

The Committee on OTC Derivatives Central Clearing Consultation  
Reserve Bank of Australia  
GPO Box 3947  
Sydney NSW 2001  
Australia

1 September 2011

Dear Sirs,

### **Consultative Report: “Central Clearing of OTC Derivatives in Australia”**

LCH.Clearnet Group Limited<sup>1</sup> (“LCH.Clearnet” or the “Group”) is pleased to provide feedback to the Council of Financial Regulators’ report on Central Clearing of OTC Derivatives in Australia.<sup>2</sup>

LCH.Clearnet is the world’s leading clearinghouse group and the most experienced provider of OTC clearing services globally. The Group’s SwapClear service is the only truly global clearing service for interest rate swaps (“IRS”). Since launch in 1999, over 1.6 million IRS trades have been cleared through SwapClear. The service currently has 57 clearing members and a portfolio of 950,000 trades with a notional value in excess of US \$300 trillion (a further US\$66 trillion of cleared transactions have been removed through multilateral trade compressions). Crucially, SwapClear is also the only OTC clearing service to have successfully handled a significant default. Indeed, as the Reserve Bank of Australia noted in its March 2009 *Financial Stability Review*<sup>3</sup>, SwapClear’s centralised and tested default-management process ensured that the unwind of the Lehman Brothers’ \$9 trillion IRS default proceeded smoothly and without loss or impact on surviving members or the wider marketplace.

### **Consultation**

The Council is seeking to assess how best to harness the benefits of central counterparty clearing to increase the resilience of the Australian OTC market. The Council is particularly interested to establish whether the optimal solution for central clearing of OTC products for the Australian market would best be implemented by a CCP in Australia, or through a global provider.

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<sup>1</sup> LCH.Clearnet was formed out of the merger of the London Clearing House Limited and Clearnet SA, and operates two central counterparty clearinghouses or CCPs, LCH.Clearnet Limited in London and LCH.Clearnet SA in Paris. The two central counterparties (“CCPs”) serve major international exchanges and platforms, clearing a broad range of asset classes, including cash equities, exchange-traded derivatives, metals, energy, freight, bonds and repos.

<sup>2</sup> <http://www.rba.gov.au/publications/consultations/201106-otc-derivatives/pdf/201106-otc-derivatives.pdf>

<sup>3</sup> “For example, the unwinding of Lehman’s US\$9 trillion open positions in LCH.Clearnet Limited’s SwapClear, a central counterparty for OTC interest rate swaps, proceeded smoothly. SwapClear’s centralised and tested default-management process brought in dealers from participant firms to hedge the market exposure associated with Lehman’s open positions and then auction the hedged portfolio to surviving participants. Recourse to LCH.Clearnet Limited’s default fund proved unnecessary for any of the products it cleared, since adequate margin had already been collected from Lehman.” The full report can be found at: <http://www.rba.gov.au/publications/fsr/2009/mar/html/box-b.html>

Whilst we are sympathetic to some of the concerns raised by the Council in its consultative report, LCH.Clearnet's considered view is that OTC clearing is best provided by a global operator. A single CCP clearing all the products and participants in a given market - in this instance the OTC interest rate swap market - can provide netting, operational and capital efficiencies that would otherwise be lost. Further, it will have a greater capacity to mutualise risk across the market, delivering further benefits in the form of lower costs, greater liquidity and tighter bid-offer spreads.

In contrast a smaller or local CCP that has fewer participants and which clears a smaller range of products will inevitably have a higher fee-base, and will be unable to provide the risk mutualisation and netting benefits that the larger CCP can afford. As the Council itself observes in the consultative report, the costs involved may mean that when faced with a choice between clearing through a small, local CCP and not participating in that market at all, some dealers may choose to exit the market completely, with a detrimental effect on liquidity and efficiency.

The global character of OTC interest rate swaps, and the large number of active international participants, makes this market particularly susceptible to the benefits of a global CCP provider - and to the realisation of scale and scope economies such a CCP can bring. A further consideration relates to the CCP monitoring function. A single CCP will have a greater ability to monitor risk; in contrast the jurisdictional fragmentation of clearing in a large global market will complicate this monitoring function and, potentially, lead to the disruption of the coordination of CCPs in the event of a crisis.

### **LCH.Clearnet**

LCH.Clearnet is ready to work with the Australian authorities to extend its SwapClear OTC interest rate swap clearing service into the Australian marketplace. This long-established service is well-proven and is recognised globally as the pioneer and market-leading provider of OTC clearing services. The SwapClear service is in constant expansion and provides clearing in the widest range of tenors and currencies – including AUD interest rate swap clearing out to 30 years. Furthermore, it offers direct and indirect clearing membership with individual client-level protections, supported by world-class risk management and the most stringent risk policies of any CCP globally.

LCH.Clearnet is fully supportive of all the ongoing moves to increase the resilience of CCPs through higher risk and financial standards and believe that standards should be agreed at the highest level globally, such that the G20 commitments can be successfully met. Global CCP providers that uphold themselves to these highest standards should be able to extend their safeguards to the widest range of products and participants, affording smaller local markets and their participants affordable, efficient access to global markets and vice versa.

### **Conclusion**

We hope that the Council find the above comments, together with the more detailed commentary set out in the attached annex, to be helpful and constructive. We believe that the depth of our

experience, combined with our OTC market expertise and the wide geographic scope and deep product breadth of our activities, makes us uniquely well-qualified to comment on these matters.<sup>4</sup>

Ahead of making recommendations to the Government on this matter, we note that the Council is seeking feedback on the views and propositions set out in the paper and that Council agencies will be hosting a number of roundtable discussions over the period ahead, as well as other meetings as appropriate. LCH.Clearnet would like to take this opportunity to confirm its readiness to attend such discussions and meetings and make its senior management team and technical staff available to the Council as required.

LCH.Clearnet, as the world's pioneering OTC derivatives CCP group, fully shares the Council's goals in ensuring a stable, safe and efficient global financial system. Please do not hesitate to contact us should you have any questions on our submission, or if you would like to discuss any of the matters raised in greater detail.

Yours faithfully,

A handwritten signature in blue ink, appearing to be 'I.Axe'.

**Ian Axe**  
**Chief Executive Officer**

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<sup>4</sup> The Group works closely with market participants and exchanges to identify and develop services for new asset classes, particularly in support of OTC derivatives market reforms. Already, LCH.Clearnet Limited clears more than 50% of the OTC interest rate swap market representing trades with a total notional principal of over \$295 trillion in 17 currencies, whilst LCH.Clearnet SA cleared more than €42 billion notional value in OTC credit default swaps over the last year.