

**TESTIMONY OF DANIEL J. MAGUIRE  
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EXECUTIVE COMMITTEE MEMBER, LONDON STOCK EXCHANGE GROUP PLC  
BEFORE THE HOUSE COMMITTEE ON AGRICULTURE  
SUBCOMMITTEE ON COMMODITY EXCHANGES, ENERGY, AND CREDIT**

Brexit and Other International Developments Affecting U.S. Derivatives Markets  
June 26, 2019

**Introduction**

Chairman Scott, Ranking Member Scott, and members of the Committee, I appreciate the opportunity to appear before you today to discuss Brexit, its impact on the markets and the evolving international dialogue on cross-border regulation of clearing houses.

I am Daniel Maguire and I serve as Chief Executive Officer of LCH Group Limited (“LCH”) and as a Member of the Executive Committee of London Stock Exchange Group (“LSEG”), a global financial market infrastructure business.<sup>1</sup> LSEG has approximately 4,500 employees around the world, over 700 of which are employed in the U.S. across offices in five states. LCH and FTSE Russell, one of the world’s largest index providers, which is also part of LSEG, are important components of the U.S. financial markets.

LCH operates the world’s largest swaps clearing house, LCH Ltd, which is domiciled in the UK.<sup>2</sup> LCH Ltd is directly licensed in 10 jurisdictions, has customers in 60 jurisdictions and offers clearing services in 26 different currencies. LCH Ltd’s home country regulator is the Bank of England (“BoE”) and LCH Ltd has been registered with the U.S. Commodity Futures Trading Commission (“CFTC”) as a Derivatives Clearing Organization (“DCO”) since 2001. LCH also clears futures traded on the London Stock Exchange Derivatives Market (“LSEDM”), which is registered as a Foreign Board of Trade (“FBOT”) by the CFTC.

LCH’s interest rate swap (“IRS”) clearing service, SwapClear, clears over 90 percent of the cleared IRS market globally. The health and liquidity of the IRS market allows banks and other financial institutions to manage fluctuations in interest rates, which translates into direct benefits for end users, U.S. consumers and the broader U.S. economy. Our U.S. end user clients includes pension funds, regional banks, Federal Home Loan Banks and government sponsored enterprises, among many others.

**Summary**

My remarks today will focus on three related topics.

First, I will discuss LCH’s response to Brexit and what this means for our market participants, including U.S. banks and end users. Through the focused efforts of the derivatives industry and key central banks and market regulators, contingency measures have been established that will permit LCH and other

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<sup>1</sup> LSEG holds an 82.6% stake in LCH Group, the remaining share is held by a consortium of banks.

<sup>2</sup> LCH also operates LCH SA, domiciled in Paris, which is regulated in four jurisdictions. LCH SA has been registered at the CFTC since 2013 and the U.S. Securities and Exchange Commission (“SEC”) since 2016. LCH SA’s primary regulator is the Autorité de contrôle prudentiel et de résolution (“ACPR”).

clearing houses in the UK and EU to continue to offer services to our clients in the event the UK exits the EU without an agreement, referred to as “no-deal” or “Hard” Brexit.

Second, I will discuss the evolving international dialogue on cross-border regulation of global clearing houses. Brexit has sharpened the ongoing focus on this topic between the UK and EU as well as many other jurisdictions around the world, including here in the U.S. We have been encouraged by the progress and regulatory cooperation among major jurisdictions, yet significant work lies ahead. LCH will continue to work with our regulators, market partners and customers towards outcomes that enhance financial stability and support global markets.

Finally, I will discuss the topic of clearing house resilience and our views on how the global regulatory framework for clearing houses can best support the common objective of strengthening these increasingly important components of the financial markets. I will specifically discuss the role central bank deposit accounts play in enhancing the resilience of clearing houses as the safest place to deposit cash margin, an issue that is widely agreed on by the industry and regulatory community.

### **UK Withdrawal from the EU and “Hard Brexit” Contingency Measures**

Three years ago, on June 23, 2016, the UK voted to leave the EU. In March 2017, the legal instrument to commence this withdrawal, known as Article 50, was triggered. The UK Government and EU began withdrawal negotiations in June 2017. In November 2018, the UK Government and the EU agreed on a Brexit deal, known as the Withdrawal Agreement, subject to approval by the EU Council and UK Parliament. In a series of three votes between January and March of this year, the UK Parliament voted against the Withdrawal Agreement. It was subsequently agreed to extend the deadline for Brexit until October 31, 2019.

Currently, if no agreement is reached by October 31 and no extension of the current deadline is provided, the UK will leave the EU without transitional arrangements in place. To avoid the significant market disruption and financial stability risks in the event of a Hard Brexit, on December 19, 2018, the European Commission (“EC”) implemented its no-deal contingency action plan that includes a conditional and temporary equivalence decision to allow UK clearing houses to continue to provide services in the EU.<sup>3</sup>

On February 18, 2019, the European Securities and Markets Authority (“ESMA”) recognized three UK clearing houses following the EC’s equivalence decision.<sup>4</sup> ESMA’s recognition of LCH Ltd as a “third country CCP” applies until March 30, 2020 and is only triggered in the event of a Hard Brexit, allowing LCH Ltd the ability to continue to offer all clearing services for all products to all members and clients. We welcomed these actions by the European Commission and ESMA, which provided clarity for our market participants.<sup>5</sup>

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<sup>3</sup> Brexit: European Commission implements “no-deal” Contingency Action Plan in specific sectors, available at [http://europa.eu/rapid/press-release\\_IP-18-6851\\_en.htm](http://europa.eu/rapid/press-release_IP-18-6851_en.htm). Similar temporary equivalence was granted by the BoE for EU27 domiciled clearing houses, including LCH SA and LSEG’s Italian clearing house, Cassa di Compensazione e Garanzia (“CC&G”).

<sup>4</sup> ESMA to Recognise Three UK CCPs in the Event of a No-Deal Brexit, available at <https://www.esma.europa.eu/press-news/esma-news/esma-recognise-three-UK-ccps-in-event-no-deal-brexit>.

<sup>5</sup> LCH Member Update, April 5, 2019, available at <https://www.lch.com/membership/ltd-membership/ltd-member-updates/brexit-update-lch-limited-article-25-recognition-0>.

As a systemically important institution, our main priority is ensuring the orderly functioning of markets, continuity of service to our customers and supporting financial stability. As the negotiations progress, we will continue to engage with the relevant regulatory authorities to secure the long-term recognition of LCH Ltd in the EU. It remains LCH's objective to ensure a smooth transition for our customers whatever the outcome of the negotiations around the UK's withdrawal from the EU.

### **Cross-Border Regulation of Global Clearing Houses**

The IRS market, along with many other derivatives asset classes, are global in nature. This requires different jurisdictions to agree on regulatory mechanisms that allow national rules to interact on an international level. This supports global market health and liquidity and avoids fragmentation into smaller, localized markets.<sup>6</sup> Creating a harmonized, level playing field of regulation and cross-border market access enhances competition among global markets and increases financial stability. This results in lower costs and increased protection for market participants, including end users.

Large, global clearing houses manage different levels of risk in the various jurisdictions where they operate. A key debate among national regulators is how to measure a foreign clearing house's importance in their jurisdiction and the resulting regulatory oversight needed to oversee those clearing houses. We believe that regulation of clearing houses outside of their home jurisdiction should be proportionate to the risk that clearing house is managing in the host jurisdiction. Host country regulators should afford deference to comparable home country oversight where appropriate.

The regulatory frameworks governing the cleared swaps markets were significantly enhanced and redefined with the Dodd-Frank Act in 2010 and the European Market Infrastructure Regulation ("EMIR") in 2012. Similar derivatives reforms were implemented in many other markets around the world pursuant to the G20 financial regulatory reforms, which were established following the 2008 financial crisis.<sup>7</sup>

In 2016, an equivalence decision concerning the cross-border regulation of clearing houses was made between the CFTC and EC.<sup>8</sup> In 2017, the EC proposed amendments to EMIR, known as "EMIR 2.2," which were agreed this past March.<sup>9</sup> Provisions in EMIR 2.2 will redefine how non-EU domiciled clearing houses that provide clearing services to EU participants will be regulated by EU authorities.

In the event of the UK departure from the EU, the UK will be treated similar to the U.S. and other non-EU jurisdictions, referred to as "third countries" in the EU regulatory context. We will continue to work with our regulators in the UK, EU and U.S. to define how these regulatory standards under EMIR 2.2 are developed, which will result in enhanced regulatory cooperation among these three major jurisdictions and beyond.

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<sup>6</sup>IOSCO notes fragmenting global markets into smaller, localized markets increases counterparty risk, restricts liquidity, increases costs and reduces financial stability, *IOSCO Report on Market Fragmentation & Cross-border Regulation*, June 2019, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD629.pdf>.

<sup>7</sup> Implementation and Effects of the G20 Financial Regulatory Reforms: Fourth Annual Report, November 28, 2018, available at <https://www.fsb.org/2018/11/implementation-and-effects-of-the-g20-financial-regulatory-reforms-fourth-annual-report/>.

<sup>8</sup> CFTC Approves Substituted Compliance Framework in Follow-up to the Recent Equivalence Agreement between the U.S. and the EU, available at <https://www.cftc.gov/PressRoom/PressReleases/pr7342-16>; European Commission adopts equivalence decision for CCPs in USA, available at [http://europa.eu/rapid/press-release\\_IP-16-807\\_en.htm](http://europa.eu/rapid/press-release_IP-16-807_en.htm).

<sup>9</sup> EMIR 2.2 Final Compromise Text, available at <https://data.consilium.europa.eu/doc/document/ST-7621-2019-ADD-1/en/pdf>.

Given LCH's significant risk management role in the U.S. financial markets, we have supported the direct registration of LCH Ltd with the CFTC since our registration 18 years ago and the legal certainty this has provided for our customers under the CFTC's customer protection rules, which serve as an important cornerstone of the CFTC's mission. We also believe the cooperative relationship between the BoE and the CFTC is a model to follow for oversight of swaps clearing houses that play a substantial risk management role in multiple jurisdictions.

### **Strengthening the Resiliency of Clearing Houses**

A central component of the risk management function of clearing houses is the collection of margin from counterparties to collateralize their derivatives trades, serving as a buffer in the event a counterparty or clearing member defaults on their financial obligations. Clearing houses are prohibited from holding this margin within their own legal entity and regulation carefully prescribes the management and placement of collateral. Clearing house placement or investment options for collateral is appropriately limited to a small number of very conservative options.<sup>10</sup>

Central bank deposit accounts are widely agreed as the safest option for clearing houses to place collateral in any given currency, especially during periods of financial market stress.<sup>11</sup> LCH Ltd holds more margin than any other global clearing house.<sup>12</sup> LCH Ltd operates an extensive global collateral management function to ensure the safety and liquidity of margin it receives, in line with applicable regulation and conservative risk management practices that often exceed minimum standards. LCH Ltd's SwapClear service daily U.S. dollar cash margin holdings fluctuate between \$35-40 billion. Daily

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<sup>10</sup> Including overnight reverse repurchase agreements, government bonds, commercial banks, money market funds (allowed in the U.S. but not the EU), and, where available, central bank deposit accounts.

<sup>11</sup> "[Fed] accounts permit DFMUs to hold funds at the Federal Reserve, but not to borrow from it. Allowing DFMUs to deposit balances at the Federal Reserve helps them avoid some of the risk involved in holding balances with their clearing members. Doing so also provides CCPs with a flexible way to hold balances on days when margin payments unexpectedly spike and it is difficult to find banks that are willing to accept an unexpected influx in deposits. In such a case, it may also be too late in the day to rely on the repo market. The availability of Fed accounts could help avoid potential market disruptions in those types of circumstances," Federal Reserve Governor Jerome Powell, Central Clearing and Liquidity, June 2017, available at <https://www.federalreserve.gov/newsevents/speech/powell20170623a.htm>; "Where CCPs are permitted to have deposit accounts at central banks, they can deposit initial margin cash there instead of investing it, eliminating investment risk. As many of the banks providing custodial services to CCPs are also major clearing members, central bank deposit accounts would also help CCPs avoid wrong-way exposure to clearing members." Federal Reserve Bank of Chicago, "Non-default loss allocation at CCPs," April 2017, available at <https://www.chicagofed.org/~media/publications/policy-discussion-papers/2017/pdp-2017-02-pdf.pdf>; "CCP access to central bank money in the currencies in which they do business makes clearing more efficient and reduces risk to end users and the broader financial system. Access should include the ability to use central bank money for payments, central bank accounts for safe-keeping of participants' cash, and access to central bank liquidity, at least in emergency situations." ISDA, "The Case for CCP Cooperation," April 2019, available at <https://www.isda.org/2018/04/18/the-case-for-ccp-supervisory-cooperation/>; "Allowing CCPs to hold cash initial margin with central banks will reduce CCP exposure to commercial bank risk generally. ...Permitting CCPs to maintain central bank deposits will also reduce the need for CCPs to utilize reverse repos and/or directly purchase securities to reduce settlement or concentration bank risk, which pose enormous investment challenges and risks, like forced diversification." FIA Global, "CCP Risk Position Paper," April 2015, available at [https://fia.org/sites/default/files/content\\_attachments/FIAGLOBAL\\_CCP\\_RISK\\_POSITION\\_PAPER.pdf](https://fia.org/sites/default/files/content_attachments/FIAGLOBAL_CCP_RISK_POSITION_PAPER.pdf); "As a result of the initiative of our staff and the assistance of the Federal Reserve, the pre-funded resources held by systemically important clearinghouses can now be deposited and held at Federal Reserve Banks. This is good for customer protection and for financial stability," CFTC Chairman Timothy Massad, Keynote Remarks at SEFCON VII, January 18, 2017, available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-55>.

<sup>12</sup> Per LCH Ltd's Q4 2018 CPMI-IOSCO quantitative disclosures, LCH Ltd holds \$195 billion U.S. dollar equivalent in margin. A list of all clearing houses' CPMI-IOSCO quantitative disclosures is available at <https://ccp12.org/ccp12-public-quantitative-disclosures/>.

margin flows range from \$10-20 billion in U.S. dollar cash. Currently, LCH does not have access to a Federal Reserve Bank deposit account.

In the U.S., Title VIII of Dodd-Frank provided a legal framework by which clearing houses can deposit margin in central bank deposit accounts.<sup>13</sup> We believe the Financial Stability Oversight Council (“FSOC”) has the statutory authority to take measures that would allow non-U.S. domiciled DCOs that are systemically relevant to the U.S. market to apply to the Federal Reserve for deposit account access. As the discussion over cross-border clearing house regulation progresses, we believe it is critical for central banks to require clearing houses that manage substantial risks in their jurisdiction to maintain a deposit account for their respective currency. This would further strengthen the financial resilience of clearing houses, and overall, the financial markets. Central bank deposit accounts also provide end users with the ultimate reassurance that their U.S. dollar cash margin is protected during times of market stress. In line with the 2017 recommendation from the U.S. Department of the Treasury, we call on Congress to further evaluate the important financial stability role that central bank deposit accounts can play for non-U.S. domiciled DCOs such as LCH who manage a substantial portion of cleared derivatives risk in the U.S. markets.<sup>14</sup>

## **Conclusion**

Despite the many challenges Brexit has presented, our industry and regulatory community have worked collaboratively to mitigate the risk of market disruption and preserve financial stability in the event of a Hard Brexit scenario.

Brexit has also reshaped the ongoing debate around the future cross-border framework for global clearing houses. We believe this framework should support global markets and avoid fragmentation. LCH believes the CFTC’s direct registration model remains appropriate for LCH Ltd in the U.S. and other jurisdictions where we manage a substantial risk in the market. We recognize that other models may be more proportionate for clearing houses that do not manage the same level of risk in a foreign jurisdiction.

Strengthening the resiliency of clearing houses and ensuring that client margin can be managed in the safest and most efficient manner, including the role of central bank deposit accounts, should continue to remain a key focus as the cross-border framework for global clearing houses evolves.

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<sup>13</sup> Specifically, financial market utilities (“FMUs”) can be designated by the Financial Stability Oversight Council (“FSOC”) as systemically important or designated financial market utilities (“DFMUs”). DFMUs may apply to a Federal Reserve Bank for a deposit account. In 2012, FSOC designated eight DFMUs.

<sup>14</sup> U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Capital Markets*, page 217, October 2018, available at <https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf>.