

Questionnaire for CDS CCPs on Protection of Customer Initial Margin

This questionnaire has been prepared by an ad hoc group (comprising both buy-side and sell-side constituents)¹ to more fully understand the rights of “customers” – i.e., buy-side and other market participants proposing to clear CDS transactions through clearing members (“CM”) of a central CDS counterparty (“CCP”) – to initial margin (“IM”) posted in connection with the central clearing of certain CDS transactions.

The questions are divided into two sections. The first part solicits responses to several factual matters regarding the clearing structure of the CCP, the precise means by which IM is held by the CCP and CMs (and their custodians, if applicable), and the CCP’s proposals as to segregation and portability of customer positions and initial and variation margin (and any associated contractual relationships).² The second part solicits responses as to the legal treatment of the CCP’s proposed clearing structure. As the latter inquiry is largely dependent on the legal and contractual framework governing the CCP, the CMs and the customers (and the relationships between them), the questions in the second part should be considered under the laws of all jurisdictions relevant to the CCP (and its custodian, if applicable), the CMs (and their custodians, if applicable) and the customers. We note that although similar or identical questions are posed throughout certain portions of the questionnaire, this repetition arises from the need to consider the questions for each level at which IM is held: (i) IM held at the CCP (or the CCP’s custodian) – referred to in this questionnaire as “CCP Margin”, and (ii) IM held at a CM (or the CM’s custodian) – referred to in this questionnaire as “Dealer Margin”.

I. Factual Matters

A. Composition and Structure of the CCP, CMs, Custodians and Customers

Structure of the CCP

1. Please describe the legal structure (e.g., entity type, jurisdiction, governing structure, etc.) of the CCP. Include references to any required licenses or registration orders obtained in connection with the establishment of the CCP.

¹ This group was formed at the behest of the Federal Reserve Bank of New York, and consists of buy-side members Alliance Bernstein, Barclays Global Investors, Blue Mountain, Brevan Howard, D.E. Shaw, Goldman Sachs Asset Management, King Street and PIMCO, and sell-side members Barclays Capital, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JPMorgan Chase, Morgan Stanley and UBS. ISDA, the Asset Managers Group of SIFMA, and Managed Funds Association are facilitating and observing the group’s activities.

² If the CCP is envisioning a multi-step approach to implementation, please detail both the interim and final phases, and an approximate time frame for achievement of the latter. If customers or CMs may elect one of multiple options with respect to any aspect of the clearing structure, please describe all such options.

LCH.Clearnet Limited (“LCH.C”) is a wholly owned subsidiary of LCH.Clearnet Group Limited. LCH.Clearnet Group Limited is owned primarily by its users. An ICSD and a number of exchanges also have stakes in the company. Both entities are UK companies and LCH.C is regulated by the Financial Services Authority (“FSA”) as a Recognised Clearing House (“RCH”) under the Financial Services and Markets Act 2000 (“FSMA”). LCH.C is also a Derivatives Clearing Organization in the USA and subject to Commodity Futures Trading Commission (“CFTC”) rules and the US Commodity Exchange Act.

2. Please list all relevant regulatory and supervisory authorities of the CCP.

see above

3. Please detail any legal or regulatory segregation requirements applicable to customer IM held at the CCP.

Chapter 7 of the Client Assets (CASS) Sourcebook of the UK Financial Services Authority requires CMs to obtain confirmation from the CCP that client funds will not be set-off to satisfy house debts.

Structure of CMs

4. Please describe the legal structures applicable to the CMs
 - a. Does the CCP restrict either the (i) organizational type (e.g., banks, broker-dealers, futures commission merchants, unregulated entities, etc.) or (ii) jurisdictions of organization of CMs? (Note: This will be key, as much of the legal analysis will depend on the insolvency laws applicable to the CMs.)

LCH.C restricts membership as per the criteria stated in our rules and regulations; the CDS products are offered as part of the Liffe service, and so clearing members must meet the stated criteria for this service. These criteria are set out in the relevant section of the rules and regulations:

http://www.lchclearnet.com/Images/Section1_tcm6-43738.pdf

5. Please list all relevant regulatory and supervisory authorities applicable to the CMs.

This answer would most appropriately be provided by our clearing members.

6. Please detail any legal or regulatory segregation requirements applicable to customer IM held at the CM.

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

Structure of Custodians (If Applicable)

7. Please describe the legal structures applicable to the custodians used by the CCP and CMs to hold IM.

LCH.C secures 85% of its cash holdings; it deposits the rest with banks with a rating of at least AA- and with any single deposit being within its capital base; securities are held with (I)CSDs or highly rated banks who are regularly assessed; bank guarantees are held by LCH.C itself.

These arrangements are subject to ongoing scrutiny, information concerning this is available here:

http://www.lchclearnet.com/Images/LCH.Clearnet%20Ltd%20-%20external%20standards_tcm6-44533.pdf

LCH.C does not specify rules for CM's use of custodians.

- a. Does the CCP restrict either the (i) organizational type or (ii) jurisdictions of organization of entities that may serve as custodians of the CCP or CMs to hold IM? Are there any restrictions on whether such custodians may be affiliated with the CCP or CMs? (Note: This will be key, as much of the legal analysis will depend on the insolvency laws applicable to the respective custodians, to the extent IM is held by custodians.)

While LCH.C does not formally restrict its use of custodians by organisational type or jurisdiction, its custody arrangements are subject to ongoing and rigorous scrutiny as stated above.

LCH.C does not specify rules for CM's use of custodians.

8. Please list all relevant regulatory and supervisory authorities applicable to the custodians.

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

9. Please detail any legal or regulatory segregation requirements applicable to customer IM held at the custodians.

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

Structure of the Customers

10. Please describe the legal structures applicable to the customers

- a. Does the CCP restrict either the (i) organizational type or (ii) jurisdictions of organization of customers? (Note: This may be important, as some of the legal analysis may depend on the insolvency laws applicable to the customers.)

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

11. Please list all relevant regulatory and supervisory authorities applicable to the customers.

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

Expansion/Restriction of Permitted Entity Types

12. In weighing the relative benefits and drawbacks of expanding or restricting the entity types and jurisdictions of the CMs, customers and custodians, what factors did the CCP consider in its analysis? For example, to what extent did the CCP consider the following issues in reaching its proposed structure?

A variety of factors are considered, depending on the service and product in question.

- a. Netting implications for CMs and their affiliates (from a credit, accounting and capital perspective);
- b. Regulatory capital implications for CMs and their affiliates;
- c. Operational efficiencies or inefficiencies, and other business implications of operating through the permitted entity types;

- d. Adverse pass-through effects (e.g., unfavorable pricing) flowing from the CMs to customers as a result of the foregoing; and
 - e. The legal regime applicable to the proposed clearing framework upon an insolvency of a CM, customer or custodian.
13. What is the process for approval and consideration of risks presented by additional CM or custodian entity types (by way of inclusion of new CMs or custodians or mergers of existing CMs or custodians in a manner that changes the applicable legal structure)?

As part of the new member take on process LCH.C staff visit potential clearing members to discuss corporate structure and strategy; the scope of their business generally and clearing activities specifically (planned and current); financials; regulation; operational processes; banking facilities, and risk management (of clients and any proprietary business, margining, credit management policy, stress testing, etc.). In addition, this visit provides the opportunity for the applicant to demonstrate the systems that are in place and to give an overview of their operational processes.

B. Segregation and Safekeeping of IM

IM Held at or for the CCP (“CCP Margin”)³

Composition of CCP Margin

1. Please describe the types of assets (e.g., Treasury securities, US dollars, non-US currencies, etc.) that may be deposited as CCP Margin to satisfy IM requirements imposed by the CCP (“Required Margin”). To what extent did customer protection considerations affect the CCP’s determination in this regard?

Details of the acceptable forms of cash and collateral that can be posted to LCH.C, and applicable haircuts, are available on our website:

http://www.lchclearnet.com/risk_management/ltd/acceptable_collateral.asp

Acceptable collateral is selected based on factors including market liquidity and volatility, and issuer quality.

³ Please also answer the questions below with respect to excess variation margin (i.e., mark-to-market margin posted by customers in excess of the CCP’s requirements), to the excess variation is treated differently from CCP Excess Margin.

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

Nature of Relationship Between CCP, CMs, Custodians and Customers

2. Please describe the nature of the legal and contractual relationship between the CCP, the CMs, custodians, the customers and any other relevant parties, specifically addressing the following:

A copy of the Clearing Member Agreement relevant to this market is supplied.

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- a. Are CMs acting as agents or principals (or operating with aspects of both) vis-à-vis (i) the CCP and (ii) customers? Please elaborate.

LCH.C deals with CMs as principal and is not party to CM/customer arrangements.

- b. If customers are permitted to clear transactions through non-CM affiliates of the CM, who in turn clear through the affiliated CM, please describe in detail the mechanics of such an arrangement.

Description of Proposed Clearing Structure⁴

3. Please detail the manner in which customers will post CCP Margin.
 - a. Will the CCP Margin be posted pursuant to pledge or title transfer arrangements?

Cash is transferred outright to the CCP.

Securities are subject to a charge in favour of the CCP.

⁴ Please address the relevant questions with respect to each proposed clearing structure. For instance, if the CCP has one clearing structure for transactions entered into directly between a customer and its CM / prime broker, and another for transactions originally entered into between a customer and an executing broker that are subsequently given up to the customer's CM / prime broker, please respond to the questions with respect to each proposed clearing structure.

- b. May the CCP Margin consist of property posted by customers and pledged or transferred to the CCP, or must it consist of the proprietary assets of the CM?

Regulation 12 (cc) states:

cc) (i) The Clearing House shall be entitled to assume that all securities and other assets furnished or deposited by a Member to or with the Clearing House as cover pursuant to these Regulations or under the terms of any agreement made with the Member are the sole legal and beneficial property of the Member or are furnished or deposited for the purposes of these Regulations with the legal and beneficial owner's unconditional consent and free of such owner's interest. A Member may not furnish or deposit securities or other assets to or with the Clearing House as cover otherwise than in conformity to this paragraph. It shall be accepted by every person dealing on the terms of these Regulations that a Member has such person's unconditional consent to furnish or deposit to or with the Clearing House as cover for the purposes of these Regulations any securities or other assets of such person in the Member's possession, free of such person's interest.

(ii) Each Member represents and warrants to the Clearing House as at each date on which such Member furnishes or deposits securities or other assets to or with the Clearing House as cover pursuant to these Regulations (a) that such Member is the sole legal and beneficial owner of those securities or other assets or, as the case may be, those securities or other assets are so furnished or deposited with the legal and beneficial owner's unconditional consent and free of such owner's interest and (b) that the provision to the Clearing House of such securities or other assets pursuant to these Regulations will not constitute or result in a breach of any trust, agreement or undertaking whatsoever.

4. Please detail the manner in which CCP Margin will be held (noting any circumstances in which the default clearing structure may be modified by elections available to CMs or customers), distinguishing between various categories of margin to the extent appropriate – e.g., (i) Required Margin, (ii) margin in excess of that required by the CCP to secure performance obligations in connection with cleared transactions (“CCP Excess Margin”), (iii) margin posted in respect of requirements imposed by CMs on their customers in excess of the CCP's margin requirements (“Dealer Excess Margin”), etc. – and specifically addressing the following:

- a. CCP Margin Held Directly at a CCP (or at a Custodian Holding Solely for the Benefit of the CCP) – If the CCP will hold CCP Margin directly (without a custodian), or the custodian will hold CCP Margin only for the CCP (rather than for individual CMs or customers (individually or as a

group)), please detail all aspects of the arrangement that are relevant from a customer protection standpoint, specifically addressing the following:

- i. The manner in which the CCP holds the CCP Margin, distinguishing to the extent relevant between various categories and types of CCP Margin (e.g., securities or cash), and identifying in particular:

1. On behalf of whom the CCP is holding the property – itself, the CMs or the customers (as a group or individually);

Cash margin is transferred to and held by the CCP as principal.

Securities are transferred to LCH.C's accounts at (I)CSDs or custodians and are subject to a charge in favour of LCH.C. Beneficial ownership of those securities is not transferred to LCH.C (LCH.C never holds those securities in a beneficial capacity except in the event of a CM default.)

2. Whether CCP Margin securing the positions of a particular CDS customer will be segregated from (i) the CCP Margin posted by other CDS customers and (ii) the property of other custodial claimants of the CCP or instead, commingled in a single-omnibus account (either for CDS customers or custodial claimants of the CCP generally);

The margin for segregated customers is calculated based on an omnibus customer account.

Note that CCP margin does not secure the position of a particular customer.

- a. In whose name(s) has/have the account(s) been established?

N/A

3. Whether CCP Margin securing customer positions will be segregated from the CCP Margin securing proprietary positions of CMs;

Margin for segregated customer positions is calculated separately from margin for proprietary positions of CMs. However, as stated above, margin does not secure the positions of a particular customer.

4. Any operational practices (whether voluntary or mandated by regulators) relevant to the analysis of customer protection and the sharing of any shortfalls in custodial property;⁵

N/A

5. Under what circumstances CCP Excess Margin held at the CCP may be (i) withdrawn by the CM or customers or (ii) applied by CMs or the CCP.

- (i) Excess Margin can be withdrawn by CMs
- (ii) The CCP can apply all margin (including Excess Margin) in the event of a default of a CM

- ii. Whether the CCP has the right to rehypothecate or cause liens to be placed on the CCP Margin – e.g., to potential lenders or liquidity providers to the CCP – and if so, whether any such liens have been subordinated or waived; and

Securities margin cannot be rehypothecated. Cash margin is held as principal.

- iii. Whether investment of CCP Margin in interest-bearing instruments or vehicles (e.g., overnight sweeps into repos) is permitted or required, and if so, in what types of instruments or vehicles.

Cash is invested in line with policies set by LCH.C's internal Risk Committee.

Securities are not beneficially owned and so are not reinvested.

⁵ See clause (ii) of note 6.

1. Who obtains the economic benefit of investment of CCP Margin in permitted instruments? Who bears the risk of loss?

Some economic benefit is passed to the CMs in the form of interest. LCH bears the risk of loss.

2. How does the above response differ as between Required Margin and CCP Excess Margin posted to the CCP?

No difference.

- b. CCP Margin Held at a Custodian (Whether the Custodian is Holding for the CCP, Individual CMs or Customers) – If the CCP will hold CCP Margin at a custodian, please detail all aspects of the custodial arrangement that are relevant from a customer protection standpoint, specifically addressing the following:

N/A

- i. The manner in which the custodian holds the CCP Margin, distinguishing to the extent applicable between various types of CCP Margin (e.g., securities or cash), and identifying in particular:

1. On whose behalf the custodian is holding the property – the CCP, the CMs or the customers (as a group or individually);

N/A

2. Whether CCP Margin securing the positions of a particular CDS customer will be segregated from (i) the CCP Margin posted by other CDS customers and (ii) the property of other custodial claimants of the custodian, or instead, commingled in a single omnibus account (either for CDS customers or custodial claimants of the custodian generally);

N/A

- a. In whose name(s) has/have the account(s) been established?

N/A

3. Whether CCP Margin securing customer positions will be segregated from the CCP Margin securing proprietary positions of CMs;

N/A

4. Any operational practices (whether voluntary or mandated by regulators) relevant to the analysis of customer protection and the sharing of any shortfalls in custodial property;⁶ and

N/A

5. Under what circumstances CCP Excess Margin held at the custodian may be (i) withdrawn by the CM or customers or (ii) applied by CMs or the CCP.

N/A

- ii. Whether the custodian has the right to rehypothecate or cause liens to be placed on the CCP Margin, and if so, whether any such liens have been subordinated or waived;

N/A

⁶ For example, please consider, to the extent relevant, (i) whether the intermediary is a UCC securities intermediary that credits securities to a securities account in the name of a particular customer or customers generally, and whether the securities intermediary debits securities from the securities accounts of its customers upon any rehypothecation of such securities, and (ii) whether any cash held by the intermediary is maintained as a segregated “special deposit” that remains property of a particular customer or customers generally under applicable law (as distinguished from a “general deposit” in which legal title to the cash passes to the intermediary).

- iii. Whether investment of CCP Margin in interest-bearing instruments or vehicles (e.g., overnight sweeps into repos) is permitted or required, and if so, in what types of instruments or vehicles; and

N/A

- 1. Who obtains the economic benefit of investment of CCP Margin in permitted instruments? Who bears the risk of loss?

N/A

- 2. How does the above response differ as between Required Margin and CCP Excess Margin posted to the CCP?

N/A

- iv. How the risk of the custodian's insolvency is allocated among the CCP, the CMs and the customers (as a group and individually).

N/A

Transfer of CCP Margin from CMs to the CCP

- 5. If CCP Margin will be deposited by customers at their respective CMs, and subsequently transferred to the CCP, please address the following (distinguishing between various categories of CCP Margin (e.g., Required Margin, CCP Excess Margin, Dealer Excess Margin, etc.) and types of CCP Margin (e.g., securities or cash) to the extent relevant):

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- a. How long will it typically take for a CM to transfer CCP Margin posted by customers to the CCP?

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- b. In the intervening period, where at a CM will the CCP Margin be held?

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- c. At what point is the CM deemed to be in default for failing to transfer CCP Margin to the CCP?

Under default rule 3, the CH can declare a default in respect of a member who appears to the CH to be unable or likely to become unable to meet its obligations in respect of one or more contracts. Failure to make a payment due to the CH is indicative of the CM being so unable by virtue of default rule 5(f).

- d. What considerations militate in favor of, or against, allowing customers to deposit CCP Margin directly with the CCP?

Economic Effects of Proposed Clearing Structure for CCP Margin

6. Please describe the economic benefits or disadvantages (from the perspective of CMs and their customers) of the proposed clearing structure for holding IM at the CCP or its custodian (as opposed to at CMs or their custodians).

As CCP LCH.C is neutral on this matter. We require that IM is provided in a timely and legally robust manner. Further questions regarding our clearing members etc. are a matter for them. However it must be clear that, whether IM is related to a house or client position, LCH.C has clear and unambiguous legal rights in such IM.

- a. Do CMs have the ability to generate returns on customer property under the proposed structure?
- b. To what extent do the benefits or disadvantages of the proposed structure flow through from CMs to their customers?

Determination of Required Margin and Related Considerations

7. Is Required Margin determined on the basis of net exposures (i.e., by netting offsetting positions across different customers) or gross exposures? Are offsetting positions within a particular customer-CM relationship netted for this purpose?

As stated above segregated customer margin is calculated via a customer omnibus account, for which account a net required margin figure is determined.

8. Please describe whether margin requirements will be reported and published, and whether calculations are replicable by the CCP upon demand from a CM or customer).

Clearing members receive reports detailing the level of margin that they are required to post, and the parameters that drive the calculation, and are able to replicate the calculation.

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

9. Are there any restrictions on the ability of the CCP to demand additional margin from a CM or customer?

Regulations 12(b) and (c) permit the CCP to call additional margin from the CM where the CCP determines the cover to be insufficient.

10. Are there any restrictions on the ability of a CM to demand additional margin from its customer?

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

11. Is the required amount of CM guarantee fund contributions relating to customer positions at the CCP determined on the basis of net or gross clearing exposures? Are offsetting positions of a single customer netted for this purpose?

Contributions to the Default Fund are assessed on the basis of the level of CM activity.

12. Please discuss the approximate timeline for trade execution, submission to the CCP and novation, and how the CCP's structure in this regard (together with any other operational efficiencies) affects the customer protection analysis.

Trades novate to the CCP as an end of day process. Work is in progress to move to intra-day novation. In practice, in previous default situations, LCH.C has stood behind intra-day business.

Allocation of Risk upon CM Default

13. In the event of a CM default to the CCP, please detail the risk waterfall among guarantee fund contributions, Required Margin securing CM proprietary positions, Required Margin securing customer positions, and any other applicable source of funds (e.g., CCP Excess Margin, to the extent accessible by the clearinghouse), drawing distinctions between defaulting and non-defaulting parties where relevant.

In the event of a CM default, LCH.C applies the following waterfall:

1. Defaulter's Margin Collateral (cash, securities and bank guarantees)
2. Defaulter's own Default Fund contribution
3. LCH.Clearnet Ltd capital (up to a limit)
4. Remaining Default Fund

For details of the default protections see the following:

http://www.lchclearnet.com/Images/LCH.Clearnet%20Ltd%20-%20default%20protections_tcm6-44534.pdf

As stated above LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- a. How does the applicable risk waterfall vary (if at all) depending upon whether the default arises from an insolvency event, as opposed to a non-insolvency event?

It does not vary.

- b. How does the applicable risk waterfall vary (if at all) depending upon the nature of the IM being applied – i.e., is IM securing customer positions applied in a different manner from IM securing proprietary CM positions?

It does not vary.

- c. In the event of a CM default arising from a failure to post sufficient margin, how does the applicable risk waterfall vary (if at all) depending upon whether the failure to post sufficient margin arose in respect of customer positions, rather than proprietary positions?

It does not vary (but see comment above)

- i. Please explain (to the extent applicable) how the CCP's methodology for isolating the origins of the CM default permits the CCP to identify, in a sufficiently precise manner, which risk waterfall applies in any particular instance (especially in

circumstances under which the CM default may have arisen from multiple complex and interlocking factors).

N/A

14. If a CM has defaulted on an obligation to its customer in respect of a cleared transaction (or a transaction related to a cleared transaction), but is not otherwise in default to the CCP, what are the customer's remedies against the CCP?

None.

IM Held at or for the CM (“Dealer Margin”)

Permitted Asset Types for Customer Margin

15. Do the types of assets that may be deposited as margin with the CM differ from the types of assets that qualify as Required Margin?

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

Description of Proposed Clearing Structure for Dealer Margin⁷

16. Please detail the manner in which customers will post Dealer Margin.

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- a. Will Dealer Margin be posted pursuant to pledge or title transfer arrangements?

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

17. Please detail the manner in which Dealer Margin will be held (noting any circumstances in which the default clearing structure may be modified by elections available to customers), specifically addressing the following and distinguishing between different types of margin (e.g., cash versus securities) and categories of margin (e.g., Required Margin, CCP Excess Margin, Dealer

⁷ See note 4.

Excess Margin and any other applicable categories of margin) where appropriate:

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- a. Dealer Margin Held Directly at a CM (or at a Custodian Holding Solely for the Benefit of the CM) – If the CM will hold Dealer Margin directly (without a custodian), or the custodian will hold Dealer Margin only for the CM (rather than for customers (individually or as a group)), please detail all aspects of the arrangement that are relevant from a customer protection standpoint, specifically addressing the following:
 - i. The manner in which the CM holds the Dealer Margin, distinguishing to the extent applicable between various types of Dealer Margin (e.g., securities or cash), and identifying in particular:
 1. Whether Dealer Margin securing the positions of a particular CDS customer will be segregated from (i) the Dealer Margin posted by other CDS customers and (ii) the property of other custodial claimants of the CM, or instead, commingled in a single omnibus account (either for CDS customers or custodial claimants of the CM generally);
 - a. In whose name(s) has/have the account(s) been established?
 2. Whether Dealer Margin securing customer positions will be segregated from the margin securing proprietary positions of CMs;
 3. Any operational practices (whether voluntary or mandated by regulators) relevant to the analysis of customer protection and the sharing of any shortfalls in custodial property;⁸ and
 4. Under what circumstances Dealer Margin may be (i) withdrawn by customers or (ii) applied by CMs or the CCP.

⁸ See note 6.

- ii. Whether the CM has the right to rehypothecate or cause liens to be placed on Dealer Margin, and if so, whether any such liens have been subordinated or waived; and
- v. Whether investment of Dealer Margin in interest-bearing instruments or vehicles (e.g., overnight sweeps into repos) is permitted or required, and if so, in what types of instruments or vehicles.
 - 1. Who obtains the economic benefit of investment of Dealer Margin in permitted instruments? Who bears the risk of loss?
- b. Dealer Margin Held at a Custodian (Whether the Custodian is Holding for the CM or the Customers) – If the CM will hold Dealer Margin at a custodian, please detail all aspects of the custodial arrangement that are relevant from a customer protection standpoint, specifically addressing the following:
 - i. The manner in which the custodian holds the Dealer Margin, distinguishing to the extent applicable between various types of Dealer Margin (e.g., securities or cash), and identifying in particular:
 - 1. On whose behalf the custodian is holding the property – the CM or the customers;
 - 2. Whether Dealer Margin securing the positions of a particular CDS customer will be segregated from (i) the Dealer Margin posted by other CDS customers and (ii) the property of other custodial claimants of the custodian or instead, commingled in a single omnibus account (either for CDS customers or custodial claimants of the custodian generally);
 - a. In whose name(s) has/have the account(s) been established?
 - 3. Whether Dealer Margin securing customer positions will be segregated from Dealer Margin securing the proprietary positions of CMs; and
 - 4. Any operational practices (whether voluntary or mandated by regulators) relevant to the analysis of customer

protection and the sharing of any shortfalls in custodial property.⁹

- ii. Whether the custodian has the right to rehypothecate or cause liens to be placed on the Dealer Margin that is not posted to the CCP, and if so, whether any such liens have been subordinated or waived;
- vi. Whether investment of Dealer Margin that is not posted to the CCP in interest-bearing instruments or vehicles (e.g., overnight sweeps into repos) is permitted or required, and if so, in what types of instruments or vehicles;
 - 1. Who obtains the economic benefit of investment of Dealer Margin in permitted instruments? Who bears the risk of loss?
- vii. Under what circumstances Dealer Margin may be (i) withdrawn by customers or (ii) applied by CMs or the CCP; and
- viii. How the risk of the custodian's insolvency is allocated among the CMs and the customers (as a group and individually).

C. Portability

- 1. Please consider whether a customer's positions and initial and variation margin (and any associated contractual relationships) can be ported to another CM, under each of the following scenarios.

- a. Can a customer effect a voluntary, pre-CM default transfer of its positions and margin (and any associated contractual relationships)? From which entities must the customer obtain consent before effecting such a transfer?

CMs cannot transfer margin except through withdrawing excess margin. Positions can be transferred with consent from both CMs and LCH.C.

- b. Does the CCP have the authority to mandate that a CM transfer any or all of its customer positions and initial and variation margin (and any associated contractual relationships) to another clearing member, if such CM is not in "default" (as defined in the CCP's rules)?

⁹ See note 6.

- i. Does the answer change if the CM, although not in default, is perceived by the CCP to be in a state of impending financial distress?

LCH.C does not have the authority to mandate CM position transfers pre-default. Where a position transfer would reduce the possibility of a potential default, LCH.C may choose to inform the CM.

- ii. To what extent is a default under the CCP's rules the product of the CCP's subjective determination, rather than being determined by reference to objectively verifiable events?

As above: Under default rule 3, the CH can declare a default in respect of a member who appears to the CH to be unable or likely to become unable to meet its obligations in respect of one or more contracts.

- c. How does the CCP intend to transfer customer positions and initial and variation margin (and any associated contractual relationships) from a defaulting CM to a non-defaulting CM? Please elaborate on the following details (distinguishing between Required Margin, CCP Excess Margin, Dealer Excess Margin and any other categories of margin where relevant):

We are not obliged to transfer customer positions but, if requested to do so in a timely manner by the relevant customer, may do so.

- i. The expected timeline from CM default to re-establishment of customer positions and initial and variation margin (and any associated contractual relationships) at a non-defaulting CM;

See above

- ii. The mechanism for transferring customer positions and initial and variation margin (and any associated contractual relationships) to a non-defaulting CM, including a description of:

As part of our default management processes customer positions are identified and customers requested to identify an alternative (non-defaulting) CM. With the consent of the customer and the receiving CM customer positions are then transferred.

As Initial Margin is held from the CM as principal it cannot be transferred with a customer position. Variation Margin that accrues during the period between the default of a clearing member and the transfer or close out of positions likewise forms part of the margin held by LCH.C against the defaulted clearing member. Any such margin that remains once all positions of the defaulting member are transferred or closed out is returned to the defaulting member or its administrators.

1. How customer positions and initial and variation margin (and any associated contractual relationships) are allocated and how transferee CMs are selected (including whether a non-defaulting CM and its customers can be forced by the CCP to accept a transfer of positions through auction, assignment or other allocation procedures);

Transferee CMs are nominated by the customer. A non defaulting CM cannot be compelled to accept a transfer under the rules of this service. Note that LCH.C operates other services on which there is provision for formal auctions and can, under certain circumstances, be an assignment of positions to non-defaulting CMs.

2. Whether customer positions and initial and variation margin (and any associated contractual relationships) in respect of cleared transactions can be effectively transferred separately from non-cleared transactions between the defaulting CM and its customers;

LCH.C is not a party to non-cleared transactions between the defaulting CM and its customers.

3. Whether the treatment of CCP Margin differs from the treatment of Dealer Margin, from a portability perspective; and

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

4. Any pledge or other arrangements designed to facilitate transfer of customer positions and initial and variation margin (and any associated contractual relationships).

N/A

- iii. Any procedures designed to control the effect of market movements on the value of customer positions during the pendency of the transfer – e.g., institution of hedge positions subsequent to the CM default, or assigned allocation of customer margin deficits to non-defaulting CMs – and the allocation of losses if the customer positions cannot be assigned to a non-defaulting CM.

During the management of a default LCH.C may use hedging trades to protect itself from the effects of market movements. LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- 1. Who determines the close-out price applicable to terminated positions? If the CCP, does the CCP's close-out price flow through to the customer? How is the close-out price determined? Does the same close-out price apply to CM-customer positions and offsetting CM-CCP proprietary positions?

Transferred customer positions move to the receiving CM and are marked to market at the applicable market price.

LCH.C's Default Rules detail how it closes out against the CMs.

- 2. How does the CCP account for any unpaid variation margin obligations that may have accrued subsequent to the default of the CM?

As stated above, Variation Margin that accrues during the period between the default of a clearing member and the transfer or close out of positions likewise forms part of the margin held by LCH.C against the defaulted clearing member. Any such margin that remains once all positions of the defaulting member are transferred or closed out is returned to the defaulting member or its administrators.

- iv. Any limitations on the rights of customers to (a) terminate non-cleared transactions with CMs upon a CM default, or (b) set off

their obligations under non-cleared transactions against obligations to CMs under cleared transactions;

LCH.C is not a party to non-cleared transactions between the defaulting CM and its customers.

- v. Whether affiliate and third-party liens or cross-margining and netting arrangements in respect of non-cleared transactions affect the portability analysis;

No.

- vi. Whether the defaulting CM's contractual agreements with the customer are binding upon the transferee CM and such customer upon any transfer of the customer's positions and initial and variation margin, or whether the transferee CM and such customer can (or must) execute a new set of documentation;

The customer must execute any documentation necessary to become a customer of the CM receiving the positions.

- vii. In connection with a transfer of customer positions and initial and variation margin (and any associated contractual relationships) to a non-defaulting CM, any rights of customers to elect not to transfer the associated margin, and instead, to apply such margin as a setoff against other amounts that may be payable to the defaulting CM (while separately posting new IM to the transferee CM); and

N/A

- viii. The effects on the portability analysis of (a) IM at the CCP for customer positions being posted on a gross or net basis (as applicable), (b) the existence of Dealer Margin held at the defaulting CM, and (c) non-cleared trades between the defaulting CM and its customers being "in-the-money" or "out-of-the-money" (as applicable) to the CM.

D. Documentation

Required Documentation

1. What trading documentation will CMs (and their custodians, if applicable) and customers need to execute with the CCP (and its custodian, if applicable) in order to have customer transactions cleared?

Clearing Members need to have a Clearing Member Agreement in place.

Please see LCH.C Liffe Clearing Membership pack, sent separately, and Section 1 of the LCH.C Rules, here: http://www.lchclearnet.com/Images/Section1_tcm6-43738.pdf

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- a. Please discuss the extent to which the CCP “knows” the customers under the required documentation, and how this affects the customer protection analysis.

The CCP does not ‘know’ the customers.

2. What trading documentation will customers need to execute with CMs (and their custodians, if applicable) in order to have their transactions cleared?

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

3. Please describe any legal, operational or other issues arising from the adoption by CMs and customers of a pledge arrangement (from an existing title transfer structure), or of a title transfer arrangement (from an existing pledge structure), for the provision of collateral security.

We are aware of no issues related to this.

Key Terms of Standardized Documentation

4. Please describe the material terms of any documentation standardized by the CCP, including (but not limited to) terms relating to:
 - a. Circumstances under which posted margin may be returned to customers, and all related conditions and requirements;

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- b. Specification of events of default and termination events with respect to the CM (noting any distinctions drawn between insolvency and non-insolvency events) or customer;

LCH.C's Default Rules 3 and 5 specify the circumstances for calling a default of a CM. LCH.C does not deal directly with customers.

- c. Standstill upon the occurrence of a CM default;

LCH can exercise any of its powers under Default Rule 6.

- d. Advance elections to liquidate or transfer cleared contracts;

None documented.

- e. Advance consents (particularly those obtained to enhance portability of cleared contracts);

None documented.

- f. Limitations on rehypothecation;

Not relevant.

- g. Limitations on setoff against non-cleared bilateral transactions between customers and their CMs; and

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- h. Close-out calculations.

LCH.C's Default Rules detail how it closes out against the CMs.

Modification of Proposed Clearing Structure

- 5. Please state the circumstances in which the CCP has the ability to amend by rule or order any aspect of its proposed clearing structure.

LCH can alter its Regulations at any time by virtue of Regulation 34.

II. Legal Considerations

As stated in the introductory note to this questionnaire, the following questions should be considered under the laws of all jurisdictions relevant to the CCP (and its custodian, if applicable), the CMs (and their custodians, if applicable) and the customers. In the responses below, please highlight any areas of legal uncertainty. For matters requiring reasoned legal judgment, please state the level of legal comfort associated with the relevant response.

Customer Rights to CCP Margin

1. Please detail the ability of customers to recover IM held at the CCP (or the CCP's custodian) upon the insolvency of the CCP (or the CCP's custodian) == distinguishing between Required Margin, CCP Excess Margin, Dealer Excess Margin and any other categories of margin where relevant – in the event their positions are liquidated rather than transferred. Consider all relevant facts, including: (i) the manner in which the IM is held at the CCP or its custodian; (ii) the nature of the customer obligations secured by liens on the IM; (iii) the composition of the IM (e.g., whether the IM consists of securities or cash); (iv) in the event of the insolvency of the CCP's custodian, any restrictions (legal or otherwise) on the ability of the CCP to recover IM from the insolvent custodian; and (v) any other matters described in your responses to the questions above that are relevant to this analysis. Analyze how these facts ultimately affect the conclusions reached.

LCH.C deals only with CMs and has no relationship with customers. Customers have no direct right to IM posted by CMs with LCH.C

- a. What is the legal nature of the customers' rights in the IM held at the CCP (or the CCP's custodian)?

See above

- i. To the extent relevant to this analysis, please consider whether customers hold proprietary (i.e., ownership) rights in the IM held at the CCP (or the CCP's custodian), or merely contractual rights to recovery of the IM vis-à-vis the defaulted CCP (or the CCP's custodian).

See above

1. How does the selection of pledge versus title transfer for the provision of collateral security affect this determination?
 2. What are the relevant legal standards with respect to tracing or other requirements necessary to demonstrate proprietary rights in the IM?
 3. What is the practical effect of maintaining proprietary versus contractual rights?
- ii. If the distinction between proprietary versus contractual rights to the IM held at the CCP (or the CCP's custodian) is irrelevant as a legal matter, please describe the legal framework that is relevant to the analysis.
- b. How is a shortfall in CCP Margin and other custodial property (i.e., property held in a custodial capacity for purposes unrelated to the clearing of CDS) held by the CCP (or its custodian) allocated as between the CCP (or the CCP's custodian), the CMs, the customers (as a group and individually) and other custodial claimants? Distinguish where relevant between Required Margin, CCP Excess Margin, Dealer Excess Margin and any other categories of margin.

See above

- i. With what other types of custodial claimants may the customers potentially be required to share with in the event of a shortfall in custodial property?
 1. Are there any applicable regulatory regimes that limit the claims of those who may share in CCP Margin?
- ii. Is it possible to contractually vary the sharing regime that would otherwise apply in any particular instance (e.g., by holding CCP Margin at a third party custodian)?

Customer Rights to Dealer Margin

2. Please detail the ability of customers to recover IM held at the CM (or the CM's custodian) upon the insolvency of the CM (or the CM's custodian) – distinguishing between Required Margin, CCP Excess Margin, Dealer Excess

Margin and any other categories of margin where relevant – in the event their positions are liquidated rather than transferred. Consider all relevant facts, including: (i) the manner in which the IM is held at the CM or its custodian; (ii) the nature of the customer obligations secured by liens on the IM; (iii) the composition of the IM (e.g., whether IM consists of securities or cash); (iv) in the event of the insolvency of the CM’s custodian, any restrictions (legal or otherwise) on the ability of the CM to recover IM from the insolvent custodian; and (v) any other matters described in your responses to the questions above that are relevant to this analysis. Analyze how these facts ultimately affect the conclusions reached.

LCH.C only deals with CMs as principal and is not party to CM/customer arrangements.

- a. What is the legal nature of the customers’ rights in the IM held at the CM (or the CM’s custodian)?

N/A

- iii. To the extent relevant to this analysis, please consider whether customers hold proprietary (i.e., ownership) rights in the IM held at the CM (or the CM’s custodian), or merely contractual rights to recovery of the IM vis-à-vis the CM (or the CM’s custodian).

1. How does the selection of pledge versus title transfer for the provision of collateral security affect this determination?
2. What are the relevant legal standards with respect to tracing or other requirements necessary to demonstrate proprietary rights in the IM?
3. What is the practical effect of maintaining proprietary versus contractual rights?

- iv. If the distinction between proprietary versus contractual rights to the IM held at the CM (or the CM’s custodian) is irrelevant as a legal matter, please discuss the legal framework that is relevant to the analysis.

- b. How is a shortfall in Dealer Margin and other custodial property (i.e., property held in a custodial capacity for purposes unrelated to cleared CDS) held by the CM (or its custodian) allocated as between the CMs, the

customers (as a group and individually) and other custodial claimants? Distinguish where applicable between Required Margin, CCP Excess Margin, Dealer Excess Margin and any other categories of margin where relevant.

N/A

- i. Are there any applicable regulatory regimes that limit the claims of those who may share in Dealer Margin?
- ii. Is it possible to contractually vary the sharing regime that would otherwise apply in any particular instance (e.g., by holding Dealer Margin at a third party custodian)?

Legal Enforceability of Portability Framework

3. Please discuss the legal enforceability of the CCP's portability framework in the event of either or both (i) a CM insolvency (or the insolvency of the CM's custodian) and/or (ii) a customer. In particular, consider how the enforceability of the portability framework is affected by the following:

(i) LCH.C Default Rule 6 deals with transferring a defaulting CM's positions to a solvent CM who consents to such transfer. Such transfer would be protected under Part VII of the Companies Act 1989. (ii) A customer's insolvency will not affect LCH.C's portability framework as LCH.C has no direct relationship with customers.

- a. Whether, if either the CCP or insolvency trustee/receiver of the CM transfers any cleared positions and margin (and any associated contractual relationships) of the defaulted CM with the CCP, it must also transfer the defaulting CM's (i) other cleared positions and margin (and any associated contractual relationships) with the CCP, and (ii) non-cleared positions (and associated margin and contractual relationships) with customers of the defaulting CM;
- b. The effect of any standstill provisions upon default, and the interplay of such provisions with any statutorily protected termination rights;
- c. Any affiliate and third-party liens or cross-margining and netting arrangements;
- d. Any setoff rights or limitations between cleared and non-cleared trades;

- e. Any mandatory setoff requirements for CMs or customers under applicable law;
- f. Any pledge arrangements or other provisions for collateral security between CMs and customers related to cleared transactions; and
- g. Whether the CM is acting as principal (rather than as agent) vis-à-vis the CCP in respect of customer transactions.

Legal Enforceability of Novation/Netting Framework

- 4. Please discuss the legal enforceability of the CCP's novation and netting framework in the event of either or both (i) a CM insolvency (or the insolvency of the CM's custodian) or (ii) a customer insolvency, giving due regard to the CCP's ability (and, in the event of a customer insolvency, a CM's ability) to exercise its legal and contractual remedies on (a) IM held at the CCP (or the CCP's custodian) and (b) IM held at the CM (or the CM's custodian).

Part VII of the Companies Act 1989 protects LCH.C's actions taken under its Default Rules in the event of a CM insolvency (LCH.C has no concern in relation to a customer insolvency as its relationship is principal to principal with the CM).

- a. How would challenges to the validity or enforceability to an underlying bilateral transaction (prior to novation) – e.g., if a transaction was entered into in bad faith, fraudulently, or in contemplation of insolvency – affect the enforceability of the novated transaction, in the event of either or both (i) a CM insolvency or (ii) a customer insolvency?

Section 164 of Part VII of the Companies Act 1989 puts 'market contracts' and the provision of margin etc beyond challenge unless the CCP has notice of a petition being presented. A CCP has no power to unwind registered contracts.

LCH.C is also designated under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 which allows LCH.C to benefit from the provisions of the Settlement Finality Directive.

Considerations Relating to Netting vis-à-vis the CCP

- 5. Please evaluate, from an accounting and regulatory capital perspective, the ability of CMs to net (i) proprietary positions against other proprietary positions and (ii) customer positions against proprietary positions, in each case vis-à-vis the CCP, upon a CCP default or insolvency.

This answer would most appropriately be provided by our clearing members.

Enforcement and Monitoring Mechanisms

6. Please describe any enforcement or monitoring mechanisms (imposed by the CCP, applicable regulatory authorities or otherwise) designed to ensure that CMs (and their custodians, to the extent applicable) comply with their obligations in respect of any legal or contractual requirements described in your response above.

LCH.C's compliance with obligations and best practices is a matter of public record available via our website. Our most recent CPSS-IOSCO assessment is about to be presented to the FSA/BoE for verification, we can submit a copy of this document once verified.

Legislative or Regulatory Reforms

7. As requested above, please identify in your responses above any areas of legal uncertainty and the level of legal comfort provided on various aspects of the proposed framework. Please consider whether there are any legislative or regulatory reforms that would be helpful to clarify or improve the legal framework governing any of the foregoing issues and areas of legal uncertainty identified above. If so, describe any such proposed reforms in detail.

This is subject to current review and discussion and we will be responding to various circulated papers etc. in due course.

Much will depend on how regulators, CMs etc. determine client accounts should be operated going forwards, gross vs net, segregated, omnibus etc.

Other Considerations

8. Please feel free to elaborate on any topic you deem to be relevant to the analysis of customer protection or systemic risk issues.

LCH.C is perfectly willing to be flexible in terms of the account types and structures that we offer; we are also able to add specific language to our rules to protect certain categories of customer (e.g. US customers), subject to the agreement of our regulator(s).



Independently of this, and critically, Part VII ensures the enforceability of LCH.C's default rules, and provides protection in the event of the insolvency of clearing members.