

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59164; File No. S7-34-08)

December 24, 2008

ORDER GRANTING TEMPORARY EXEMPTIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 IN CONNECTION WITH REQUEST OF LIFFE ADMINISTRATION AND MANAGEMENT AND LCH.CLEARNET LTD. RELATED TO CENTRAL CLEARING OF CREDIT DEFAULT SWAPS, AND REQUEST FOR COMMENTS

I. Introduction

In response to the recent turmoil in the financial markets, the Securities and Exchange Commission (“Commission”) has taken multiple actions to protect investors and ensure the integrity of the nation’s securities markets.¹ Today the Commission is taking further action designed to address concerns related to the market in credit default swaps (“CDS”). The over-the-counter (“OTC”) market for CDS has been a source of concerns to us and other financial regulators. These concerns include the systemic risk posed by CDS, highlighted by the possible

¹ A nonexclusive list of the Commission's actions to stabilize financial markets during this credit crisis include: adopting a package of measures to strengthen investor protections against naked short selling, including rules requiring a hard T+3 close-out, eliminating the options market maker exception of Regulation SHO, and expressly targeting fraud in short selling transactions (See Securities Exchange Act Release No. 58572 (September 17, 2008), 73 FR 54875 (September 23, 2008)); issuing an emergency order to enhance protections against naked short selling in the securities of primary dealers, Federal National Mortgage Association (“Fannie Mae”), and Federal Home Loan Mortgage Corporation (“Freddie Mac”) (See Securities Exchange Act Release No. 58166 (July 15, 2008), 73 FR 42379 (July 21, 2008)); taking temporary emergency action to ban short selling in financial securities (See Securities Exchange Act Release No. 58592 (September 18, 2008), 73 FR 55169 (September 24, 2008)); approving emergency rulemaking to ensure disclosure of short positions by hedge funds and other institutional money managers (See Securities Exchange Act Release No. 58591A (September 21, 2008), 73 FR 55557 (September 25, 2008)); proposing rules to strengthen the regulation of credit rating agencies and making the limits and purposes of credit ratings clearer to investors (See Securities Exchange Act Release No. 57967 (June 16, 2008), 73 FR 36212 (June 25, 2008)); entering into a Memorandum of Understanding with the Board of Governors of the Federal Reserve System (“FRB”) to make sure key federal financial regulators share information and coordinate regulatory activities in important areas of common interest (See Memorandum of Understanding Between the U.S. Securities and Exchange Commission and the Board of Governors of the Federal Reserve System Regarding Coordination and Information Sharing in Areas of Common Regulatory and Supervisory Interest (July 7, 2008), http://www.sec.gov/news/press/2008/2008-134_mou.pdf).

inability of parties to meet their obligations as counterparties and the potential resulting adverse effects on other markets and the financial system.² Recent credit market events have demonstrated the seriousness of these risks in a CDS market operating without meaningful regulation, transparency,³ or central counterparties (“CCPs”).⁴ These events have emphasized the need for CCPs as mechanisms to help control such risks.⁵ A CCP for CDS could be an important step in reducing the counterparty risks inherent in the CDS market, and thereby help mitigate potential systemic impacts. In November 2008, the President’s Working Group on Financial Markets stated that the implementation of a CCP for CDS was a top priority⁶ and, in furtherance of this recommendation, the Commission, the FRB and the Commodity Futures Trading Commission (“CFTC”) signed a Memorandum of Understanding⁷ that establishes a framework for consultation and information sharing on issues related to CCPs for CDS. Given the continued uncertainty in this market, taking action to help foster the prompt development of

² In addition to the potential systemic risks that CDS pose to financial stability, we are concerned about other potential risks in this market, including operational risks, risks relating to manipulation and fraud, and regulatory arbitrage risks.

³ See Policy Objectives for the OTC Derivatives Market, The President’s Working Group on Financial Markets, November 14, 2008, available at <http://www.ustreas.gov/press/releases/reports/policyobjectives.pdf> (“Public reporting of prices, trading volumes and aggregate open interest should be required to increase market transparency for participants and the public.”).

⁴ See The Role of Credit Derivatives in the U.S. Economy Before the H. Agric. Comm., 110th Cong. (2008) (Statement of Erik Sirri, Director of the Division of Trading and Markets, Commission).

⁵ See *id.*

⁶ See Policy Objectives for the OTC Derivatives Market, The President’s Working Group on Financial Markets (November 14, 2008), <http://www.ustreas.gov/press/releases/reports/policyobjectives.pdf>. See also Policy Statement on Financial Market Developments, The President’s Working Group on Financial Markets (March 13, 2008), http://www.treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf; Progress Update on March Policy Statement on Financial Market Developments, The President’s Working Group on Financial Markets (October 2008), <http://www.treas.gov/press/releases/reports/q4progress%20update.pdf>.

⁷ See Memorandum of Understanding Between the Board of Governors of the Federal Reserve System, the U.S. Commodity Futures Trading Commission and the U.S. Securities and Exchange Commission Regarding Central Counterparties for Credit Default Swaps (November 14, 2008), <http://www.treas.gov/press/releases/reports/finalmou.pdf>.

CCPs, including granting conditional exemptions from certain provisions of the federal securities laws, is in the public interest.

A CDS is a bilateral contract between two parties, known as counterparties. The value of this financial contract is based on underlying obligations of a single entity or on a particular security or other debt obligation, or an index of several such entities, securities, or obligations. The obligation of a seller under a CDS to make payments under a CDS contract is triggered by a default or other credit event as to such entity or entities or such security or securities. Investors may use CDS for a variety of reasons, including to offset or insure against risk in their fixed-income portfolios, to take positions in bonds or in segments of the debt market as represented by an index, or to capitalize on the volatility in credit spreads during times of economic uncertainty. In recent years, CDS market volumes have rapidly increased.⁸ This growth has coincided with a significant rise in the types and number of entities participating in the CDS market.⁹

The Commission's authority over this OTC market for CDS is limited. Specifically, Section 3A of the Securities Exchange Act of 1934 ("Exchange Act") limits the Commission's authority over swap agreements, as defined in Section 206A of the Gramm-Leach-Bliley Act.¹⁰ For those CDS that are swap agreements, the exclusion from the definition of security in Section 3A of the Exchange Act, and related provisions, will continue to apply. The Commission's

⁸ See Semiannual OTC derivatives statistics at end-December 2007, Bank for International Settlements ("BIS"), available at <http://www.bis.org/statistics/otcder/dt1920a.pdf>.

⁹ CDS were initially created to meet the demand of banking institutions looking to hedge and diversify the credit risk attendant with their lending activities. However, financial institutions such as insurance companies, pension funds, securities firms, and hedge funds have entered the CDS market.

¹⁰ 15 U.S.C. 78c-1. Section 3A excludes both a non-security-based and a security-based swap agreement from the definition of "security" under Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10). Section 206A of the Gramm-Leach-Bliley Act defines a "swap agreement" as "any agreement, contract, or transaction between eligible contract participants (as defined in section 1a(12) of the Commodity Exchange Act. . .) . . . the material terms of which (other than price and quantity) are subject to individual negotiation." 15 U.S.C. 78c note.

action today does not affect these CDS, and this Order does not apply to them. For those CDS that are not swap agreements (“non-excluded CDS”), the Commission’s action today provides conditional exemptions from certain requirements of the Exchange Act.

The Commission believes that using well-regulated CCPs to clear transactions in CDS would help promote efficiency and reduce risk in the CDS market and among its participants. These benefits could be particularly significant in times of market stress, as CCPs would mitigate the potential for a market participant’s failure to destabilize other market participants, and reduce the effects of misinformation and rumors. CCP-maintained records of CDS transactions would also aid the Commission’s efforts to prevent and detect fraud and other abusive market practices.

A well-regulated CCP also would address concerns about counterparty risk by substituting the creditworthiness and liquidity of the CCP for the creditworthiness and liquidity of the counterparties to a CDS. In the absence of a CCP, participants in the OTC CDS market must carefully manage their counterparty risks because the default by a counterparty can render worthless, and payment delay can reduce the usefulness of, the credit protection that has been bought by a CDS purchaser. CDS participants currently attempt to manage counterparty risk by carefully selecting and monitoring their counterparties, entering into legal agreements that permit them to net gains and losses across contracts with a defaulting counterparty, and often requiring counterparty exposures to be collateralized.¹¹ A CCP could allow participants to avoid these risks specific to individual counterparties because a CCP “novates” bilateral trades by entering

¹¹ See generally R. Bliss and C. Papathanassiou, “Derivatives clearing, central counterparties and novation: The economic implications” (March 8, 2006), at 6. See also “New Developments in Clearing and Settlement Arrangements for OTC Derivatives,” Committee on Payment and Settlement Systems, BIS, at 25 (March 2007), available at <http://www.bis.org/pub/cpss77.pdf>; “Reducing Risks and Improving Oversight in the OTC Credit Derivatives Market,” Before the Sen. Subcomm. On Secs., Ins. and Investments, 110th Cong. (2008) (Statement of Patrick Parkinson, Deputy Director, Division of Research and Statistics, FRB).

into separate contractual arrangements with both counterparties – becoming buyer to one and seller to the other.¹² Through novation, it is the CCP that assumes counterparty risks.

For this reason, a CCP for CDS would contribute generally to the goal of market stability. As part of its risk management, a CCP may subject novated contracts to initial and variation margin requirements and establish a clearing fund. The CCP also may implement a loss-sharing arrangement among its participants to respond to a participant insolvency or default.

A CCP would also reduce CDS risks through multilateral netting of trades.¹³ Trades cleared through a CCP would permit market participants to accept the best bid or offer from a dealer in the OTC market with very brief exposure to the creditworthiness of the dealer. In addition, by allowing netting of positions in similar instruments, and netting of gains and losses across different instruments, a CCP would reduce redundant notional exposures and promote the more efficient use of resources for monitoring and managing CDS positions. Through uniform margining and other risk controls, including controls on market-wide concentrations that cannot be implemented effectively when counterparty risk management is decentralized, a CCP can help prevent a single market participant's failure from destabilizing other market participants and, ultimately, the broader financial system.

In this context, LIFFE Administration and Management (“LIFFE A&M”) and LCH.Clearnet Ltd. (“LCH.Clearnet”) have requested that the Commission grant exemptions

¹² “Novation” is a “process through which the original obligation between a buyer and seller is discharged through the substitution of the CCP as seller to buyer and buyer to seller, creating two new contracts.” Committee on Payment and Settlement Systems, Technical Committee of the International Organization of Securities Commissioners, Recommendations for Central Counterparties (November 2004) at 66.

¹³ See “New Developments in Clearing and Settlement Arrangements for OTC Derivatives,” *supra* note 11, at 25. Multilateral netting of trades would permit multiple counterparties to offset their open transaction exposure through the CCP, spreading credit risk across all participants in the clearing system and more effectively diffusing the risk of a counterparty's default than could be accomplished by bilateral netting alone.

from certain requirements under the Exchange Act with respect to their proposed activities in clearing and settling certain index-based CDS, as well as the proposed activities of certain other persons, as described below.¹⁴

Based on the facts that LIFFE A&M and LCH.Clearnet have presented and the representations they have made,¹⁵ and for the reasons discussed in this Order, the Commission temporarily is exempting, subject to certain conditions, LCH.Clearnet from the requirement to register as a clearing agency under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS transactions. The Commission also temporarily is exempting eligible contract participants and others from certain Exchange Act requirements with respect to non-excluded CDS cleared by LCH.Clearnet. The Commission's exemptions are temporary and will expire on September 25, 2009. To facilitate the operation of one or more CCPs for the CDS market, the Commission has also approved interim final temporary rules providing exemptions under the Securities Act of 1933 and the Exchange Act for non-excluded CDS. Finally, the Commission is providing temporary exemptions in connection with Sections 5 and 6 of the Exchange Act for transactions in non-excluded CDS.¹⁶

¹⁴ See Letter from Arthur W. Hahn, KattenMuchinRosenman LLP, to Florence Harmon, Acting Secretary, Commission, December 24, 2008.

¹⁵ See *id.* The exemptions we are granting today are based on representations made by LIFFE A&M and LCH.Clearnet. We recognize, however, that there could be legal uncertainty in the event that one or more of the underlying representations were to become inaccurate. Accordingly, if any of these exemptions were to become unavailable by reason of an underlying representation no longer being materially accurate, the legal status of existing open positions in non-excluded CDS associated with persons subject to those unavailable exemptions would remain unchanged, but no new positions could be established pursuant to the exemptions until all of the underlying representations were again accurate.

¹⁶ See Securities Exchange Act Release No. 59165 (December 24, 2008).

II. Discussion

A. Description of LIFFE A&M and LCH.Clearnet's Proposal

The exemptive request by LIFFE A&M and LCH.Clearnet describes how their proposed arrangements for central clearing of CDS would operate, and makes representations about the safeguards associated with those arrangements, as described below:

1. LCH Central Counterparty Services for CDS

LIFFE A&M has developed and makes available to its members an OTC derivatives processing service, called Bclear, that will provide a mechanism for the processing and centralized clearing of CDS based on credit default swap indices. The Bclear service processes OTC transactions that are submitted to it by LIFFE A&M members or authorized customers of those members. The Bclear service submits these transactions for clearance to LCH.Clearnet, which stands as the central counterparty to all transactions processed through Bclear.¹⁷ LIFFE A&M will begin processing index CDS through Bclear and would like to make such services available to certain market participants in the U.S. LIFFE A&M represents that the following information regarding index CDS will be available on its Web site (www.nyx.com): (a) contract specifications for index CDS that may be processed and cleared through the Bclear Service, and (b) a description of the Bclear Service and rules applicable thereto.

¹⁷ Bclear provides a means by which counterparties to an index CDS may negotiate a transaction on a bilateral basis and then submit the transaction for processing and clearance by LCH.Clearnet. Bclear accepts only completed transactions and is not a matching system for counterparties.

LCH.Clearnet provides CCP services to the following markets and services: London Stock Exchange, SWX Europe Ltd., LIFFE, EDX London, London Metal Exchange, other European Multilateral Trading Facilities (“MTF”), and RepoClear and SwapClear.¹⁸

LIFFE A&M has been granted recognition as a Recognised Investment Exchange under the United Kingdom (“U.K.”) Financial Services and Markets Act 2000 (“FSMA”) by the Financial Services Authority (“FSA”). LCH.Clearnet has been granted recognition as a Recognized Clearing House (“RCH”) under FSMA by the FSA.¹⁹ Regulation and oversight in the U.K. is carried out by the FSA and the Bank of England. The FSA is the main regulator of LCH.Clearnet as an RCH, while the Bank of England’s oversight is confined to LCH.Clearnet’s payment system.²⁰

The FSA has a regulatory supervision relationship with LIFFE A&M and with LCH.Clearnet. On an annual basis, the FSA undertakes a risk assessment of LIFFE A&M and LCH.Clearnet pursuant to which the FSA determines whether relevant regulatory obligations

¹⁸ LCH.Clearnet publishes its rules and procedures for the various markets cleared, together with information on risk management, application costs and procedures, minimum contributions towards and interest rates on the default fund, and transactions tariffs.

¹⁹ LCH.Clearnet has been approved as a Derivatives Clearing Organization (“DCO”) by the CFTC. In addition, FSA and the Bank of England performed a risk assessment of LCH in June 2006 against the Recommendations for Central Counterparties (“RCCP”), which was drafted by a joint task force composed of representative members of the International Organization of Securities Commissions (“IOSCO”) and Committee on Payment and Settlement Systems (“CPSS”) and published in November 2004.

The Task Force consisted of securities regulators and central bankers from 19 countries and the European Union. The U.S. representatives on the Task Force included staff from the Commission, FRB, and the CFTC. The complete RCCP Report is available on the Web sites of the Bank for International Settlements and the International Organization of Securities Commission at, <http://www.bis.org/publ/cpss64.htm>, and at <http://www.iosco.org>, respectively. LCH.Clearnet has assured the Commission that it is in full compliance with the Recommendations for Central Counterparties. The assessment can be found at <http://www.fsa.gov.uk/pubs/other/lchclearnet.pdf>.

²⁰ LCH.Clearnet is owned 73.3 percent by users, 10.9 percent by exchanges, and 15.8 percent by Euroclear. Euroclear is a user-owned, user-governed Brussels, Belgium-based financial services company that specializes in the settlement of securities transactions.

continue to be met and whether the activities of either LIFFE A&M or LCH.Clearnet pose any risks to the FSA's statutory objectives, including maintaining market confidence and providing customer protection. The FSA approves the business continuity plans of LCH.Clearnet.

2. CCP Role of LCH.Clearnet in Connection with LIFFE A&M

LIFFE A&M has two categories of members, clearing members and non-clearing members. LIFFE A&M further has two types of clearing members: Individual Clearing Members that clear and settle business for their own account or, in the case of broker-dealers, on behalf of their customers; and General Clearing Members that, in addition, clear and settle business on behalf of other LIFFE A&M members. All transactions of non-clearing members must be cleared through a specific clearing member. All clearing members must also be members of LCH.Clearnet and all are subject to standards of capital adequacy (set by LCH.Clearnet as well as by their respective regulators). Clearing members must also satisfy LIFFE A&M and LCH.Clearnet that they have adequate systems and controls to clear and settle transactions.

The rules of LIFFE A&M provide for members to trade for their own account and/or for their customers, but all transactions must be in the name of the member effecting the trade and that member will be the counterparty for those transactions. Thus, a LIFFE A&M member will be considered to be "acting as principal." This means that a transaction on LIFFE A&M automatically generates a sequence of matching contracts. For example, a sequence could be between a customer and a LIFFE A&M member, between that member and a clearing member, and between the clearing member and LCH.Clearnet.

The purpose of the LIFFE A&M rules is to ensure that a party to a transaction need only look to its immediate counterparty for performance and need not concern itself with parties at

other points on the contractual chain. Thus, LCH.Clearnet need only look to its clearing members and would have no contractual relationship with, or knowledge of, the non-clearing members of LIFFE A&M or customers on whose behalf the transaction was executed.

Hence, LCH.Clearnet is the CCP to clearing firms each acting as principal in respect of index CDS. Non-clearing members and non-member customers are not party to any contracts registered by clearing members with LCH.Clearnet. Once an index CDS contract has been accepted by LIFFE A&M, a chain of linked contracts is created, all having the same terms. Specifically, the process by which the chain of linked contracts is created is as follows:

a. When a non-member customer enters into an index CDS with or through a non-clearing member, the non-clearing member submits the contract to Bclear. Once LIFFE A&M has accepted the contract, an exchange contract²¹ is created between the non-clearing member, as principal, and its customer. If another customer was originally a counterparty to the index CDS, an exchange contract is created between the non-clearing member, as principal, and the second customer. The contracts are referred to as “customer contracts.” The customer contracts replace the initial index CDS, which ceases to exist at that point.

b. Simultaneously, a matching contract between the non-clearing member and its clearing member, called a “parallel contract,” comes into existence for each of the customer contracts.

c. If the counterparty to the trade is a customer of another non-clearing member, a “related contract” is created between the respective clearing members. The related contract is presented to LCH.Clearnet for registration. If there is a single non-clearing member involved in the transaction, the parallel contracts are presented to LCH.Clearnet for registration.

²¹ An “exchange contract” refers to a contract that is subject to the rules of LIFFE A&M. The term does not indicate that a central order book exists for a product.

d. The related contract is replaced by contracts between LCH.Clearnet and the clearing member on each side of the transaction.

Through this process, the index CDS is discharged and a set of on-exchange contracts arise imposing equivalent obligations on and granting equivalent rights to the original parties to the index CDS, but with LCH.Clearnet as the CCP. Because the non-member customer will not be a party to a contract registered with LCH.Clearnet by the clearing member, the relationship between the non-member customer and the non-clearing member will remain intact, although such relationship will now be based upon the exchange contract, rather than the index CDS originally entered into by the respective parties.

3. LCH Risk Management

LCH.Clearnet requires the posting of initial margin and maintenance (“variation”) margin for all clearing accounts. The initial margin and maintenance margin is determined utilizing the London SPAN (Standard Portfolio Analysis of Risk) methodology. London SPAN was adapted from the Chicago Mercantile Exchange’s margining system.

The initial margin requirement for a member’s CDS portfolio is the largest loss identified under these various market conditions that might reasonably occur taking into account risk offsets within the CDS portfolio. Initial margin is refunded when the margined index CDS position is closed. This risk management methodology is designed to protect LCH.Clearnet against the worst likely loss from one or two days’ move in the market.

Net Liquidation Value (“NLV”), the value of a member’s portfolio at closing market prices representing the income or expenditure which would be associated with closing out an index CDS position, is added to initial margin to give the total margin requirement.

LCH.Clearnet revalues the margin positions of its members on at least a daily basis to account for changes or volatility in the market price of the underlying index and in LCH.Clearnet's valuation of margin collateral provided in the form of securities. During the day, LCH.Clearnet monitors market prices and clearing members' positions and may call for additional margin payments from members. LCH.Clearnet then revalues each member's margin requirements each night.²²

LCH.Clearnet's margin requirements are only applicable to clearing members. All clearing members must provide LCH.Clearnet with enough margin to cover the risk on their total net positions for each account they clear. Clearing members and/or non-clearing members in turn set the margin requirements applicable to their customers.

4. Margin Collateral

LCH.Clearnet accepts a wide variety of collateral types from clearing members in meeting their initial and NLV margin payments. Members may meet their margin requirements by cash payments in the following currencies: sterling, U.S. dollars, yen, Swiss francs, and euros. In addition, LCH.Clearnet will accept an extensive range of collateral including approved bank

²² While LCH.Clearnet's margin requirements are central to its risk management, LCH.Clearnet also has other measures at its disposal, including:

1. additional financial resource requirements (buffers);
2. additional initial margin requirements;
3. imposition of position limits;
4. trading for liquidation only;
5. prior authorization of trades above a certain size; and
6. issuing instructions to reduce positions.

LCH.Clearnet also monitors large cumulative profits or losses. If large and unusual trading activity is detected (relative to previous exposures), LCH.Clearnet will contact compliance officers and seek assurances from the senior executives or boards of a member firm or parent company.

guarantees, certain U.K. treasury bills, U.K. gilts, sterling, U.S. dollar certificates of deposit, German, Italian, and Spanish government bonds and U.K. equities.

To avoid frequent margin payments, clearing members may deposit margin in excess of the LCH.Clearnet required minimum. In such cases, LCH.Clearnet pays interest to clearing members on excess cash margin on deposit currently at the overnight London Inter-Bank Bid Rate (“LIBID”) minus twenty-five basis points.

5. Member Default

If a clearing member appears to LCH.Clearnet to be unable, or likely to become unable, to meet its obligations to LCH.Clearnet, it may be declared by LCH.Clearnet in default under LCH.Clearnet’s default rules in relation to the contracts registered by it with LCH.Clearnet. Where a clearing member has been declared in default by LCH.Clearnet, contracts between such clearing member and its non-clearing members and clients will be dealt with under LIFFE A&M’s default rules. A default by a non-clearing member will also be dealt with under LIFFE A&M’s default rules. Where the defaulting party is an LCH.Clearnet clearing member, LCH.Clearnet’s default rules take primacy over LIFFE A&M’s, although all actions in such circumstances are typically coordinated between LCH.Clearnet and LIFFE A&M to take advantage of statutory protections afforded to LCH.Clearnet as an RCH.

As the legal counterparty to each clearing member, LCH.Clearnet bears any loss arising from the default of a clearing member, beyond the margin deposits held as security in respect of the defaulting member’s liabilities. LCH.Clearnet’s supplementary resources for use in default cases, should a member’s margin deposits prove insufficient, comprise a Default Fund, totaling approximately £600 million, which is provided by members and held in cash by LCH. Each member’s Default Fund contribution is assessed every three months on the basis of that

member's initial margin and (in the case of exchange traded derivatives) trading volumes over the preceding three months.

The Default Fund is "mutualized" in that any loss faced by LCH.Clearnet as a result of a default which cannot be met from the defaulter's margin on deposit at LCH.Clearnet or from its contribution to the Default Fund will be met by the Default Fund generally. Customers of a defaulting clearing member have no contractual relationship with LCH.Clearnet, but are protected to the extent of their client agreement with the defaulting member and any segregation arrangements in place with the defaulting member.²³

LCH.Clearnet uses a stress testing model to ensure that its post-default financial backing is sufficient. The stress testing model assesses the adequacy of initial margin requirements and the Default Fund on the basis of extreme price movement scenarios in all contracts cleared by LCH.

The sequence of protections to be applied in the event of a default is as follows:²⁴

- a. Defaulting Member's Initial Margin (including excess collateral posted).
- b. Defaulting Member's Default Fund Contribution.
- c. Up to £20 million of LCH.Clearnet's capital and reserves.
- d. Remainder of the Default Fund.
- e. Remainder of LCH.Clearnet's capital and reserves.

As the counterparty to every clearing member, LCH.Clearnet reduces the scope of counterparty risk between clearing members. LCH.Clearnet is legally responsible for the financial performance of the contracts that it has registered and any resulting delivery

²³ LCH is not a counterparty to contracts that clearing members have with their customers.

²⁴ The sequence does not take into account the anticipated replenishment of the Default Fund by market members and/or national governments between steps d. and e.

obligations. LCH.Clearnet represents that its rules and procedures are available on its Web site and such rules and procedures generally set forth the sequence of protections to be applied in the event of a default by a clearing member.

6. Client Money Rules and Other Member Requirements

Clearing members that undertake business for clients are subject to UK client money and client asset rules or, if they are authorized outside the UK, similar rules of their relevant regulator. In the European Union, the client money rules are governed by the Markets in Financial Instruments Directive, although the UK client money rules prescribe some extended conditions in certain cases. Clearing members may have two accounts with LCH.Clearnet, one for segregated customer business and one for all house and non-segregated client business, and neither LCH.Clearnet nor the clearing member can offset liabilities on the house margin account with credits arising on the client margin account. Clearing members are required to segregate customer funds and securities except in instances where the investor, if permitted to do so, contracts out of the segregation requirement.

LIFFE A&M represents that it only considers for membership entities located in jurisdictions with regulatory arrangements it deems satisfactory regarding: (i) supervision of investment activity; (ii) information sharing and cooperation between the supervisory authority of the jurisdiction concerned and LIFFE A&M and/or the FSA; and (iii) capital adequacy, liquidity, and segregation of customers' funds and securities (and related books and records provisions). LIFFE A&M further represents that before offering Index CDS services to U.S. persons, LIFFE A&M will adopt a requirement that will prohibit a member from directly or indirectly submitting, or permitting an authorized customer to submit, an Index CDS to the Bclear service when the member receives or holds funds or securities of U.S. persons for the

purpose of purchasing, selling, clearing, settling, or holding that Index CDS position, unless the member, in connection with such Index CDS activities, is regulated by: (i) a signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, (ii) a signatory to a bilateral arrangement with the Commission for enforcement cooperation, or (iii) a financial regulatory authority in Ireland or Sweden. In that regard, LIFFE A&M states that it intends to launch the Index CDS service for non-U.S. persons on December 22, 2008. LIFFE A&M will notify members at that time that the service may not be offered to U.S. persons until LIFFE A&M issues an additional notice.

In addition, LCH.Clearnet represents that its rules require its clearing members to: (i) meet specific capital adequacy standards that vary depending on the type of activities undertaken by the member; (ii) provide copies of audited annual financial statements to LCH.Clearnet; and (iii) notify LCH.Clearnet upon the happening of certain material events, such as significant reductions in shareholders' funds or net capital.

B. Temporary Conditional Exemption from Clearing Agency Registration Requirement

Section 17A of the Exchange Act sets forth the framework for the regulation and operation of the U.S. clearance and settlement system, including CCPs. Specifically, Section 17A directs the Commission to use its authority to promote enumerated Congressional objectives and to facilitate the development of a national clearance and settlement system for securities transactions. Absent an exemption, a CCP that novates trades of non-excluded CDS that are securities and generates money and settlement obligations for participants is required to register with the Commission as a clearing agency.

Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons,

securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.²⁵

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant an exemption until September 25, 2009 to LCH.Clearnet from Section 17A of the Exchange Act, solely to perform the functions of a clearing agency for Cleared Index CDS,²⁶ subject to the conditions discussed below.

Our action today balances the aim of facilitating the prompt establishment of LCH.Clearnet as a CCP for non-excluded CDS transactions – which should help reduce systemic risks during a period of extreme turmoil in the U.S. and global financial markets – with ensuring that important elements of Commission oversight are applied to the non-excluded CDS market. In doing so, we are mindful that applying the full scope of the Exchange Act to transactions involving non-excluded CDS could deter the prompt establishment of LCH.Clearnet as a CCP to settle those transactions.

²⁵ 15 U.S.C. 78mm.

²⁶ For purposes of this exemption, and the other exemptions addressed in this Order, “Cleared Index CDS” means a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to LCH.Clearnet, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which the reference index is an index in which 80 percent or more of the index’s weighting is comprised of the following entities or securities: (i) an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available; (ii) a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States; (iii) a foreign sovereign debt security; (iv) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or (v) an asset-backed security issued or guaranteed by the Fannie Mae, Freddie Mac, or the Government National Mortgage Association (“Ginnie Mae”). As discussed above, the Commission’s action today does not affect CDS that are swap agreements under Section 206A of the Gramm-Leach-Bliley Act. See text at note 10, supra.

While we are acting so that the prompt establishment of LCH.Clearnet as a CCP for non-excluded CDS will not be delayed by the need to apply the full scope of Exchange Act Section 17A's requirements that govern clearing agencies, the relief we are providing is temporary and conditional. The limited duration of the exemptions will permit the Commission to gain more direct experience with the non-excluded CDS market after LCH.Clearnet becomes operational, giving the Commission the ability to oversee the development of the centrally cleared non-excluded CDS market as it evolves. During the exemptive period, the Commission will closely monitor the impact of the CCPs on the CDS market. In particular, the Commission will seek to assure itself that the CCPs do not act in anticompetitive manner or indirectly facilitate anticompetitive behavior with respect to fees charged to members, the dissemination of market data and the access to clearing services by independent CDS exchanges or CDS trading platforms. The Commission will take that experience into account in future actions.

Moreover, this temporary exemption in part is based on LCH.Clearnet's representation that it meets the standards set forth in the RCCP.²⁷ The RCCP establishes a framework that requires a CCP to have: (i) the ability to facilitate the prompt and accurate clearance and settlement of CDS transactions and to safeguard its users' assets; and (ii) sound risk management, including the ability to appropriately determine and collect clearing fund and monitor its users' trading. This framework is generally consistent with the requirements of Section 17A of the Exchange Act.

In addition, this Order is designed to assure that – as LCH.Clearnet and LIFFE A&M have represented – information will be available to market participants about the terms of the CDS cleared by LCH.Clearnet, the creditworthiness of LCH.Clearnet or any guarantor, and the

²⁷ See note 19, *supra*.

clearing and settlement process for the CDS. Moreover, to be within the definition of Cleared Index CDS for purposes of this exemption (as well as the other exemptions granted through this Order), at least 80 percent of the weighting of the index must be comprised of reference entities or reference securities that satisfy certain conditions relating to the availability of information about such persons or securities. The definition does not prescribe the type of financial information that must be available nor the location of the particular information, recognizing that eligible contract participants have access to information about reference entities and reference securities through multiple sources. The Commission believes, however, that it is important in the CDS market, as in the market for securities generally, that parties to transactions should have access to financial information that would allow them to appropriately evaluate the risks relating to a particular investment and make more informed investment decisions.²⁸ Such information availability also will assist LCH.Clearnet and the buyers and sellers in valuing their Cleared Index CDS and their counterparty exposures. As a result of the Commission's actions today, the Commission believes that information should be available for market participants to be able to make informed investment decisions, and value and evaluate their Cleared Index CDS and their counterparty exposures.

This temporary exemption is subject to a number of conditions that are designed to enable Commission staff to monitor LCH.Clearnet's clearance and settlement of CDS transactions, coordinate and cooperate with the FSA, and help reduce risk in the CDS market. These conditions require that LCH.Clearnet: (i) make available on its Web site annual audited

²⁸ The Commission notes the recommendations of the President's Working Group on Financial Markets regarding the informational needs and due diligence responsibilities of investors. See Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets, March 13, 2008, available at: http://www.treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf.

financial statements; (ii) preserve records related to the conduct of its Cleared Index CDS clearance and settlement services for at least five years (in an easily accessible place for the first two years); (iii) supply information relating to its Cleared Index CDS clearance and settlement services to the Commission; (iv) provide access to the Commission to conduct on-site inspections of facilities, records and personnel related to its Cleared Index CDS clearance and settlement services, subject to coordination with FSA and upon terms and conditions agreed between the FSA and the Commission; (v) notify the Commission about material disciplinary actions taken against users of its Cleared Index CDS clearance and settlement services, and about the involuntary termination of the membership of an entity using those services; (vi) provide the Commission with prior notice of changes to its Default Rules and Default Fund Rules; (vii) provide the Commission with reports with respect to certain automated systems used in connection with its Cleared Index CDS clearance and settlement services, and with annual audited financial statements;²⁹ and (viii) provide notice to the Commission regarding the suspension of services or the inability to operate facilities in connection with its Cleared Index CDS clearance and settlement services.

In addition, this relief is conditioned on LCH.Clearnet, directly or indirectly, making available to the public on terms that are fair and reasonable and not unreasonably discriminatory:

(i) all end-of-day settlement prices and any other prices with respect to Cleared Index CDS that LCH.Clearnet may establish to calculate mark-to market margin requirements for LCH.Clearnet

²⁹ As a condition of LCH.Clearnet's exemption, LIFFE A&M has agreed to provide the Commission with reports with respect to certain automated systems used in connection with LCH.Clearnet's Cleared Index CDS clearance and settlement services. These reports will be generated in accordance with risk assessments of the areas set forth in the Commission's Automation Review Policy Statements ("ARPs"). See Automated Systems of Self-Regulatory Organization, Securities Exchange Act Release No. 27445 (November 16, 1989), 54 FR 48703 (November 24, 1989), and Automated Systems of Self-Regulatory Organization (II), Securities Exchange Act Release No. 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991).

or LIFFE A&M participants; and (ii) any other pricing or valuation information with respect to Cleared Index CDS as is published or distributed by LCH.Clearnet or LIFFE A&M. The Commission believes this is an appropriate condition for LCH.Clearnet's exemption from registration as a clearing agency. In Section 11A of the Exchange Act, Congress included a finding that "[i]t is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . . the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities."³⁰ The President's Working Group on Financial Markets has stated that increased transparency is a policy objective for the over-the-counter derivatives market,³¹ which includes the market for CDS. This condition is designed to further this policy objective of both Congress and the President's Working Group by requiring LCH.Clearnet and LIFFE A&M to make available to the public on terms that are fair and reasonable all end-of-day settlement prices and any other prices with respect to Cleared Index CDS that LCH.Clearnet may establish to calculate mark-to-market margin requirements for LCH.Clearnet or LIFFE A&M Participants. In addition, LCH.Clearnet or LIFFE A&M must make available to the public on terms that are fair and reasonable and not unfairly discriminatory any other pricing or valuation information with respect to Cleared Index CDS as is published or distributed by LCH.Clearnet or LIFFE A&M.

As a CCP, LCH.Clearnet will collect and process information about CDS transactions and positions from all of its participants. With this information, a CCP will, among other things, calculate and disseminate current values for open positions for the purpose of setting appropriate

³⁰ 15 U.S.C. 78k-1(a)(1)(C)(iii). See also 15 U.S.C. 78k-1(a)(1)(D).

³¹ See President's Working Group on Financial Markets, Policy Objectives for the OTC Derivatives Market (November 14, 2008), <http://www.ustreas.gov/press/releases/reports/policyobjectives.pdf> ("Public reporting of prices, trading volumes and aggregate open interest should be required to increase market transparency for participants and the public.").

margin levels, or have an agent perform these functions on its behalf. The availability of such information can improve fairness, efficiency, and competitiveness of the market – all of which enhance investor protection and facilitate capital formation. Moreover, with pricing and valuation information relating to Cleared Index CDS, market participants would be able to derive information about underlying securities and indexes. This may improve the efficiency and effectiveness of the securities markets by allowing investors to better understand credit conditions generally.

C. Temporary General Exemption for LCH.Clearnet, LIFFE A&M and Certain Eligible Contract Participants

Applying the full panoply of Exchange Act requirements to participants in transactions in non-excluded CDS likely would deter some participants from using CCPs to clear CDS transactions. At the same time, it is important that the antifraud provisions of the Exchange Act apply to transactions in non-excluded CDS; indeed, OTC transactions subject to individual negotiation that qualify as security-based swap agreements already are subject to these antifraud provisions.³²

³² While Section 3A of the Exchange Act excludes “swap agreements” from the definition of “security,” certain antifraud and insider trading provisions under the Exchange Act explicitly apply to security-based swap agreements. See (a) paragraphs (2) through (5) of Section 9(a), 15 U.S.C. 78i(a), prohibiting the manipulation of security prices; (b) Section 10(b), 15 U.S.C. 78j(b), and underlying rules prohibiting fraud, manipulation or insider trading (but not prophylactic reporting or recordkeeping requirements); (c) Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices; (d) Sections 16(a) and (b), 15 U.S.C. 78p(a) and (b), which address disclosure by directors, officers and principal stockholders, and short-swing trading by those persons, and rules with respect to reporting requirements under Section 16(a); (e) Section 20(d), 15 U.S.C. 78t(d), providing for antifraud liability in connection with certain derivative transactions; and (f) Section 21A(a)(1), 15 U.S.C. 78u-1(a)(1), related to the Commission’s authority to impose civil penalties for insider trading violations.

“Security-based swap agreement” is defined in Section 206B of the Gramm-Leach-Bliley Act as a swap agreement in which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

We thus believe that it is appropriate in the public interest and consistent with the protection of investors temporarily to apply substantially the same framework to transactions by market participants in non-excluded CDS that applies to transactions in security-based swap agreements. Applying substantially the same set of requirements to participants in transactions in non-excluded CDS as apply to participants in OTC CDS transactions will avoid deterring market participants from promptly using CCPs, which would detract from the potential benefits of central clearing.

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant an exemption until September 25, 2009 from certain requirements under the Exchange Act. This temporary exemption applies to LCH.Clearnet and LIFFE A&M, and also to certain eligible contract participants³³ other than: eligible contract participants that receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling or holding Cleared Index CDS positions for other persons;³⁴ eligible contract participants that are

³³ This exemption in general applies to eligible contract participants, as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order, other than persons that are eligible contract participants under paragraph (C) of that section.

³⁴ For these purposes, and for the purpose of the definition of “Cleared Index CDS,” the terms “purchasing” and “selling” mean the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under, a Cleared Index CDS, as the context may require. This is consistent with the meaning of the terms “purchase” or “sale” under the Exchange Act in the context of security-based swap agreements. See Exchange Act Section 3A(b)(4).

A separate temporary conditional exemption addresses members of LIFFE A&M that hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared Index CDS positions for other persons. See Part II.D, infra.

self-regulatory organizations; or eligible contract participants that are registered brokers or dealers.³⁵

Under this temporary exemption, and solely with respect to Cleared Index CDS, these persons generally are exempt from provisions of the Exchange Act and the rules and regulations thereunder that do not apply to security-based swap agreements. Those persons thus would still be subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements.³⁶ In addition, all provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions would remain applicable.³⁷ In this way, the temporary exemption would apply the same Exchange Act requirements in connection with non-excluded CDS as apply in connection with OTC credit default swaps.

This temporary exemption, however, does not extend to Sections 5 and 6 of the Exchange Act. The Commission separately is issuing a conditional exemption from these provisions to all broker-dealers and exchanges.³⁸ This temporary exemption also does not extend to Section 17A of the Exchange Act; instead, LCH.Clearnet is exempt from registration as a clearing agency under the conditions discussed above. In addition, this exemption does not apply to Exchange

³⁵ A separate temporary exemption addresses the Cleared Index CDS activities of registered broker-dealers. See Part II.E, infra.

³⁶ See note 32, supra.

³⁷ Thus, for example, the Commission retains the ability to investigate potential violations and bring enforcement actions in the federal courts and administrative proceedings, and to seek the full panoply of remedies available in such cases.

³⁸ See note 16, supra. A national securities exchange that effects transactions in Cleared Index CDS would continue to be required to comply with all requirements under the Exchange Act applicable to such transactions. A national securities exchange could form subsidiaries or affiliates that operate exchanges exempt under that order. Any subsidiary or affiliate of a registered exchange could not integrate, or otherwise link, the exempt CDS exchange with the registered exchange including the premises or property of such exchange for effecting or reporting a transaction without being considered a "facility of the exchange." See Section 3(a)(2), 15 U.S.C. 78c(a)(2).

Act Sections 12, 13, 14, 15(d) and 16;³⁹ eligible contract participants and other persons instead should refer to the interim final temporary rules issued today by the Commission. Finally, this temporary exemption does not extend to the Commission’s administrative proceeding authority under Sections 15(b)(4) and (b)(6),⁴⁰ or to certain provisions related to government securities.⁴¹

D. Conditional Temporary General Exemption for Certain Clearing Members of LIFFE

A&M and LCH.Clearnet

Absent an exception, persons that effect transactions in non-excluded CDS that are securities may be required to register as broker-dealers pursuant to Section 15(a)(1) of the Exchange Act.⁴² Moreover, certain reporting and other requirements of the Exchange Act could

³⁹ 15 U.S.C. 78l, 78m, 78n, 78o(d), 78p.

⁴⁰ Exchange Act Sections 15(b)(4) and 15(b)(6), 15 U.S.C. 78o(b)(4) and (b)(6), grant the Commission authority to take action against broker-dealers and associated persons in certain situations. Accordingly, while this exemption generally extends to persons that act as inter-dealer brokers in the market for Cleared Index CDS and do not hold funds or securities for others, such inter-dealer brokers may be subject to actions under Sections 15(b)(4) and (b)(6) of the Exchange Act.

In addition, such inter-dealer brokers may be subject to actions under Exchange Act Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices. As noted above, Section 15(c)(1) explicitly applies to security-based swap agreements. Sections 15(b)(4), 15(b)(6) and 15(c)(1), of course, would not apply to persons subject to this exemption who do not act as broker-dealers or associated persons of broker-dealers.

⁴¹ This exemption specifically does not extend to the Exchange Act provisions applicable to government securities, as set forth in Section 15C, 15 U.S.C. 78o-5, and its underlying rules and regulations; nor does the exemption extend to related definitions found at paragraphs (42) through (45) of Section 3(a), 15 U.S.C. 78c(a). The Commission does not have authority under Section 36 to issue exemptions in connection with those provisions. See Exchange Act Section 36(b), 15 U.S.C. 78mm(b).

⁴² 15 U.S.C. 78o(a)(1). This section generally provides that, absent an exception or exemption, a broker or dealer that uses the mails or any means of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, any security must register with the Commission.

Section 3(a)(4) of the Exchange Act generally defines a “broker” as “any person engaged in the business of effecting transactions in securities for the account of others,” but provides 11 exceptions for certain bank securities activities. 15 U.S.C. 78c(a)(4). Section 3(a)(5) of the Exchange Act generally defines a “dealer” as “any person engaged in the business of buying and selling securities for his own account,” but includes exceptions for certain bank activities. 15 U.S.C. 78c(a)(5). Exchange Act Section 3(a)(6) defines a “bank” as a bank or savings association that is directly supervised and examined by state or federal banking authorities (with certain additional requirements for banks and savings associations

apply to such persons, as broker-dealers, regardless of whether they are registered with the Commission.

It is consistent with our investor protection mandate to require that intermediaries in securities transactions that receive or hold funds and securities on behalf of others comply with standards that safeguard the interests of their customers. For example, registered broker-dealers are required to segregate assets held on behalf of customers from proprietary assets, because segregation will assist customers in recovering assets in the event the intermediary fails. To the extent that funds and securities are not segregated, they could be used by a participant to fund its own business and could be attached to satisfy debts of the participant were the participant to fail. Moreover, the maintenance of adequate capital and liquidity protects customers, CCPs and other market participants. Adequate books and records (including both transactional and position records) are necessary to facilitate day to day operations as well as to help resolve situations in which a participant fails and either a regulatory authority or receiver is forced to liquidate the firm. Appropriate records also are necessary to allow examiners to review for improper activities, such as insider trading or fraud.

At the same time, requiring intermediaries that receive or hold funds and securities on behalf of customers in connection with transactions in non-excluded CDS to register as broker-dealers may deter the use of CCPs in CDS transactions, to the detriment of the markets and market participants generally. Also, as noted above with regard to other eligible contract participants to non-excluded CDS transactions, immediately applying the panoply of Exchange Act requirements to centrally cleared transactions may deter the use of CCPs for CDS transactions.

that are not chartered by a federal authority or a member of the Federal Reserve System). 15 U.S.C. 78c(a)(6).

Those factors argue in favor of flexibility in applying the requirements of the Exchange Act to these intermediaries. Along with those factors, in granting an exemption here we are particularly relying on the representation of LIFFE A&M that it only considers for membership entities located in jurisdictions with regulatory arrangements it deems satisfactory regarding: (i) supervision of investment activity; (ii) information sharing and cooperation between the supervisory authority of the jurisdiction concerned and LIFFE A&M and/or the FSA; and (iii) capital adequacy, liquidity, and segregation of customers' funds and securities (and related books and records provisions). We also are particularly relying on the representation of LCH.Clearnet that its rules require its clearing members to: (i) meet specific capital adequacy standards that vary depending on the type of activities undertaken by the member; (ii) provide copies of audited annual financial statements to LCH.Clearnet; and (iii) notify LCH.Clearnet upon the happening of certain material events, such as significant reductions in shareholders' funds or net capital.

We further are relying on LIFFE A&M's representation that before offering Index CDS services to U.S. persons,⁴³ LIFFE A&M will adopt a requirement that will prohibit a member from directly or indirectly submitting, or permitting an authorized customer to submit, an Index CDS to the Bclear service when the member receives or holds funds or securities of U.S. persons for the purpose of purchasing, selling, clearing, settling, or holding that Index CDS position, unless the member, in connection with such Index CDS activities, is regulated by: (i) a signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, (ii) a signatory to a bilateral arrangement with the Commission for enforcement cooperation, or (iii) a financial regulatory authority in Ireland or

⁴³ As noted above, LIFFE A&M states that it intends to launch the Index CDS service for non-U.S. persons on December 22, 2008. LIFFE A&M will notify members at that time that that the service may not be offered to U.S. persons until LIFFE A&M issues an additional notice.

Sweden.⁴⁴ This will help ensure that the Commission can access trading records and other information of LIFFE A&M members as needed to enforce the federal securities laws.

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant a conditional exemption until September 25, 2009 from certain Exchange Act requirements. In general, we are providing a temporary exemption, subject to the conditions discussed below, to any member of LIFFE A&M that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling or holding Cleared Index CDS positions for other persons. Solely with respect to Cleared Index CDS, those members generally will be exempt from those provisions of the Exchange Act and the underlying rules and regulations that do not apply to security-based swap agreements.⁴⁵

As with the exemption discussed above that is applicable to LCH.Clearnet, LIFFE A&M and certain eligible contract participants, and for the same reasons, this exemption for LIFFE A&M members that receive or hold funds and securities does not extend to Exchange Act provisions that explicitly apply in connection with security-based swap agreements,⁴⁶ or to related enforcement authority provisions.⁴⁷ As with the exemption discussed above, we also are

⁴⁴ The Commission has established informal relationships with securities authorities in Ireland and Sweden and cooperates with them on an ad hoc basis. The Commission will explore entering into arrangements for cooperation with these authorities and, in the near term, will seek letters of intent to cooperate.

⁴⁵ This exemption will be available both to clearing members and to non-clearing members of LIFFE A&M that hold funds and securities on behalf of others in connection with transactions in Cleared Index CDS.

⁴⁶ See note 32, supra.

⁴⁷ See note 37, supra.

not exempting those members from Sections 5, 6, 12(a) and (g), 13, 14, 15(b)(4), 15(b)(6), 15(d), 16 and 17A of the Exchange Act.⁴⁸

This temporary exemption is subject to the member complying with conditions that are important for protecting customer funds and securities. Particularly, the member must be in material compliance with the rules of LIFFE A&M and, if it is a clearing member, with the rules of LCH.Clearnet, and applicable laws and regulations, relating to capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to non-excluded CDS.⁴⁹ Also, to the extent that the member receives or holds funds or securities of U.S. eligible contract participants for the purpose of purchasing, selling, clearing, settling or holding non-excluded CDS positions for those persons, this exemption is predicated on the member satisfying the following three conditions: (i) the U.S. persons cannot be natural persons; (ii) the member must segregate such funds and securities of such U.S. persons from the member's own assets (i.e., the member may not permit U.S. persons to "opt out" of applicable segregation requirements for such funds and securities even if regulations or laws would permit the person to "opt out"); and (iii) the member shall disclose to such U.S. persons that the member is not regulated by the Commission and that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the member.

⁴⁸ Nor are we exempting those members from provisions related to government securities, as discussed above.

⁴⁹ A member would not be "in material compliance" if it failed in any way to segregate customer funds and securities consistent with these rules, laws and regulations. In that circumstance, the member could not rely on this exemption.

E. Temporary General Exemption for Certain Registered Broker-Dealers

The temporary exemptions addressed above – with regard (i) to LCH.Clearnet, LIFFE A&M and certain eligible contract participants and (ii) to LIFFE A&M members that receive or hold funds and securities of others – are not available to persons that are registered as broker-dealers with the Commission (other than those that are notice registered pursuant to Section 15(b)(11)).⁵⁰ The Exchange Act and its underlying rules and regulations require broker-dealers to comply with a number of obligations that are important to protecting investors and promoting market integrity. We are mindful of the need to avoid creating disincentives to the prompt use of CCPs, and we recognize that the factors discussed above suggest that the full panoply of Exchange Act requirements should not immediately be applied to registered broker-dealers that engage in transactions involving Cleared Index CDS. At the same time, we also are sensitive to the critical importance of certain broker-dealer requirements to promoting market integrity and protecting customers (including those broker-dealer customers that are not involved with CDS transactions).

This calls for balancing the facilitation of the development and prompt implementation of CCPs with the preservation of certain key investor protections. Pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant an exemption until September 25, 2009 from certain Exchange Act requirements. Consistent with the temporary exemptions discussed above, and solely with respect to Cleared Index CDS, we are exempting registered broker-dealers in general from provisions of the Exchange Act and its underlying rules and regulations that do not apply to security-based swap agreements. As

⁵⁰ Exchange Act Section 15(b)(11) provides for notice registration of certain persons that effect transactions in security futures products. 15 U.S.C. 78o(b)(11).

above, we are not excluding registered broker-dealers from Exchange Act provisions that explicitly apply in connection with security-based swap agreements or from related enforcement authority provisions.⁵¹ As above, and for similar reasons, we are not exempting registered broker-dealers from: Sections 5, 6, 12(a) and (g), 13, 14, 15(b)(4), 15(b)(6), 15(d), 16 and 17A of the Exchange Act.⁵²

Further we are not exempting registered broker-dealers from the following additional provisions under the Exchange Act: (1) Section 7(c),⁵³ which addresses the unlawful extension of credit by broker-dealers; (2) Section 15(c)(3),⁵⁴ which addresses the use of unlawful or manipulative devices by broker-dealers; (3) Section 17(a),⁵⁵ regarding broker-dealer obligations to make, keep and furnish information; (4) Section 17(b),⁵⁶ regarding broker-dealer records subject to examination; (5) Regulation T⁵⁷, a Federal Reserve Board regulation regarding extension of credit by broker-dealers; (6) Exchange Act Rule 15c3-1, regarding broker-dealer net capital; (7) Exchange Act Rule 15c3-3, regarding broker-dealer reserves and custody of securities; (8) Exchange Act Rules 17a-3 through 17a-5, regarding records to be made and preserved by broker-dealers and reports to be made by broker-dealers; and (9) Exchange Act Rule 17a-13, regarding quarterly security counts to be made by certain exchange members and broker-dealers. Registered broker-dealers should comply with these provisions in connection

⁵¹ See notes 32 and 37, *supra*. As noted above, broker-dealers also would be subject to Section 15(c)(1) of the Exchange Act, which prohibits brokers and dealers from using manipulative or deceptive devices, because that provision explicitly applies in connection with security-based swap agreements.

⁵² We also are not exempting those members from provisions related to government securities, as discussed above.

⁵³ 15 U.S.C. 78g(c).

⁵⁴ 15 U.S.C. 78o(c)(3).

⁵⁵ 15 U.S.C. 78q(a).

⁵⁶ 15 U.S.C. 78q(b).

⁵⁷ 12 CFR 220.1 *et seq.*

with their activities involving non-excluded CDS because these provisions are especially important to helping protect customer funds and securities, ensure proper credit practices and safeguard against fraud and abuse.⁵⁸

F. Solicitation of Comments

The Commission intends to monitor closely the development of the CDS market and intends to determine to what extent, if any, additional regulatory action may be necessary. For example, as circumstances warrant, certain conditions could be added, altered, or eliminated. Moreover, because these exemptions are temporary, the Commission will in the future consider whether they should be extended or allowed to expire. The Commission believes it would be prudent to solicit public comment on its action today, and on what action it should take with respect to the CDS market in the future. The Commission is soliciting public comment on all aspects of these exemptions, including:

1. Whether the length of this temporary exemption (until September 25, 2009) is appropriate. If not, what should the appropriate duration be?
2. Whether the conditions to these exemptions are appropriate. Why or why not? Should other conditions apply? Are any of the present conditions to the exemptions provided in this Order unnecessary? If so, please specify and explain why such conditions are not needed.
3. Whether LCH.Clearnet ultimately should be required to register as a clearing agency under the Exchange Act. Why or why not?

⁵⁸ Indeed, Congress directed the Commission to promulgate broker-dealer financial responsibility rules, including rules regarding custody, the use of customer securities and the use of customers' deposits or credit balances, and regarding establishment of minimum financial requirements.

4. Whether LIFFE A&M members that receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling or holding non-excluded CDS positions for other persons ultimately should be required to register as broker-dealers? Why or why not?

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-34-08 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov/>). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-34-08. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/other.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

III. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 36(a) of the Exchange Act, that, until September 25, 2009:

(a) Exemption from Section 17A of the Exchange Act.

LCH.Clearnet Ltd. (“LCH.Clearnet”) shall be exempt from Section 17A of the Exchange Act solely to perform the functions of a clearing agency for Cleared Index CDS (as defined in paragraph (e) of this Order), subject to the following conditions:

(1) LCH.Clearnet shall make available on its Web site annual audited financial statements.

(2) LCH.Clearnet shall keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made or received by it relating to its Cleared Index CDS clearance and settlement services. These records shall be kept for at least five years and for the first two years shall be held in an easily accessible place.

(3) LCH.Clearnet shall supply such information and periodic reports relating to its Cleared Index CDS clearance and settlement services as may be reasonably requested by the Commission.

(4) Subject to coordination with the FSA and upon such terms and conditions as may be agreed between the FSA and the Commission, LCH.Clearnet shall provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), records, and personnel related to LCH.Clearnet’s Cleared Index CDS clearance and settlement services.

(5) LCH.Clearnet shall notify the Commission, on a monthly basis, of any material disciplinary actions taken against any of its members utilizing its Cleared Index CDS clearance and settlement services, including the denial of services, fines, or penalties. LCH.Clearnet shall notify the Commission promptly when it involuntarily terminates the membership of an entity that is utilizing LCH.Clearnet's Cleared Index CDS clearance and settlement services. Both notifications shall describe the facts and circumstances that led to LCH.Clearnet's disciplinary action.

(6) LCH.Clearnet shall provide the Commission with notice of all changes to its Default Rules and Default Fund Rules, not less than one day prior to effectiveness or implementation of such rule changes or, in exigent circumstances, as promptly as reasonably practicable under the circumstances. If LCH.Clearnet gives notice to, or seeks approval from, the FSA regarding any other changes to its rules regarding its Index CDS clearance and settlement services, LCH.Clearnet will also provide notice to the Commission. All such rule changes will be posted on LCH.Clearnet's Web site. Such notifications will not be deemed rule filings that require Commission approval.

(7) LCH.Clearnet shall provide the Commission with reports with respect to automated systems used in connection with Cleared Index CDS clearance and settlement services, other than the TRS/CPS system, prepared by independent audit personnel that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements ("ARPs"). LIFFE A&M shall provide the Commission with reports with respect to its TRS/CPS system prepared by audit personnel from Risk and Audit Services, an independent department of NYSE Euronext, that are generated in accordance with risk assessment of the areas set forth in

the ARPs. LCH.Clearnet shall provide the Commission with annual audited financial statements prepared by independent audit personnel.

(8) LCH.Clearnet shall provide notice to the Commission at the same time it provides notice to the FSA in accordance with FSA REC 3.15 and FSA REC 3.16 regarding the suspension of services or inability to operate its facilities in connection with the clearance and settlement of Cleared Index CDS.

(9) LCH.Clearnet, directly or indirectly, shall make available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (a) all end-of-day settlement prices and any other prices with respect to Cleared Index CDS that LCH.Clearnet or LIFFE A&M may establish to calculate mark-to-market margin requirements for LCH.Clearnet or LIFFE A&M Participants; and (b) any other pricing or valuation information with respect to Cleared Index CDS as is published or distributed by LCH.Clearnet or LIFFE A&M.

(b) Exemption for LCH.Clearnet, LIFFE A&M, and certain eligible contract participants.

(1) Persons eligible. The exemption in paragraph (b)(2) is available to:

(i) LCH.Clearnet;

(ii) LIFFE A&M; and

(iii) Any eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), other than: (A) an eligible contract participant that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared Index CDS positions for other persons; (B) an eligible contract

participant that is a self-regulatory organization, as that term is defined in Section 3(a)(26) of the Exchange Act; or (C) a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof).

(2) Scope of exemption.

(i) In general. Such persons generally shall, solely with respect to Cleared Index CDS, be exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply in connection with security-based swap agreements. Accordingly, under this exemption, those persons would remain subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements (i.e., paragraphs (2) through (5) of Section 9(a), Section 10(b), Section 15(c)(1), paragraphs (a) and (b) of Section 16, Section 20(d) and Section 21A(a)(1) and the rules thereunder that explicitly are applicable to security-based swap agreements). All provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions also remain applicable.

(ii) Exclusions from exemption. The exemption in paragraph (b)(2)(i), however, does not extend to the following provisions under the Exchange Act:

- (A) Paragraphs (42), (43), (44), and (45) of Section 3(a);
- (B) Section 5;
- (C) Section 6;
- (D) Section 12 and the rules and regulations thereunder;
- (E) Section 13 and the rules and regulations thereunder;
- (F) Section 14 and the rules and regulations thereunder;

- (G) Paragraphs (4) and (6) of Section 15(b);
- (H) Section 15(d) and the rules and regulations thereunder;
- (I) Section 15C and the rules and regulations thereunder;
- (J) Section 16 and the rules and regulations thereunder; and
- (K) Section 17A (other than as provided in paragraph (a)).

(c) Exemption for certain LIFFE A&M members.

Any member of LIFFE A&M that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling or holding Cleared Index CDS positions for other persons shall be exempt from the provisions of the Exchange Act and the rules and regulations thereunder specified in paragraph (b)(2), solely with respect to Cleared Index CDS, subject to the following conditions:

(1) The member shall be in material compliance with the rules of LIFFE A&M and, if a clearing member, with the rules of LCH.Clearnet, and applicable laws and regulations, relating to capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to Cleared Index CDS; and

(2) To the extent that the member receives or holds funds or securities of U.S. persons for the purpose of purchasing, selling, clearing, settling, or holding Cleared Index CDS positions:

(i) The U.S. persons shall not be natural persons;

(ii) The member shall segregate such funds and securities of such U.S. persons from the member's own assets (i.e., the member may not permit U.S.

persons to “opt out” of applicable segregation requirements for such funds and securities even if regulations or laws would permit the person to “opt out”); and

(iii) The member shall disclose to such U.S. persons that the member is not regulated by the Commission and that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the member.

(d) Exemption for certain registered broker-dealers.

A broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) shall be exempt from the provisions of the Exchange Act and the rules and regulations thereunder specified in paragraph (b)(2), solely with respect to Cleared Index CDS, except:

- (1) Section 7(c);
- (2) Section 15(c)(3);
- (3) Section 17(a);
- (4) Section 17(b);
- (5) Regulation T, 12 CFR 200.1 et seq.;
- (6) Rule 15c3-1;
- (7) Rule 15c3-3;
- (8) Rule 17a-3;
- (9) Rule 17a-4;
- (10) Rule 17a-5; and
- (11) Rule 17a-13.

(e) For purposes of this Order, “Cleared Index CDS” shall mean a credit default swap that is submitted (or offered, purchased or sold on terms providing for submission) to LCH.Clearnet, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which the reference index is an index in which 80 percent or more of the index’s weighting is comprised of the entities or securities described below:

(1) an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available;

(2) a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States;

(3) a foreign sovereign debt security;

(4) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or

(5) an asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae.

By the Commission.

Florence E. Harmon
Acting Secretary