatory alignment supporting of the use of such models in clearing. We believe that adoption rates will improve as more clients and regulators become familiar with the models.

- All account structures that LCH offers across services are designed to allow porting and we will seek to port positions to the greatest possible extent. In addition to typical omnibus and individually segregated account structures, SwapClear also offers the CustodialSeg structure, which allows clients to deliver non-cash collateral directly to LCH, removing transit risk associated with delivery via a clearing broker.

- We find that there are limited areas that warrant further consideration by CCPs. For example, we agree that some standardisation around the type, format and granularity of key data (including customer account information, such as initial margin, delta ladder, positions, customer name and account mapping), file formats, templates and terminology could improve management of the porting process. However, regarding transparency and in line with the report's observations, we believe that disclosure requirements currently envisaged by either EMIR or CPMI-IOSCO principles, to which LCH adheres to, provide adequate disclosures to members and their respective clients.

Access (Section 2)

Design of direct and sponsored access models

1. **Do you agree with the observation in the discussion paper that the direct and sponsored access models are designed for and generally used more by larger and/or more sophisticated clients?**

LSEG generally agrees with the observations in the discussion paper that the direct and sponsored access models are designed for and generally used more by larger and/or more sophisticated clients. However, this does not mean that less sophisticated market participants are excluded, and there are different models available in markets to cater for participants' individual requirements depending on their engagement and activity within that market.

We should make a clear distinction between direct and client access models and the more traditional "client clearing" model. Sponsored membership models, which are discussed in the CPMI-IOSCO paper, are a form of direct participation to the CCP whereas client clearing, whilst it enables clients' access to CCPs, does not increase counterparty risk to the CCP as a result of a client's direct participation.

The more traditional direct and indirect/client clearing access models, as noted in the report, are available throughout most of LCH's clearing services. Sponsored access models are offered in the government debt repo market facilitating clients' access to RepoClear via a credit institution (acting as a sponsoring agent). Input provided in our response in relation to sponsored clearing model will be with regards to RepoClear's sponsored clearing model offered at both LCH Ltd and LCH SA. Comments submitted in the "Porting" section of this discussion paper will be mostly in relation to client clearing access models since porting is not available for sponsored clearing models which has specific mechanisms in place in case of default of the sponsor (cf. Q.14).

Direct clearing models are most often used by larger participants due to specific membership requirements that cannot often be fulfilled by smaller or indirect participants. Hence the need for client clearing models and sponsored access models. Direct models rely on the fact that a member is a sophisticated market participant with the ability to undertake all the obligations of CCP membership such as:

- The obligation to post a Default Fund contribution and be capable to mutualise risk.
- The ability to contribute to further assessments in the event that the Default Fund is exhausted.
- Obligations relating to the provision of hedges to the CCP to neutralise a defaulter's open risk and the provision of bids to acquire the defaulter's (hedged) portfolio.
- A direct operational and technology relationship with the CCP, for example involving multiple margin calls per day.

LCH's Sponsored Clearing enables clients to access RepoClear as a clearing member with the support of a sponsored bank who acts as a sponsoring agent. The sponsored members are then able to use the operational services of the sponsoring agent such as to post or collect VM directly whilst still benefiting from all other functionality which is offered to direct members. Additionally, the sponsor contributes to the default fund in lieu of the client (i.e., takes on the risk mutualisation aspect of CCP membership). This model has been designed to overcome various challenges that certain market participants face, e.g., pension funds, which may be prevented in certain jurisdictions to post default fund contributions and that may have less flexibility to post variation margin.

Hence, RepoClear's Sponsored Clearing model can help address challenges in liquidity management and operational capability that clients have identified as potential barriers to accessing central clearing facilities as well as risk mutualisation at the CCP. In addition, the specificities of Repo clearing at LCH S.A. allow having a Contingent Variation Margin (CVM) model (as opposed to VM) which enables non-cash to be posted as VM. For clients with limited access to place cash margin, this may ease the barriers to the cleared repo markets and further enhance the role of Cleared repo solutions to support clients' access to OTC clearing. Finally, there are significant operational and legal benefits for participants in the form of settlement netting efficiencies and through the replacement of multiple GMRAs with a single CCP documentation.

2. Could there be any other solutions that would facilitate access, either through greater use of such access models by small and medium-sized clients, or through some other solution?

We believe that standard and indirect clearing models[1] may assist in the process and may well be more appropriate for small and medium sized clients. CCPs should be in a position to offer multiple access points and familiarise clients with their respective benefits & costs depending on their activity in the given market. Also, an improved balance sheet treatment for sponsored clearing models could promote greater use of such models.

From a regulatory perspective, we believe that, initiatives aimed at promoting the use of such clearing arrangements could result in the greater uptake of such access models. For example, a more streamlined regulatory approval process to allow new fund types to onboard to the CCP, would be welcomed by the clearing community. Also, changes to the accounting standards for sponsor firms similar to the US model, whereby default fund contributions provided by sponsors do not have an impact on the balance sheet of sponsor firms, would also pave the way for a more uptake of those models.

We also note the different capital treatment that firms are subject to under a principal-to-principal clearing model (e.g., UK and EU - SCM) versus an agency model (US/FCM). Under the European clearing model, clearing banks stand between their clients and the CCP, both in practice and in legal terms. The agency model works in the same way, but, legally, end-users themselves face the CCP, and banks act as their agents and guarantors. The legal difference between the two models has an impact on a capital add-on that applies to G-Sibs. For example, for the size factor (one of the 5 to determine the final score), when a US clearing bank operates under the principal model, it must report as two separate trades the position it has with the CCP and the opposite position it has with the client. This differs from the agency model, in which as a legal matter the client has the trade with the clearing house directly, and that trade is not on the clearing member's book.

Barriers

3. Do you agree with the findings in the discussion paper that direct and sponsored access models are used more for certain types of products (e.g., repos) than for others? Do you agree with the reasons described in the paper for why this is the case? Why/why not?

Different models suit different markets and customer types. LCH provides access points in line with demand adapted to markets/participants. Sponsored models are potentially more suitable for repo transactions. The reasons that the sponsored models may be more suitable are as follows:

- Improved liquidity management

[1] RTS 2017/2154

- Operational benefits afforded to the users when compared to the uncleared market.

Additionally, from a bank balance sheet perspective, a sponsored model is perhaps better suited for a physically settling product like a repo than a client clearing model which works better for products which are predominately off-balance sheet such as OTC derivatives. A sponsored model means the end-user faces the CCP directly in the repo transaction – hence a clearing broker does not have to consume significant balance sheet by sitting in between the client and the CCP.

We also find that liquidity management and particularly the passing of VM is an element which has led most of the existing sponsored clients to limit their activities to the repo market given the composition of their portfolios (i.e., securities collateral). Through sponsored access models, the sponsored members can use the operational services of the sponsoring agent to post or collect VM directly whilst still benefiting from all other functionalities which are offered to direct members.

The model can help addressing both liquidity management and operational capability issues that the buy-side seem to have identified as major barriers to accessing central clearing facilities. Also, the specificities of Repo clearing at LCH S.A. allow having a Contingent Variation Margin (CVM) model (as opposed to VM) which enables non-cash to be posted as VM. For clients with limited access to place cash margin, this may ease the barriers to the cleared repo markets and further enhance the role of Cleared repo solutions to support clients' access to OTC clearing.

Challenges related to direct and sponsored access models

4. Do you agree that direct and sponsored access models have the potential to diversify the risk profile of the direct clearing participant basis of a CCP by introducing new types of direct participants? Why/why not?

We agree that direct and sponsored access models have the potential to diversify the risk profile of the direct clearing participant basis of a CCP leading to the decrease of concentration within Client Clearing Service Providers (CCSPs), rebalance the market and further enhance market liquidity.

However, with regards to the shift of responsibility as highlighted in the report (section 2.2.1), we would note that CCPs have a well-established risk framework and risk appetite. which will remain unaffected at all times to ensure financial stability. At LCH, our robust risk governance process will ensure that any new client who applies for a direct or sponsored membership will be evaluated against a CCPs' risk appetite, and various access/membership criteria which amongst other things relate to minimum capital requirements and high creditworthiness. Such criteria and CCPs' related risk appetite are subject to ongoing monitoring.

To accommodate the development of new type of clearing models, procedures can be enhanced to translate, integrate and test the profile of direct clients against internal risk framework before they are accepted as participants within the CCP (and thereafter on an on-going basis).

5. Do you think that CCPs have introduced sufficient safeguards to prevent risk transmission from direct participants using direct and sponsored access models? Why/why not? If not, what additional safeguards do you think are necessary?

The EMIR framework provides all the necessary tools and procedures to enable CCPs and regulators to manage effectively risk undertaken by CCPs. These standards will apply to any type of membership. At LCH, we consistently implement the highest standards available in all jurisdictions we operate in. This consistency enables us to operate in the safest and most effective and transparent way for both market participants and supervisory authorities.

Furthermore, and in addition to the sponsor's obligations to provide for default fund contributions, at LCH, sponsors are obliged to deliver additional pre-funded resources to the Sponsored Member's default waterfall, a buffer to cover margin and facilitate the payment of margins in a paying agent capacity via its Protected Payments System (PPS) account.

6. Do you think that sponsors are properly incentivised to closely monitor the activity of their sponsored participants (i.e., the direct participants)? Why/why not? If not, how do you think sponsors could be properly incentivised?

We believe that sponsors are properly incentivised to closely monitor the activity of their sponsoring participants. Their obligations to not only deliver additional pre-funded resources to the Sponsored Member's default waterfall but also contribute to further assessments in the event that the Default Fund is exhausted provides enough incentives to closely monitor the activity of their sponsored participants. Additionally, sponsor firms must consent to each trade they sponsor thereby increasing the need for closely monitoring their participants' activities.

7. Do you think that the number of sponsors is limited? Are you concerned about sponsor concentration risk? If so, is this because it is difficult to find a sponsor? Are there any other reasons?

Although we cannot comment on behalf of sponsor firms, we observe that the sponsored clearing model is still developing, and adapted models are being considered to cater for a broader range of buy side participants. We anticipate additional sponsors will come to market as the market matures in the coming months/years. We also believe that the evolution of the existing offering by CCPs could further increase interest and attract a wider diversity of sponsored firms wanting to offer such services. To some extent the number of sponsors will be driven by market demand from potential sponsored clearing members. We believe that a greater number of sponsors promotes user choice, competition, pricing and liquidity to the Sponsored Repo product and therefore we support there being a greater number of sponsors.

8. Do you think that CCP rules adequately address the issue of sponsor default? If so, what are the CCP rules that adequately address this issue? If not, what kind of CCP rules are required to address this issue?

We believe that LCH sponsored models adequately address the issue of sponsor default. At LCH, a sponsor default is stipulated in our Rulebook and the default process allows the affected sponsored members to offboard the risk in an orderly and gradual way (currently over a period on 30 days). Contrary, perhaps with client clearing where the default of a GCM results (absent porting) in immediate liquidation via the CCP's Default Management Process (DMP). Also, sponsored members are tested similarly to any other member during the onboarding process.

At LCH, our onboarding process and risk approach remains unchanged irrespective of the membership type ensuring a potential sponsor's default can be addressed in a timely manner following the CCP's rulebook. The fact that we do not deviate from our Rulebook ensures that there is legal certainty to both CCSPs and sponsored members on both their obligations towards the CCP and the risks associated with each type of membership.

Testing

9. Have you participated in default management exercises that test direct and sponsored access models?

At LCH, we conduct regular fire drill tests to test the default management procedures across clearing services and membership types. The 2021 Annual Fire Drill, in Q4 2021, included in scope the default of a sponsored member within RepoClear Ltd. LCH regularly varies the scope of future Fire Drill exercises including the types of membership tested, to ensure appropriate coverage and frequency tested procedures.

10. Without providing identifying information, what has worked well in such exercises? What has not? Do you have recommendations as to what could be improved for such exercises?

N/A

Additional considerations

11. Please describe any additional factors that may be impacting the activity and uptake of direct and sponsored models that are not considered in this paper.

We believe that sponsored models are new types of models which require time to mature. In our opinion, emphasis must be placed on familiarising clients and regulators on (i) how the different models work, (ii) on the roles and responsibilities of each participant and (iii) on regulatory alignment supporting of the use of such models in clearing. We believe that adoption rates will improve as more clients and regulators become familiar with the models.

Also, resource capacity for change can be a limiting factor impacting the activity and uptake of direct and sponsored models. Whilst the market works well, clearing may not be made the highest change priority for some market participants.

From a regulatory perspective, we believe that regulatory initiatives have had significant influence on the slow rate of uptake of those models. In particular, the EU Money Market Fund (MMF)[2] Regulation which restricts assets received by an MMF as part of a reverse repurchase agreement to a given issuer to 15 % of the MMF's NAV. The EU MMF regulation treats CCPs the same as any other counterparts (such as an Investment Bank) which impacts the activity and uptake of sponsored clearing models. We believe that an amendment is clearly required to reduce/eliminate this barrier for sponsored members.

Some wholesale market participants may not fully factor in balance sheet and capital costs into their repo rate pricing, the all-in economic benefits (excluding the systemic risk benefits) of clearing may not therefore be easily visible. Furthermore, recent market conditions have not really incentivised client use of central clearing for repo (i.e., low interest rate environment, repo dealers and banks in general perhaps not under the same pressure to reduce/constrain balance sheet and leverage as at other times). Inevitably market conditions can and will change and central clearing will be a vital piece of the toolkit going forward to manage liquidity and balance sheet capacity.

Finally, as noted in our response to question 2, the different access model used for clearing certain products, e.g., swaps, may impact clearing entities from a capital perspective. In particular, the level

[2] REGULATION (EU) 2017/ 1131 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL - of 14 June 2017 - on money market funds (europa.eu)

of clearing activity of those large members that meet the G-SIBs criteria may be impacted by the different calculation of the size factor and the related capital add-ons under the principal-to-principal model vs the agency model.

12. Please provide any additional comments with regards to the impact that direct and sponsored access models have on access to client clearing.

In line with our response to question one, different models exist in particular markets to cater for participants' individual requirements depending on their engagement and activity.

As noted in the CPMI report, "the term client clearing encompasses the activities and the services that enable clients' access to CCPs". Reasons for a client not joining directly, as noted above, relate to their capacity to respond to a CCP's strict membership requirements and obligations or due to operational constraints. Under sponsored access models, sponsored firms can use the full functionalities offered at direct clients whilst benefiting from liquidity management, operational capabilities and risk mutualisation at the CCP through its sponsor.

13. Please provide additional comments with regard to access to client clearing more generally.

We believe that solutions facilitating access to clearing, through greater use of direct or sponsored clearing models have the potential to reduce overall risk and enhance financial stability in markets more broadly.

In line with regulatory requirements (e.g., EMIR Art. 39), LCH offers different account structures and segregation options tailored to the specific needs of market participants. For example, clients of SwapClear may choose to join the service via omnibus and/or individually segregated account structures, which provide for different options in terms of positions and assets' protection.

In addition to these typical account structures, SwapClear also offers an enhanced segregated account called CustodialSeg. The latter ringfences clients' assets and positions and enables clients to leverage the custodial relationships to more efficiently manage and control collateral. In particular, the client may deliver non-cash collateral directly to LCH, removing transit risk associated with delivery via a clearing broker. CustodialSeg also enables clients to continue to deliver securities post clearing broker default, hence protecting the collateral from liquidation during the porting window. We believe that this type of account supports access to clearing for various entities, with particular regard to those that operate within a defined regulatory perimeter in terms of asset segregation and custody, e.g., pension funds. At the same time, we believe that the benefits of this type of account are still not fully understood by such market participants and further education and support is required. Please also see our response to questions 14 and 18 below.

Porting (Section 3)

Risks from not porting

14. Are there any additional risks or potential harm associated with not porting following a clearing participant default, which were not described in the discussion paper? If so, please describe such additional risks and/or harm.

From a CCP perspective, we don't believe there are any additional risks or potential harm associated with not porting following a clearing participant default. We would highlight that although porting of clients' positions in case of a clearing participant's default is product specific, LCH's rulebook has processes and procedures in place to manage the market risk following a clearing participant's default in all of its clearing services.

Regarding sponsored clearing models, although at LCH's RepoClear there is no concept of 'porting' in sponsored clearing, following a sponsor default, the Sponsored Member (SM) has 24 hours to find a back-up 'paying agent' to pay margins. The SM can assume that responsibility if they cannot find another agent/sponsor bank to do this for them. The SM then has 30 days to flatten the risk on the portfolio of trades that was sponsored by the defaulting bank. Risk can be flattened either by simply allowing trades to roll off naturally within 30 days or by entering offsetting (risk reducing) new trades. If a sponsored member wishes to continue clearing, they must find a new sponsor to clear trades going forward, however as noted above currently RepoClear does not offer the ability to simply 'port' the trades (and all resulting obligations) to another sponsor.

A sponsored member may at any time prior to the Default of its CCSP, notify LCH of any CCSP who is prepared to act as a backup CCSP following a Default.

Regarding client clearing models, following a clearing member default, LCH is left with (i) the clearing member's proprietary positions, which we aim to neutralise and then auction, and (ii) the client's positions, which we aim to preserve without intervention. Segregation between proprietary and client positions makes porting of positions to a non-defaulting counterparty easier. In particular, LCH seeks to port non-defaulting clients' positions and associated collateral to non-defaulting clearing members in accordance with the Default Rules and in line with the segregation and porting options related to the various account structures of the clients. Certain client account structures, such as the individually segregated account (ISA) and the CustodialSeg described above, are designed to maximise clients' protection and increase the chances of successfully porting clients. Ultimately, the success of porting depends on the availability of a back-up CCSP to receive the positions to be ported as well as on the consent of the clients' themselves to port such positions. Should both conditions not be satisfied, the CCP has no other option than liquidating the clients' portfolio/account, with all potential risks and costs attached.

Policymakers may consider options to facilitate porting for certain account structures, thus limiting the harm and risks in case of not porting, by for example: envisaging an *a priori* / implicit consent regime for those clients that onboard / participate in certain omnibus or net account structures where a client account is net margined against the CCSP's other client accounts. It is more likely that small clients would be commingled in such account structures, whereas larger clients may more frequently opt for individually segregated accounts, and at present the consent of all underlying clients is needed to enable porting and all positions must be transferred to the same non-defaulting clearing member. In this context, we also note the differences in the default and porting rules, including with specific regards to the clients' consent regime, between the European and US model, under which a "bulk transfer" of collateral may be possible without the clients' consent, subject to approval by the Bankruptcy Court and CFTC's non-objection.

An additional possibility to increase the likelihood of porting is to consider a temporary relief for capital / leverage charges attached to the portfolios of the clients to be ported, particularly under a systemic risk scenario. In this way, the non-defaulting clearing members may be more willing to accept the positions to be ported and to stretch its balance-sheet and risk appetite. For example, policymakers may consider to either remove completely the capital charges associated to ported positions under certain circumstances or to risk weight such positions by a less stringent factor, e.g., 0.5% or 0.75% in lieu of 2% for a certain period of time, during which – once ported – such positions may be offset, reduced or even transferred to a different entity.

15. Potentially effective practices. Do you agree with the two tools identified in the discussion paper as potentially successful porting practices? Are there any other tools that should be identified as potentially effective practices?

We broadly agree with the tools identified in the discussion paper, however, regarding game plans we would note that the results of game plans cannot be guaranteed. This is mainly due to:

- Lack of visibility on the portfolio of the defaulting client in advance as the game plan assumes a snapshot at a point in time, in a non-default scenario.
- The successful backup arrangements will be subject to commercial terms to be finalised only at the point where the clients agree to disclose their interest and portfolio to port.
- Incremental margin requirements called on the receiving member which can affect the clearing brokers ability to take those positions.
- Inability of a member to eventually reduce the risk.

Also, cleared portfolios, particularly in certain products like swaps, may be very dynamic and change risk profile and composition very frequently. As such, we believe that the other tools / incentives identified, such a potential change in the clients' consent regime and a potential capital relief associated to ported positions may prove more effective in practice, hence enhancing the possibility to port positions by increasing the willingness of back-up CSSPs to accept those positions. The latter is a condition required in any event, even if the ultimate porting of positions follows a certain game plan elaborated previously.

16. What additional approaches do CCPs use to pre-emptively identify a backup CCSP? What incentives can be provided to assist the development of alternative/backup CCSP relationships? Are there any other considerations for alternate/backup CCSPs not set forth in the report?

Regarding sponsored cleared models, we don't believe there are additional ways for CCPs to pre-emptively identify a backup CCSP, since it would not only be enough to identify one, but it would also require having established contractual arrangements to ensure that porting can be done on time. We don't believe that the 30-day period after a member's default would give enough time to establish such relationships between the sponsored member and a backup CCSP, this is why we have put in place the process described in Question 14. Furthermore, and although we cannot comment on behalf of clients, we believe that there could also be significant commercial impact associated with pre-emptively identifying backup CCSPs, and thus having dormant relationships, since this would lead to additional costs being borne by clients. This may contradict the principle of facilitating access to clearing for small-medium clients and this is why we believe that the focus should be on incentives / removing impediments to porting, such as capital relief and changes in the clients' consent regime for certain account structures.

17. Are there other considerations for having a game plan that were not described in the discussion paper?

N/A

18. In addition to those outlined in the paper, what attributes of account structures facilitate or impede porting client accounts?

In general, and in line with all relevant regulatory requirements, all account structures that LCH offers across services are designed to allow porting and LCH will seek to port positions to the greatest possible extent. However, we agree that certain account structures may facilitate porting since different segregation requirements may impact the actual likelihood of transferring positions and collateral. As noted above, the success of porting depends in practice on various factors, including clients' consent as applicable and the acceptance of the clients' positions by the non-defaulting clearing member. Certain account structures, where the consent of all underlying clients within the same account is needed for porting, may prove for example more difficult to port in practice.

In this context, as noted previously, in addition to typical omnibus and individually segregated account structures, SwapClear also offers the CustodialSeg structure. The latter allows clients to deliver non-cash collateral directly to LCH, removing transit risk associated with delivery via a clearing broker. This enables clients to continue to deliver securities after a clearing broker default, which can protect existing collateral from liquidation during the porting window and increasing the chances of porting positions to a non-defaulting clearing member.

19. Are some client accounts not suitable for porting?

We believe that certain account structures inherently present higher challenges to a successful porting exercise. This is the case for example of those clients' positions held under Net Account Structures, which are more difficult to port due to the need to port all positions as one to the same backup CCSP. In this case the outcome is subject not only to the need for all clients to agree on the same surviving CCSP, but also on the CCSP's capacity to take the entire portfolio of positions which can be limited due to potential capital constrains.

20. Does holding excess collateral and the ability to make direct payments improve the probability that a client will be ported successfully or are there impediments to using this collateral?

We believe that, where porting is available, excess collateral and the ability to make direct payments improve the probability that a client will be ported successfully.

In particular, higher collateral means higher resources to face the potential losses associated to the defaulted portfolios, and thus more time for the client to find a back-up clearing member whilst ensuring that the account is adequately margined. We therefore do not see impediments with holding excess collateral and we note that excess collateral is ported as well under for example the ISA structures.

With regards to the possibility to make direct payments to the CCP, we note that under the CustodialSeg account structure offered by SwapClear, the client has the possibility to directly deliver non-cash collateral to LCH, including after the default of the clearing member. By doing so, the client may endure that its account is fully margined during the porting window, thus expanding the possibility / time window to find back-up clearing arrangements and reducing the possibility of liquidation of its positions.

21. What is your view of a client consent mechanism that could be used to facilitate porting, if permitted under applicable law?

We believe that a client consent mechanism would be beneficial when it comes to porting in certain cases, however, it must be permitted under applicable law. In particular, the paper identified two ways of facilitating porting:

(1) An abridged or negative consent process which deems consent as given unless the client objects; or
(2) Advance consent for transferring to one or more backup CCSPs.

As mentioned previously, we believe that the second option may be valid for certain account structures where at present the consent of all clients within the same account is needed before the CCP may be able to port. This may prove difficult in practice, and an advanced consent that is basically given as a function of onboarding with a certain account structure (e.g., net omnibus), would certainly make the porting process easier. We note however that we don't believe that under EMIR such mechanism can be easily implemented as it would require changes in the underlying law.

22. Are the potentially effective practices described in the discussion paper consistent with prior porting experiences?

In line with our response to question 18, we believe that segregated accounts or even Gross Omnibus account stand a better chance to be ported. For example, during the default of MF Global where most clients were using Net Omnibus accounts, the main challenges were reconciling the client positions between CCP, defaulter, client and the receiving CCSP. In such account structures, when CCP moves positions, the risk profile changes in the remaining positions, this requires constant hedging/managing etc. Although we successfully managed to port all positions, we believe that the process could have been more efficient through segregated/Gross Omnibus accounts.

23. Are there any barriers to implementing potentially effective porting practices that are not described in the discussion paper?

We are not aware of additional barriers to those identified in the discussion paper.

Communication and coordination

24. Are there any additional communications by the CCP or the defaulting CCSP that may increase the probability of porting client accounts?

We believe that any additional communication and coordination which could increase the probability of porting clients' accounts should be drive by CCSPs through increased awareness around the handling of a potential default event. We note that our default management processes including any porting mechanism, are well-defined in our Rulebook and procedures are adequately transparent via regulatory disclosures.

We do not believe that there is any additional communication by the CCP that may increase the probability of porting client accounts. CCSPs are best placed to communicate to the CCP their intention/willingness to accept a client's portfolio following procedures established under the CCP's rulebook. This is due to the fact that successful porting to a surviving CCSP would require contractual agreements put in place between the CCSP and the client prior to the default of a clearing participant.

25. Are there additional actions CCPs can take following a clearing participant default to coordinate that are not set forth in the discussion paper? Are there any limitations on coordination that are not included in the paper?

We believe that although coordination may be beneficial in principle, there are various factors that may hinder its effectiveness in practice. This could potentially create unintended obstacles during a default scenario, particularly during a severe scenario involving the default of more than one clearing member.

For example, coordination may take some time whilst possible solutions are proposed and discussed by different CCPs, which may involve two or more parallel governance processes, whereas the porting or – if porting were not successful – the liquidation of clients' positions may be time critical to contain losses and risks. At the same time, there is a geographic and/or regulatory limitation to the level of coordination that CCPs may undertake. For example, any coordination attempt by CCPs should take into account the differences in time zones of CCPs' members and of the CCPs themselves. Similarly, cooperation between CCPs located in jurisdictions where there are no MoUs and/or any other solid cooperation agreements between home authorities may be questionable. This applies both with regards to CCPs and clearing members' supervisory/regulatory authorities. Also, should more CCPs (almost) simultaneously decide to liquidate, this may amplify the negative impact that closing out positions has on the market, especially in case of liquidation of large portfolios. Equally, during a coordinated effort, should one CCP decide to liquidate, this decision may actually influence another CCP and lead to the liquidation of positions by the other CCP, which might have not been necessary.

In addition, an effective coordination would probably be dependent on the harmonisation of CCPs' Rulebooks and default management practices, which may be counterproductive since it would limit the CCPs' discretion (e.g., different CCPs may have different porting windows) and ability to innovate in this space. We note also that there are differences in the legal processes (e.g., US vs EU/UK) leading to the porting of clients' positions which may also affect CCPs' coordination.

As such, we believe that it would be preferable to focus policy efforts on making the porting more likely, by for example increasing the likelihood of acceptance of clients' positions by the non-defaulting clearing members via the tools articulated in our previous responses.

Harmonisation

26. Are there additional items CCPs can harmonise or standardise during business as usual that are not outlined in the discussion paper? Are there any factors that may impede harmonisation or standardisation that are not provided in the paper?

We agree with the CPMI-IOSCO report that some standardisation around the type, format and granularity of key data (including customer account information, such as initial margin, delta ladder, positions, customer name and account mapping), file formats, templates and terminology could improve management of the porting process. However, the use of default management procedures aligned with BAU procedures within each CCPs is key for increasing the probability of porting. The requirement of standardization of across CCPs would have unwanted effects, namely the ongoing monitoring for departures from such standardization, and the negative impact of those coming to light during a default management. Furthermore, the challenge of finding one size fits across all CCPs is huge, given the heterogeny of products cleared across CCPs. Automation where possible is supported by LSEG, namely ensuring those automated processes are also used as part of the BAU process, therefore well understood by members and clients, and operationally resilient.

Therefore, we don't find there is merit in harmonising CCPs' procedures implemented to manage a clearing member's default or porting of positions to a surviving clearing member. These processes are bespoke and must follow a CCP's rulebook which is contractually agreed with its members and approved by local regulators. Accordingly, we don't believe that a one size fits all approach is appropriate.

Notable issues to consider when developing a porting protocol

27. Are there additional regulatory requirements that could impede porting? Can such impediments be addressed or mitigated through action prior to the CCSP's default?

We agree with the report's regulatory requirements that could impede porting. We believe KYC processes should be further revised and streamlined focusing on the effective and timely provision of the relevant information. Furthermore, we believe that waivers of capital requirements, which are in the hands of regulators, is one worthwhile exploring in the future.

28. Are there any additional factors that should be addressed in testing exercises?

LCH has not had a member default since the offering of sponsored clearing, so no real-world example exists. LCH tests members ability to consume client information (Client Step-In packs which contain trade FpML and reporting) on a regular basis through the Firedrill, whereby they are required to prove they can value the trades to within a tolerance set by us. Members are also required to prove that they understand the legal aspects of porting by completing and returning a Backup Clearing Member form. We would note that this only applies in the SCM/European case which is consent based, where both the client and the back-up member must actively consent. In the US/FCM model, it is organised/mandated by the CFTC, and this is not tested.

Above and beyond the member testing, LCH periodically does high volume testing to ensure that we are operationally ready to port large number of client accounts and large trade populations. Furthermore, several materials are available on the secure area for both clients and members emphasising the need for a formal, pre-agreed back up to be in place, as finding and agreeing all this at the point of default would be difficult, nearly impossible as noted in our responses above.

29. **Please provide examples of good disclosure practices from your perspective**.

We believe that by meeting all disclosure requirements currently envisaged by either EMIR or CPMI-IOSCO principles, LCH and other CCPs have adequate disclosure practices. This is supported by the fact that Rulebooks, default management procedures, including how porting would work under different account and segregation structures, are all public and can be consulted at any time. We would add that our disclosures include information about portability risks associated with different account structures in addition to the more typical disclosures about fellow customer risk (e.g., we provide clear indication of when all clients' consent is required under SwapClear account structures as well as of all the steps needed to achieve successful porting). We also note that any declaration of any LCH's members default and the related default management event is made publicly available upon occurrence of such events.

30. Are there other arrangements a CCSP can make to ensure that, post default, the CCSP can help coordinate porting at multiple CCPs if the CCSP is a non-defaulter? If the CCSP defaults, what arrangements can the CCSP make to facilitate the porting of its clients?

N/A

Suggested next steps

31. Please provide feedback on the suggested next steps for consideration. Do you agree that these issues warrant further consideration by CCPs, CCSPs and/or clients? Are there additional issues that may warrant further consideration?

Overall, we believe that the recommendations in the report appear to place increased focus on CCPs and not enough on CCSPs and clients who are best place to facilitate a number of those next steps such as communication and coordination, identification of alternative CCPs and transparency to clients.

As discussed in our responses above, we find that there are limited areas that warrant further consideration by CCPs. For example, we agree that some standardisation around the type, format and granularity of key data (including customer account information, such as initial margin, delta ladder, positions, customer name and account mapping), file formats, templates and terminology could improve management of the porting process.

However, regarding coordination, we find that there are a number of elements that may hinder its effectiveness in practice. This could potentially create unintended obstacles during a default scenario, particularly during a severe scenario involving the default of more than one clearing member as discussed in our response to question 25.

Regarding transparency and in line with the report's observations, we believe that disclosure requirements currently envisaged by either EMIR or CPMI-IOSCO principles, and which LCH adheres to, provide adequate disclosures to members and their respective clients.

Ultimately, we believe that any next steps for consideration should be focused on further familiarising clients and regulators on how the different models work to promote their use of such clearing arrangements resulting in the greater uptake of such access models. In addition, a more streamlined regulatory approval process to allow new fund types to onboard to the CCP, should be something worth looking at and welcomed by the clearing community. Finally, changes to the accounting standards for sponsor firms similar to the US model, whereby default fund contributions provided to sponsors do not have an impact on the balance sheet of sponsor firms, or the removal of capital charges associated to ported positions under certain circumstances as noted in responses above, would pave the way for a more uptake of such clearing models.