



16 December 2024

## **FIA Response to LME Clear Rulebook consultation 24 285 regarding the minimum net capital, default fund mutualization threshold and default fund anti-procyclicality measure**

Submitted electronically at [consultation@lme.com](mailto:consultation@lme.com)

To whom this may concern,

On behalf of FIA<sup>1</sup> and its members, we express our appreciation for the opportunity to comment on the consultation on LME Clear's proposals in respect of the minimum net capital, default fund mutualization threshold and default fund anti-procyclicality measure <sup>2</sup> (the "Consultation"). We generally support LME Clear's efforts to improve resilience of its market and its membership, particularly those aimed at improving the stability and predictability of the Default Fund. However, several areas require further clarification and impact assessment to ensure the proposals achieve their intended objectives without unintended consequences. Below, we offer comments on the LME Clear proposal.

### **Increase in Minimum Net Capital Requirement**

#### Member Impact Analysis

While we understand the rationale for increasing the minimum net capital requirement from \$10 million to \$30 million to enhance resilience, we would seek further clarity regarding the potential impact on existing Members. Specifically:

- How many Members are projected to fall below the new threshold?
- Has LME Clear assessed the risk of market concentration or reduced competition due to potential Member exits?
- Will transitional arrangements or phased implementation be offered to mitigate potential disruption?

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<sup>1</sup> FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent, and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's member firms play a critical role in the reduction of systemic risk in global financial markets.

<sup>2</sup> As notified under the [LME Notice reference 24 285](#).

<b>BRUSSELS</b>	Office 621, Square de Meeûs 37, 1000 Brussels, Belgium	Tel +32 2.791.7571
<b>LONDON</b>	Level 28, One Canada Square, Canary Wharf, London E14 5AB	Tel +44 (0)20.7929.0081
<b>SINGAPORE</b>	One Raffles Quay, North Tower, Level 49, Singapore 048583	Tel +65 6662.5782
<b>WASHINGTON, DC</b>	2001 K Street, NW, Suite 725, North Tower, Washington, DC 20006	Tel +1 202.466.5460

## **Default Fund Mutualisation Limit (DFML)**

### Mutualisation Limit Setting

Members expressed concern regarding the decision to set the DFML at 14% of the average Initial Margin (IM) over the past six months. It is understood that currently, the DFML is set at a 10% of the average IM over the past six month and we would welcome more transparency on how this percentage was determined and on the assessment of its appropriateness.

### Fair Allocation Beyond DFML

We seek clarification on how stress losses exceeding the DFML will be allocated among Members. Establishing a fair and proportional allocation mechanism is essential to maintaining confidence in the framework.

We strongly recommend that LME Clear extend this allocation, where feasible, to clients of clearing members. This approach aligns with the “defaulter-pays” model that LME Clear is moving towards. Additionally, it is important to note that the increase in the net minimum capital requirement may lead to greater concentration among Members. Allocating these requirements to clients would help mitigate concerns related to clearing capacity and alleviate the potential impact on Members' concentration.

### Inclusion of Stress Loss Over Initial Margin (SLOIM)

Members highlighted that Default Fund contributions are based solely on IM and do not include SLOIM. LME Clear is encouraged to revisit the allocation methodology to consider a combination of IM and SLOIM, similar to practices adopted by other CCPs like ECC.

## **Default Fund Procyclicality (APC) Control and Lookback Period**

### Stability Enhancements

The introduction of a procyclicality control to limit significant reductions in the Default Fund during recalculations is broadly supported. This measure, combined with the proposed adjustments to the lookback period, appears reasonable in stabilizing contributions and reflecting current market conditions.

### Clarification on Lookback Period

We seek confirmation regarding the shift from a six-month to a three-month lookback period for the SLOIM calculation. Although the rulebook shows the deletion of the six-month reference, the three-month adjustment is not explicitly documented<sup>3</sup>. Clear communication is needed to avoid ambiguity.

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<sup>3</sup> Please see Part B – Default Fund, section 1.2 Principles for calculating Default Fund Contributions for LME Base Service paragraph (b)(i) on page 268 of the consultation document.



## General Feedback and Recommendations

### Impact Analysis of Proposals

Members strongly request an impact analysis, including:

- Projected impacts of the proposed DFML on Member contributions during periods of extreme market volatility.
- Analysis of how the changes will influence the overall financial safeguards of LME Clear without reducing its default management capability.

### Scope of Procyclicality Control

While the procyclicality control addresses reductions in the Default Fund, Members suggest considering whether a procyclicality control appetite on significant increases might also be warranted, noting here the term appetite as opposed to limit. Such appetite could help smooth unexpected and substantial increases in contributions, which may place undue strain on Members' liquidity during volatile periods. However, we recognize the complexities of implementing this measure, given the importance of ensuring sufficient prefunded resources to manage potential default under extreme but plausible scenarios. Balancing these considerations would require a careful approach that maintains the integrity of the Default Fund while avoiding excessive burdens on Clearing Members.

We would like to thank the LME Clear for the opportunity to respond to this consultation and acknowledge the effort to improve and strengthen its markets and membership. We welcome the opportunity to discuss with you any of the comments and recommendations should you require additional information.

Respectfully submitted,

Jacqueline Mesa  
FIA Chief Operating Officer and Senior Vice President of Global Policy