

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-85940; File No. SR-LCH SA-2019-003)

May 24, 2019

Self-Regulatory Organizations; LCH SA; Notice of Filing of Proposed Rule Change, as Modified by Amendments No. 1 and 2, to Implement Settled-to-Market Treatment of Variation Margin, Permit the Creation of Multiple Account Structures, Permit Select Members to Provide Clearing Services to Affiliated Firms, and Update the Onboarding Procedures

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("**Act**")¹ and Rule 19b-4 thereunder² notice is hereby given that on May 13, 2019, Banque Centrale de Compensation, which conducts business under the name LCH SA ("**LCH SA**"), filed with the Securities and Exchange Commission ("**Commission**" or "**SEC**") the proposed rule change described in Items I, II and III below, which Items have been prepared primarily by LCH SA. On May 21, 2019, LCH SA filed Amendment No. 1 to the proposed rule change, and on May 24, 2019, LCH SA filed Amendment No. 2 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as modified by Amendments No. 1 and 2, from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change

LCH SA is proposing to amend its (i) CDS Clearing Rule Book ("**Rule Book**"), (ii) CDS Clearing Supplement ("**Supplement**"), and (iii) CDS Clearing Procedures

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendments No. 1 and 2 both corrected technical issues with the initial filing of the proposed rule change but did not make any changes to the substance of the filing or the text of the proposed rule change.

("Procedures") (collectively the "CDS Clearing Rules") to incorporate new terms and to make conforming, clarifying, and clean-up changes intended to: (1) implement a "settled-to-market" ("STM") treatment of variation margin⁴ as a method for further mitigating counterparty credit risk related to changes in the market value of transactions; (2) permit Clearing Members⁵ to create multiple account structures for a single client and multiple trade accounts per client within a single omnibus account structure; (3) permit Select Members⁶ to provide client clearing services to their "Affiliated Firms" (*discussed below*); and (4) make certain clarifications and enhancements to LCH SA's existing onboarding procedures to better reflect current business practices. Capitalized terms not defined or modified in this rule proposal will have the same meaning as in LCH SA's existing Rule Book, Supplement, or Procedures.

⁴ Lowercase "variation margin" in this rule proposal generically refers to amounts exchanged as a result of a change in market value of a transaction, irrespective of the legal characterization of such amounts as settlement or collateral transfer.

⁵ Clearing Members include Select Members (*defined below*) and General Members as the context requires. General Members are a "CCM" (*i.e.*, generally any legal entity admitted as a clearing member in accordance with the CDS Clearing Rules and party to the CDS Admission Agreement) or an "FCM Clearing Member" (*i.e.*, generally any Futures Commission Merchant ("FCM") that has been admitted as a clearing member in accordance with the CDS Clearing Rules and is a party to the CDS Admission Agreement and which has not elected to become a CCM) that has been admitted by LCH SA as a General Member in accordance with Section 1 of the Procedures.

⁶ A Select Member is a CCM or an FCM Clearing Member that: (a) does not provide CDS Client Clearing Services to Clients other than Affiliated Firms (*defined herein*); and (b) has been admitted by LCH SA as a Select Member in accordance with Section 1 of the Procedures.

The text of the proposed rule change has been annexed as Exhibit 5.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, LCH SA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. LCH SA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of these statements.

A. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.

LCH SA is proposing to amend its CDS Clearing Rules to add STM as a way to treat variation margin. Once implemented, non-FCMs and non-US Clearing Members will be able to treat variation margin either as (i) collateralized-to-market ("**CTM**") or as (ii) STM. FCMs and US Clearing Members will be required to treat variation margin as STM.

Under the CTM model, parties make daily payments of variation margin as collateral transfer as described in LCH SA's CDS Clearing Rules. LCH SA's CDS Clearing Rules also provide for the payment of Price Alignment Interest ("**PAI**") which a party that receives collateral typically pays to its counterparty. The CFTC Staff has stated that, "*[i]n cleared markets, PAI eliminates the basis risk that would otherwise exist between cleared and uncleared derivatives. Thus, PAI represents the interest that would be paid on any collateral posted in connection with an uncleared swap contract.*"⁷

⁷ See CFTC Staff Letter No. 17-51 (Oct. 27, 2017) (available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@llettergeneral/documents/letter/17-51.pdf>).

Variation margin payments collateralize the market exposure on a given day based on the market price each day but "*the exposure between the counterparties carries forward through the life of the contract*" with collateral passing back and forth between the counterparties through future variation margin payments.⁸

Under the proposed STM model, LCH SA's CDS Clearing Rules will be amended such that all Clearing Members using the STM model will make daily payments of variation margin called "NPV Payments" and payments called "Price Alignment Amount" ("**PAA**"). The PAA is economically equivalent to PAI, and represents the amount that would have been paid if the variation margin were treated as collateral as opposed to a settled amount. As the CFTC Staff explained, "*[u]nlike the collateralized-to-market model...these payments settle the outstanding exposure of the counterparties.*"⁹ Each day, the outstanding exposure will change, and new payments will be needed to settle the exposure.

LCH SA has determined to file this proposed rule change in order to, among other things, amend its CDS Clearing Rules to require the STM treatment of variation margin paid or received by FCMs and US Clearing Members, which is intended to promote the prompt and accurate clearance and settlement of all Cleared Transactions. As a result of the proposed rule change, FCMs and US Clearing Members that are subject to regulatory capital requirements promulgated by the federal bank regulatory agencies, might obtain more favourable regulatory capital treatment of Cleared Transactions.¹⁰ The proposed

⁸ *Id.* at 4.

⁹ *Id.*

¹⁰ *See Interagency Guidance on the Regulatory Capital Treatment of Certain Centrally-Cleared Derivative Contracts Under Regulatory Capital Rules* (August

rule change to require the STM treatment of variation margin would also be consistent with a recent CFTC staff Interpretive Letter indicating that CTM variation margin payments would not satisfy CFTC regulations that require daily settlement that is irrevocable and unconditional.¹¹ LCH SA will also make STM available as an option, but not a requirement, for non-FCMs and non-US Clearing Members.

LCH SA's affiliate, LCH Limited, promulgated clearing rules in its LCH Limited General Regulations which provide at Regulation 57A, among other sections, for STM for SwapClear Clearing Members established under the laws of any state of the United States or under the federal laws of the United States.¹² Regulation 57A was initially proposed in 2015. At that time, LCH Limited, through its membership in the International Swaps and Derivatives Association ("**ISDA**"), approached the SEC's Office of the Chief Accountant to discuss the accounting implications associated with implementing STM.¹³ The ISDA dialogue resulted in a confirmatory letter from ISDA to the SEC's Office of the Chief Accountant on January 4, 2017 confirming ISDA's understanding that the SEC did not object to certain tax related views associated with the implementation of STM variation margin treatment for US persons. LCH Limited's clearing rules have provided for STM variation margin treatment since on or around

14, 2017) (available at <https://www.federalreserve.gov/supervisionreg/srletters/sr1707a1.pdf>).

¹¹ See CFTC Staff Letter No. 17-51 (Oct. 27, 2017).

¹² General Regulations of LCH Limited, Regulation 57A (Nov. 2018), available at https://www.lch.com/system/files/media_root/General%20Regulations%20-%2026%20November%202018.pdf.

¹³ Confirmation Letter Related to ISDA Accounting Committee White Paper, ISDA (Jan. 4, 2017), available at <https://www.isda.org/a/lgiDE/isda-sec-vm-settlement-confirming-letter.pdf>.

December 2015. Whereas previously STM variation margin treatment was only available to LCH Limited members, this rule proposal will implement STM variation margin treatment for LCH SA, and thereby making it also available to LCH SA Clearing Members, including FCMs and US Clearing Members for which STM variation margin treatment is required.

In addition, this rule proposal will amend the CDS Clearing Rules to permit Clearing Members to create multiple account structures for a single client and multiple Trade Accounts per client within a single omnibus account structure. This rule proposal will also permit Select Members to provide clearing services to their Affiliated Firms and make clarifying changes to LCH SA's onboarding procedures to reflect current business practices.

1. **Amendments to permit Settled-to-Market Treatment for Cleared Transactions**

The updated CDS Clearing Rules will permit non-FCMs and non-US Clearing Members to utilize either the STM accounting method or CTM accounting method where permitted and will require FCMs and US Clearing Members to utilize the STM treatment. To implement the STM treatment of variation margin, the Rule Book, Supplement, and Procedures will be amended by adding new and amending existing defined terms and provisions as described below.

i. **Rule Book**

With respect to the Rule Book, LCH SA proposes to add additional defined terms and make amendments to existing defined terms contained within Title I, Chapter 1, Section 1.1.1.

The term "Client NPV Payment Requirement" will be added to describe the NPV Amount (*defined below*) that LCH SA will calculate as payment by a Clearing Member to LCH SA or by LCH SA to a Clearing Member in relation to certain STM Cleared Transactions and as the case may be, Irrevocable Backloading STM Transactions which are not Rejected Transactions, allocated to a relevant Client Margin Account.

The term "Converting Clearing Member" will be added to capture a framework whereby a Clearing Member submits a written request to LCH SA to convert all of the CTM Cleared Transactions registered in a CTM Trade Account into STM Cleared Transactions by converting the underlying account from a CTM Trade Account into an STM Trade Account. This is a one-way conversion from CTM to STM and, once complete, is irrevocable.

The term "CTM Cleared Transactions" will be added to cross reference a Cleared Transaction that is registered in a CTM Trade Account as described in Title III, Chapter 1, Section 3.1.10.

The term "CTM Trade Account" will be added to describe a Trade Account that a Clearing Member elects to classify as a CTM Trade Account in accordance with Section 5 of the Procedures.

The term "House NPV Payment Requirement" will be added to describe the NPV Amount (*defined below*) that LCH SA will calculate as payment by a Clearing Member to LCH SA or by LCH SA to a Clearing Member in relation to certain STM Cleared Transactions, and as the case may be, Irrevocable Backloading STM Transactions which are not Rejected Transactions, allocated to the relevant Clearing Member's House Margin Account.

The term "Irrevocable Backloading STM Transaction" will be added to clarify the definition of Irrevocable Backloading Transaction, which after novation by LCH SA will be registered in the relevant Account Structure as an STM Cleared Transaction.

The term "Irrevocable Backloading CTM Transaction" will be added to clarify the definition of Irrevocable Backloading Transaction which after novation by LCH SA will be registered in the relevant Account Structure as a CTM Cleared Transaction.

The term "NPV Amount" will be added to define the relevant amounts computed in accordance with Section 2 of the Procedures.

The term "NPV Payment" will be added to describe the amount of cash paid by a Clearing Member to LCH SA to satisfy the NPV Payment Requirement.

The term "NPV Payment Requirement" will be added as a collective definition of both House NPV Payment Requirement or a Client NPV Payment Requirement.

The term "Price Alignment Amount" will be added to define the relevant amounts computed in accordance with Section 2 of the Procedures.

The term "STM Cleared Transaction" will be added to define a Cleared Transaction that is registered in an STM Trade Account in accordance with Title III, Chapter 1, Section 3.1.10.

The term "STM Trade Account" will be added to describe a Trade Account that a Clearing Member elects to classify as an STM Trade Account in accordance with Section 5 of the Procedures.

The term "Variation Margin Collateral Transfer" will be added to describe the amount of cash transferred by a Clearing Member or LCH SA by way of full title transfer to satisfy a Variation Margin Requirement. The definition also includes an affirmative

statement that Variation Margin Collateral Transfer is subject to the provisions of article L. 211-38 of the French Monetary and Financial Code.

The term "Backloading Failure" will be amended to add the concept of Variation Margin Collateral Transfers as an additional possible transfer that may need to be made at the same time as the Morning Call.

The term "Cash Payment" will be amended for consistency purposes to eliminate the reference to Variation Margin which has been replaced by reference to NPV Payments and to add a reference to "Price Alignment Amount", as a parallel to the reference to "Price Alignment Interest".

The term "CCM Gross Omnibus Multi Sub-Account Client Margin Account" will be amended to add the concept of Client NPV Payment Requirement as a possible value that will be calculated, as applicable.

The term "CCM Gross Omnibus Single Sub-Account Client Margin Account" will be amended to add the concept of Client NPV Payment Requirement as a possible value that will be calculated, as applicable. The definition will also be modified to account for the concept of Account Structure.

The term "CCM House Margin Account" will be amended to add the concept of House NPV Payment Requirement as a possible value that will be calculated, as applicable.

The term "CCM Indirect Client Gross Segregated Margin Account" will be amended to add Client NPV Payment Requirement as a possible value that will be calculated, as applicable. The definition will also be modified to account for the concept of Account Structure.

The term "CCM Indirect Client Net Segregated Margin Account" will be amended to add Client NPV Payment Requirement as a possible value that will be calculated, as applicable.

The term "CCM Individual Segregated Client Margin Account" will be amended to add Client NPV Payment Requirement as a possible value that will be calculated, as applicable. The definition will also be modified to account for the concept of Account Structure.

The term "CCM Net Omnibus Segregated Client Margin Account" will be amended to add Client NPV Payment Requirement as a possible value that will be calculated, as applicable.

The term "Client Assets" will be amended to add NPV Amounts, as applicable, as an additional component of accruals which will be considered Client Assets.

The term "Client Variation Margin Requirement" will be amended to clarify that in practice, Variation Margin will be calculated on a transaction-by-transaction basis rather than on an Open Position basis. In order to affect this clarification, LCH SA proposes to replace Open Positions with CTM Cleared Transactions in the definition of Client Variation Margin Requirement. Conforming changes will be made throughout the Rule Book. The same amendments will also be made to the term "House Variation Margin Requirement."

The term "FCM Client Margin Account" will be amended to update the cross references to Irrevocable Backloading STM Transactions and Client NPV Payment Requirement.

The term "FCM Client Margin Requirement" will be amended to delete any reference to the term Variation Margin.

The term "FCM House Margin Account" will be amended to update the cross references to Irrevocable Backloading STM Transactions and House NPV Payment Requirement.

The term "FCM House Margin Requirement" will be amended to delete any reference to the term Variation Margin.

The term "Open Position" will be amended to mirror the language contained within what was formerly Article 3.2.2.3. As a result, the cross reference to Article 3.2.2.3, as well as the Article itself, will be removed from the Rule Book. The cross references to Article 5.2.3.3 and Article 6.2.3.3, as well as the Articles themselves, will also be removed from the Rule Book.

The term "Payment Failure" will be amended to replace the term Cash Payment by Variation Margin, to add the newly defined term Price Alignment Amount as a category of amounts which may trigger a Payment Failure, and to add a new sub-section (v) in reference to NPV Amount to satisfy a Clearing Member's NPV Payment Requirement.

The term "Variation Margin" will be amended to remove the reference to Price Alignment Interest.

Beyond definitional changes, LCH SA proposes to amend the Rule Book at Title I, Chapter 2, Section 1.2.7, Article 1.2.7.4 to include the term "Variation Margin Collateral Transfer" regarding the currency in which the Clearing Members are required to make payments and/or transfers.

LCH SA proposes to amend Section 1.2.9, Article 1.2.9.2 to include the payment of NPV Amounts to the Clearing Member as new item (iii) and the payment of the Price Alignment Amount to the Clearing Member as new item (iv), where applicable. In addition, item (i) is modified to clarify that the payment of Variation Margin to the relevant Clearing Member is by way of Variation Margin Collateral Transfer.

LCH SA proposes to amend the Rule Book at Title I, Chapter 3, Section 1.3.1, Article 1.3.1.4 to include clarifying language that the cumulative value of all NPV Amount(s) paid by the Clearing Member or LCH SA in respect of NPV Payment Requirements for the corresponding House Margin Account or Client Margin Account should be included in the computation of the value of each Cleared Transaction. Article 1.3.1.5 will be amended to include the concept of NPV Amount, as applicable, whereas currently it references Variation Margin only. Article 1.3.1.6 will be amended to include the concept of redelivery of Variation Margin whereas currently the section only refers to repayment.

LCH SA proposes to amend the Rule Book at Title II, Chapter 2, Section 2.2.1, Article 2.2.1.1. in order to include the reference to Variation Margin Collateral Transfer obligations whereas currently the Article only refers to Cash Payment obligations.

Rule Book at Title II, Chapter 2, Section 2.2.7, Article 2.2.7.2 will be modified to include the reference to Variation Margin Collateral Transfer obligations, whereas the Article only refers to Cash Payment obligations. The same modifications will be brought to Article 2.2.7.4.

LCH SA proposes to amend the Rule Book at Title II, Chapter 4, Section 2.4.2, Article 2.4.2.8 to add the reference to NPV Payment Requirements whereas the Article only refers to Variation Margin Requirement.

Rule Book at Title III, Chapter 1, Section 3.1.8, Article 3.1.5.1 will be modified to remove the concept of Variation Margin Requirement from the existing paragraph and to create a stand-alone paragraph that specifically addresses the method for calculating the Variation Margin Requirement and/or NPV Payment Requirement by cross-referencing Title IV, Chapter 2 of the Rule Book; Section 2 of the Procedures; and Title III, Chapter 1, Section 3.1.7 of the Rule Book.

Rule Book at Title III, Chapter 1, Section 3.1.9, Articles 3.1.9.2 and 3.1.9.3 will be modified to add the reference to NPV Payment Requirement(s) whereas currently these Articles only refer to Variation Margin Requirement(s).

LCH SA proposes to make updates to the provisions of the Rule Book that discuss the registration of cleared transactions. New Rule Book Title III, Chapter 1, Section 3.1.10, Article 3.1.10.7 through 3.1.10.9 will be added to the Rule Book. Current Article 3.1.10.7 will become Article 3.1.10.10 and current Article 3.1.10.8 will become Article 3.1.10.11. New Article 3.1.10.7 will permit Clearing Members to elect to classify each Trade Account as either a CTM Trade Account or an STM Trade Account in accordance with Section 5 of the Procedures. Trade Accounts will default to CTM Trade Accounts where a Clearing Member does not make an election. Cleared Transactions registered within a Trade Account will have the same classification as the Trade Account itself. Trade Accounts may only comprise CTM Cleared Transactions or STM Cleared Transactions, but not both simultaneously.

New Article 3.1.10.8 will introduce the concept of a "Converting Clearing Member" which is intended to capture a framework whereby a Clearing Member submits a written request to LCH SA to convert all of the CTM Cleared Transactions registered into a CTM Trade Account into STM Cleared Transactions by converting the underlying account from a CTM Trade Account into an STM Trade Account. This is a one-way conversion from CTM to STM and, once complete, is irrevocable. This caveat will be memorialized in Article 3.1.10.8.

Notwithstanding the provisions of Article 3.1.10.7 and Article 3.1.10.8, under new Article 3.1.10.9, each Cleared Transaction registered in the name of a Clearing Member that is an FCM or otherwise established under the laws of any state of the United States or under US federal law, will be registered as an STM Cleared Transaction. It will neither be possible to register transactions for these entities as CTM Cleared Transactions nor to convert from an STM Cleared Transaction to a CTM Cleared Transaction.

LCH SA proposes to update Article 4.1.1.1 of Section 4.1.1 under Title IV, Chapter 1 in order to add a reference to House NPV Payment Requirement and Client NPV Payment Requirement, whereas currently this Article only refers to House Variation Margin Requirement and Client Variation Margin Requirement.

Updated Section 4.2.3 of the Chapter 2 under Title IV will now capture the concept of Variation Margin Requirement and NPV Payment Requirement whereas the current section only refers to "Collateral Calls". In addition, the reference to NPV Payment Requirement will be added to Title IV, Chapter 2 itself, whereas currently this Chapter is only named "Margin". Article 4.2.3.1 will be amended to add the reference to NPV Payment Requirement in addition to the reference to Variation Margin Requirement

and also to add the reference to NPV Amount in addition to the reference to Variation Margin. Article 4.2.3.2 will also be amended in order to replace the term "Cash Payment" by NPV Payment as a payment to satisfy a NPV Payment Requirement and Variation Margin Collateral Transfer as a transfer to satisfy a Variation Margin Requirement; the word "transfers" will also be added in addition to the word "payments".

Section 4.2.5 will now capture the concept of NPV Amounts in addition to Variation Margin to account for the new STM business workflows and will be renamed to "Variation Margin and NPV Amounts". Specifically, Article 4.2.5.1 is modified to account for the newly defined terms described earlier in this rule proposal. The concept of Cash Payments is replaced by an obligation to make either Variation Margin Collateral Transfers or NPV Payments and to differentiate that Variation Margin Collateral Transfers are applicable to CTM Cleared Transactions or Irrevocable Backloading CTM Transactions; and that NPV Payments are applicable to STM Cleared Transactions or Irrevocable Backloading STM Transactions when such amounts are due.

Updated Article 4.2.5.2 will be amended to capture the concept of NPV Amounts within the requirement that such amounts are payable by a Clearing Member or LCH SA at the same time as the Morning Call or as otherwise provided by the Procedures. Variation Margin Collateral Transfer or NPV Payments will be made in compliance with the times set out in Section 3 of the Procedures. In addition, the Rule Book will state that LCH SA and the Clearing Member agree that satisfaction of the payment obligation arising under the NPV Payment Requirement will discharge any such obligation required to settle outstanding exposure under an STM Cleared Transaction or for an Irrevocable Backloading STM Transaction which is not a Rejected Transaction. New Article 4.2.5.3

is intended to clarify that, notwithstanding anything to the contrary in the CDS Clearing Documentation, a Variation Margin Collateral Transfer obligation does not arise for STM Cleared Transactions or for Irrevocable Backloading STM Transactions. This Article is not intended to prejudice any other rights to require Collateral to be transferred under the CDS Clearing Documentation (*e.g.*, a Collateral transfer requirement in respect of a Clearing Member's Margin Requirement for STM Cleared Transactions).

In addition, LCH SA proposes to amend Title IV, Chapter 2, Section 4.2.7, Article 4.2.7.1 to clarify the fact that risk calculation performed by LCH SA also includes the calculation of Variation Margin Requirement and NPV Payment Requirement in addition to Margin Requirements and Open Positions. Article 4.2.7.2. will also be amended in order to clarify the term "clearing functions" shall mean the validation of Variation Margin Requirements and NPV Payment Requirements, in addition to Margin Requirements.

LCH SA proposes to amend Title IV, Chapter 3, Section 4.3.2, Article 4.3.2.3 (viii) to clarify that, in case of default of a Clearing Member, LCH SA will be authorized to convert the Variation Margin Collateral Transfer obligations into cash payment obligations. The purpose of such change is to ensure that in the case of default, Variation Margin will be applied by LCH SA in the same way as an NPV Payment (*i.e.*, as a cash payment). Such treatment is consistent with how LCH SA currently treats Variation Margin, but this amendment is required because the new definition of Cash Payment will no longer capture Variation Margin and Variation Margin is not captured within the definition of Collateral.

In addition to the specific proposed changes to the Rule Book discussed above, certain conforming changes and clarifications to incorporate the concepts of NPV Payment Requirement, NPV Amount, and Price Alignment Amount with respect to STM were made throughout the Rule Book. Corresponding changes and clarifications were made with respect to CTM with conforming references to Variation Margin Requirement, Variation Margin, and Price Alignment Interest. References to Variation Margin and Variation Margin Requirements were removed in respect of FCM Clearing Members. Such proposed changes are notably inserted in Title V, Chapter 1, Section 5.1.1, Article 5.1.1.3 (xvii), Title V, Chapter 2, Section 5.2.3, Article 5.2.3.2, Title VI, Chapter 1, Section 6.1.1, Article 6.1.1.3 (xii), Title VI, Chapter 2, Section 6.2.3, Article 6.2.3.2 and Sections 1.1, 6.2, 7.1, 8.1.4, 8.2, 8.5 of the CDS Default Management Process in Appendix 1.

ii. **Procedures**

(A) **Section 2**

LCH SA Procedures Section 2 will be updated to reflect the operational steps required to facilitate the NPV Payments and Price Alignment required to operationalize the STM business model while still maintaining the CTM business model for non-FCMs and non-US Clearing Members. As a result, the Section itself will be renamed Margin, NPV Payment and Price Alignment.

The cross reference in Section 2.1 to Procedures Section 3 will be updated to reference Variation Margin Collateral Transfers whereas previously the reference was only to Cash Payments. Corresponding updates (*discussed below*) will be made throughout Section 3.

Section 2.2 will be amended to make certain clean-up and conforming changes in order to ensure that the new defined terms relevant to implementing STM are applied consistently to the existing procedure. Specifically, Section 2.2(c) will now be called Variation Margin Requirement and NPV Payment Requirement and will be broken into two sub-sections, as applicable, to either: (i) transfer Variation Margin to or receive Variation Margin from LCH SA to satisfy the Client Variation Margin Requirement and/or House Variation Margin Requirement; and/or (ii) make NPV Payment to or receive NPV Payment from LCH SA to satisfy the Client NPV Payment Requirement and/or House NPV Payment Requirement. Section 2.2(d) will be updated to add the concept of NPV Amount within the list of amounts that, when aggregated, represent the amount that can be called from a Clearing Member that is a CDS Seller in respect of a Cleared Transaction referencing a single Reference Entity. Section 2.2(g) will be retitled "Calculation of Margin and NPV Amount(s) following a Payment Failure or the issuance of a Default Notice in respect of a Clearing Member" and will be updated to incorporate the concept of NPV Amount(s) as an alternative to Margin throughout the section.

Section 2.4 will be renamed "Collateral, Cash Payments, and Variation Margin Collateral Transfers". In parallel, Section 2.4(a) will also be renamed to "Types of Collateral and currencies for Cash Payments and Variation Margin Collateral Transfers" and Section 2.4(b) will be renamed to "Transferring Collateral and making Cash Payments and Variation Margin Collateral Transfers". Within Section 2.4(a) the concept of Variation Margin Collateral Transfers, NPV Payment(s), and Variation Margin will be added to the cross reference to Procedure Section 3 which sets out the applicable types of

Collateral and currencies that may be used. Section 2.4(b) which also cross references to Procedure Section 3 will be similarly updated.

Section 2.5 will be renamed to "Payment of the Margin Requirement, Variation Margin Requirement, NPV Payment Requirement and Provision of Excess Collateral and Client Collateral Buffer". Section 2.5 (a) which discusses the Morning Call is amended to include the concept of NPV Payment Requirement in timing, notification, and payment requirement. In addition, certain requirements of Clearing Members that previously referenced Cash Payments, are now split to incorporate the concept of Variation Margin Collateral Transfers and NPV Payments where applicable. In reference to certain Excess Collateral and/or Cash Payments by FCM Clearing Members, the concept of Variation Margin Requirement will be replaced by NPV Payment Requirement. In addition, this section previously provided that LCH SA is able to credit Euro denominated Cash Collateral and/or make Cash payments to relevant Clearing Members in accordance with the process outlined in Procedure Section 3. This section will now also incorporate the concept of Variation Margin Collateral Transfer(s) with respect to relevant Clearing Members. Section 2.5(b) under the heading "Second Intraday Call" will be updated for consistency such that the existing cross reference to Procedure Section 3 will be applicable to Clearing Members that are required to transfer Collateral to satisfy their Required Collateral Amount, and now also to make Variation Margin Collateral Transfers in respect of their Variation Margin Requirement. The existing reference to Cash Payments will be revised for consistency to reference NPV Payments and any applicable NPV Payment Requirement.

LCH SA proposes to make amendments to Section 2.13 through the end of Procedures Section 2. A new Section 2.14 covering "NPV Amount" and a new Section 2.17 covering "Price Alignment Amount" will be added to the Procedures. Contingency Variation Margin (formerly Section 2.14) will be updated and re-numbered to Section 2.15 and Price Alignment Interest (formerly Section 2.15) will be updated and re-numbered to Section 2.16. Credit Quality Margin (formerly Section 2.16) will be re-numbered to Section 2.18 and Extraordinary Margin (formerly Section 2.17) will be re-numbered to Section 2.19 although neither section is subject to substantive updates.

Section 2.13 will be amended to specify that Variation Margin is applicable to CTM Cleared Transactions and Irrevocable Backloading CTM Transactions which are not Rejected Transactions, rather than all Cleared Transactions. Section 2.13 previously referred to "net position value" but will be amended to refer to "net present value" throughout. The portion of Section 2.13(ii), which previously outlined a netting procedure for payments from a Clearing Member to LCH SA and from LCH SA to a Clearing Member, will be renumbered 2.13(b) and will be amended to address the calculation of net present value for each CTM Cleared Transaction or Irrevocable Backloading CTM Transaction and to account for global changes to the defined terms in the Rule Book and Procedures.

New Section 2.14 NPV Amount will be added to the Procedures to outline the specific operational steps required to facilitate the accounting for an STM Cleared Transaction. An NPV Amount is an amount paid on each Cash Payment Day between the Clearing Member and LCH SA to account for the variation of the market value of the CDS, or as the case may be, Index Swaption that is an STM Cleared Transaction of

Irrevocable Backloading STM Transaction. The updated Procedures described the method by which LCH SA will go about calculating the NPV Amount. The NPV Amount calculation will be based on the net present value of each STM Cleared Transaction and Irrevocable Backloading STM Transaction on each Cash Payment Day. The net present value for each STM Cleared Transaction or Irrevocable Backloading STM Transaction is based on the End of Day Contributed Prices provided to LCH SA as proscribed in the Rule Book Article 4.2.7.1 and Procedures Section 5. Unless otherwise agreed between the Clearing Member and LCH SA, the net present value on the Trade Date is zero. Immediately upon determining net present value, the net present value will be reset to zero ("**NPV Reset**"), however, the NPV Reset will not be deemed to have occurred where the STM Cleared Transaction or Irrevocable Backloading STM Transaction is held in the Account Structure of an FCM and the NPV Payment Requirement is not satisfied.

Contemporaneous with the NPV Reset, if LCH SA determines that the value of the STM Cleared Transaction or Irrevocable Backloading STM Transaction has increased since the last NPV Reset, LCH SA will make a cash payment (the NPV Amount) denominated in the same currency as the STM Cleared Transaction or Irrevocable Backloading STM Transaction and equal to the amount of the increase in the net present value to the Clearing Member. If the net present value has decreased, then a corresponding payment will be made by the Clearing Member to LCH SA. If there is no change in net present value, then no payments are required. New Section 2.14 contains provisions to ensure clarity with regard to the meaning of an "increase" and "decrease" in net present value. The proposed Procedure will state that, for the avoidance of doubt, an

"increase" in the net present value means the value of an STM Cleared Transaction or Irrevocable Backloading STM Transaction has moved in favour of the Clearing Member since the immediately preceding NPV Reset while a "decrease" means the opposite.

Where amounts payable on each Cash Payment Day are in the same currency and are related to the same Margin Account, proposed Section 2.14 provides for aggregation of amounts payable by the Clearing Member to LCH SA and for aggregation of amounts payable by LCH SA to the Clearing Member. In addition, the amounts will be offset against each other as applicable. This procedure will result in a net payment amount from either the Clearing Member to LCH SA or LCH SA to the Clearing Member in accordance with Article 4.2.3.2 of the Rule Book and Procedures Section 3. In addition, at the end of Section 2.14 a cross reference will be added to Clause 7 of the CDS Default Management process, regarding the details of the adjustment of the NPV Amount which may occur.

Conforming changes are proposed to Section 2.15 to replace references to Cash payment with NPV Payment and Variation Margin Collateral Transfer and to reflect related concepts throughout the section.

Section 2.16 will be amended to specify that it is applicable to the receipt of Variation Margin Collateral Transfers and related to CTM Cleared Transactions. Previously this section referred to Variation Margin payments. A substantively new sentence will also be added to Section 2.16 to describe how LCH SA will handle a negative interest rate environment. Where the applicable Price Alignment Interest rate is negative, *"LCH SA will either (i) pay Price Alignment Interest if a Clearing Member has, on a cumulative net basis, received Variation Margin from LCH SA, or (ii) charge Price*

Alignment Interest if a Clearing member has, on a cumulative net basis, transferred Variation Margin."

New Section 2.17 Price Alignment Amount will be added to the Procedures to outline the specific operational steps required to facilitate the accounting for an STM Cleared Transaction. The Price Alignment Amount is identical to the Price Alignment Interest amount and the two payments serve the same functional purpose although the legal status of the two payments is different. Procedure Section 5 outlines the process by which a report is generated on each Cash Payment Day indicating the applicable Price Alignment Amount to be paid or received by each Clearing Member. Under proposed Section 2.17, if LCH SA determines that the Cumulative Net Present Value is greater than zero, the applicable Price Alignment Amount will immediately become payable to LCH SA by the Clearing Member in the same currency as the STM Cleared Transaction. If the Cumulative Net Present Value is less than zero, the applicable Price Alignment Amount will immediately become payable to the Clearing Member by LCH SA in the same currency as the STM Cleared Transaction. Proposed Section 2.17 also outlines the treatment of STM Cleared Transactions that are transferred to either (i) a Backup Clearing Member pursuant to the CDS Default Management Process; or (ii) a Receiving Clearing Member. In both instances, the Trade Date of the STM Cleared Transaction for the purpose of determining the Cumulative Net Present Value is the date of the transfer. The same treatment will apply in an instance where a Clearing Member elects to convert from a CTM Cleared Transaction to an STM Cleared Transaction.

Proposed Section 2.17 contains three definitions that are applicable for the purposes of this section. "Cumulative Net Present Value" is a hypothetical value

computed by LCH SA on each Cash Payment Day falling after a Trade Date, based on certain aggregate NPV Amounts payable to LCH SA by a Clearing Member and by LCH SA to a Clearing Member. "Price Alignment Amount" is computed on each Cash Payment Day falling after a Trade Date. It means the product of (i) the absolute value of the Cumulative Net Present Value on each Cash Payment Day; (ii) the applicable Price Alignment Amount Rate on each Cash Payment Day; and (iii) the day count fraction determined by LCH SA as being applicable to the currency of the STM Cleared Transaction. "Price Alignment Amount Rate" means the applicable prevailing interest rate of the Cash Payment Date as mentioned in the files and reports to the Clearing Member.

(B) Section 3

Similar to Section 2, Section 3 itself will be renamed "Collateral, Variation Margin and Cash Payment" to reflect the new business processes required to facilitate STM.

LCH SA proposes to update Procedures Section 3.7(c) and (d) at various sub-sections to make conforming changes to integrate the concepts of Variation Margin Collateral Transfers and Client NPV Payment Requirements where applicable.

Section 3.11 will be renamed to "LCH SA's rights in respect of Collateral and Variation Margin transferred with full title". Conforming amendments will be made to various sub-sections to include the concept of Variation Margin where applicable. Substantively, at Section 3.11(b), the Procedures will be updated to reflect that LCH SA may use Variation Margin transferred by Clearing Members for the purposes of transferring corresponding Variation Margin or making corresponding NPV Payment(s) to other Clearing Members in accordance with the CDS Clearing Rules. Section 3.11(c)

will include a reference to the Variation Margin in addition to the reference to the term Collateral.

Section 3.18 will be renamed "Cash Payments and Variation Margin Collateral Transfers". Conforming amendments will be made to the various sub-sections to include the concept of Variation Margin Collateral Transfer where applicable. The headings for the table at Section 3.18(a) will be updated to (i) Cash Payment/Variation Margin Type and (ii) Cash Payment/Cash transfer. A new row will be added to the table indicating that Cash in CDS Contractual Currency is the appropriate Cash Payment/Cash transfer when making an NPV Payment, Price Alignment Amount.

(C) Section 5

LCH SA proposes to make certain conforming changes throughout Procedures Section 5. In Section 5.6(c) language that previously referenced Variation Margin will be expanded to also reference rights over aggregate NPV Amounts in respect to a transfer of Client Assets. Similarly, in Section 5.6(d), row 9 of the timetable for transfers will be updated to include reference to NPV Payment Requirement whereas previously it only referred to Variation Margin Requirement.

The section titled "Registration of Cleared Transactions" which is found at Section 5.11 will be subject to updates to accommodate the STM business processes. A new Section 5.11(a) titled STM or CTM Classification of Trade Accounts will be added. As described earlier in this rule proposal, non-FCMs and non-US Clearing Members will be given the option to elect to designate a Trade Account as either an STM Trade Account or a CTM Trade Account. Where no election is made, the account will default to a CTM Trade Account. FCMs and US Clearing Members will not be given such an option as their accounts will need to be classified as STM Trade Accounts. Former

Section 5.11(a) "Notification of registration", will be re-numbered to 5.11(b). Former Section 5.11(b) will be re-numbered to Section 5.11(c) and is discussed within the Account Structures section of this rule proposal.

New Section 5.11(d), titled "Conversion of STM Cleared Transactions" will be added to the Procedures to describe the specific steps undertaken in connection with an STM Conversion Request which will convert a CTM Trade Account into an STM Trade Account. As proposed, upon receipt of an STM Conversion Request pursuant to Rule Book Article 3.1.10.8, LCH SA will have sole and absolute discretion to nominate a Business Date for the conversion which will be called the "STM Conversion Date." On the STM Conversion Date, subject to conditions discussed below, the relevant CTM Trade Account will become an STM Trade account and all Cleared Transactions registered in the Trade Account will no longer be CTM Transactions, but rather will immediately and automatically become STM Cleared Transactions. The conversion will be affected through technological and operational changes made by LCH SA, rather than by terminating the existing CTM Cleared Transactions and entering into new STM Cleared Transactions.

The occurrence of the STM Conversion Date is subject to a series of conditions outlined in the new Section 5.11(d) including: (i) the Converting Clearing Member is not a Defaulting Clearing Member; (ii) the relevant Deemed Client Transactions may not be subject to an early termination date; (iii) the STM Conversion Request may not violate applicable laws or regulations; (iv) the Converting Clearing Member must have satisfied all of its Cash Payment and Variation Margin and Collateral Transfer obligations up to, but excluding, the STM Conversion Date; (v) the Converting Clearing Member has paid

to LCH SA, or LCH SA has paid to the Converting Clearing Member (as applicable), any cash settlement amount that LCH SA determines (in its sole and absolute discretion) must be paid to ensure that the net present value of each Cleared Transaction registered in the relevant Trade Account shall be equal to zero on the STM Conversion Date. The Converting Clearing Member and LCH SA agree that LCH SA may, in its sole and absolute discretion, apply any Variation Margin transferred to and held by LCH SA in respect of the Cleared Transaction registered in the relevant Trade Account to satisfy (in whole or in part) the Converting Clearing Member's obligation to pay the amount (if any) required in relation to each such Cleared Transaction. The Converting Member and LCH SA agree that any Variation Margin transferred to and held by the Converting Clearing Member in respect of the Cleared Transaction registered in the relevant Trade Account shall be applied to satisfy (in whole or in part) LCH SA's obligation to pay the amount (if any) required in relation to each such Cleared Transaction; and (vi) the Converting Clearing Member is in satisfactory compliance with all other conditions stipulated by LCH SA.

In connection with each STM Conversion Request made by a Clearing Member, proposed Section 5.11(d) requires that the Clearing Member agree that after the STM Conversion Date, it will neither be possible to "re-convert" the Trade Account back into a CTM Trade Account nor to convert individual transactions back into CTM Cleared Transactions. Finally, LCH SA will be able to rely on an STM Conversion Request made by the person, agent, officer, employee, or representative as made under the full authority to do so and to bind the Converting Clearing Member to the STM Conversion Request.

The discussion of the Cleared Trades Report in Section 5.16(a)(i)(F) will be augmented to include an additional information element on the report to indicate the classification of the Cleared Transaction as either a CTM Cleared Transaction or an STM Cleared Transaction. This distinction was not required previously because all transactions were cleared on a CTM basis. The report discussed at Section 5.16(c)(iii) will be renamed to "Variation Margin and NPV Amount Report" and the description will be updated to reference NPV Amount and NPV Payment Requirements, whereas previously it only referenced Variation Margin and Variation Margin Requirement. In addition, the concept of a "transfer" will be added where applicable to account for the different method of money movement for CTM Cleared Transactions as contrasted with STM Cleared Transactions which are "paid" to LCH SA.

Section 5.18.4 related to the use of composite spreads/prices will be updated to include references to NPV Payment Requirement whereas previously the section only referenced the Variation Margin Requirement.

iii. **Clearing Supplement**

In support of the proposed STM business model, LCH SA will also add new provisions to the Supplement in each of its three parts. Each of these three new sections is substantially similar.

- **For Index Cleared Transactions and Single Name Transactions incorporating the 2003 ISDA Credit Derivatives Definitions – Part A, Section 2.6** will be added to the Supplement;

- For Index Cleared Transactions and Single Name Transactions incorporating the 2014 ISDA Credit Derivatives Definitions – Part B, Section 2.6 will be added to the Supplement; and
- For Credit Index Swaptions – Part C, a Section 2.4 will be added to the Supplement.

The proposed new sections will establish the "STM Cleared Terms" for each of the three categories of transactions outlined above. If a Cleared Transaction is designated as an STM Cleared Transaction in accordance with Rule Book Article 3.1.10.7, it will automatically be governed by the STM Cleared Terms.

In accordance with the STM Cleared Terms, net present value will be computed at least once per Cash Payment Day in accordance with Procedures Section 2. Immediately upon determining the net present value, a cash amount may become due and payable by the Clearing Member or LCH SA and the net present value of the STM Cleared Transaction will be reset to zero. Any required payments will be made in accordance with Section 2 of the Procedures. The STM Cleared Terms will also provide that in any circumstance that prevents NPV Payments or Variation Margin Collateral Transfers from being made in US Dollars, LCH SA will be permitted to convert such amounts into Euro in accordance with Rule Book Article 4.2.3.2.

Similarly, Price Alignment Amount will be determined at least once per Cash Payment Day in accordance with Procedures Section 2. Immediately upon determining the Price Alignment Amount, a cash amount may become due and payable by the Clearing Member or LCH SA as determined in accordance with Procedures Section 2.17. For the avoidance of doubt, the new Supplement section will state that any Price

Alignment Amount shall immediately become due and payable by the relevant party under the STM Cleared Terms applicable to the STM Cleared Transaction and will be made in such time and manner as is consistent with Procedures Section 2.

2. **Amendments to Permit Multiple Account Structures**

i. **Rule Book**

LCH SA proposes to amend the Rule Book at Title V, Chapter 2, Section 5.2.1, Article 5.2.1.1 to eliminate the existing language that restricts a CCM Client from being allocated to more than one account structure at the same time. Specifically, the current language states that "*a single CCM Client is not permitted to be allocated, at the same time, to (i) more than one CCM Client Account Structure of the same CCM (except in connection with the provision of indirect clearing services by such CCM Client to its CCM Indirect Clients) and (ii) within a CCM Gross Omnibus Segregated Account Structure, more than one CCM Gross Omnibus Sub-Account Structure.*" This language will be removed from the Rule Book.

The terms "CCM Gross Omnibus Multi Sub-Account Structure", "CCM Indirect Client Gross Segregated Account Structure", "CCM Indirect Client Net Segregated Account Structure" and "CCM Net Omnibus Segregated Account Structure" will be amended to reference "one or more" CCM Client Trade Accounts(s) where previously the definition referred to "a" CCM Client Trade Account(s).

Where relevant, the reference to a "Sub-Account Client" or to a Client in the definitions or articles will now refer to a "Sub-Account Structure" or to a "Structure" so that the wording will not imply anymore that a Client can hold only one account structure.

Title V, Chapter 2, Section 5.2.1, Article 5.2.1.3 will be modified to permit CCM Net Omnibus Segregated Account Clients to configure account allocations at the CCM Net Omnibus Segregated Account Structure level and to configure multiple allocation accounts of each type. This Article will also be modified to refer to "one or more" CCM Gross Omnibus Sub-Account Structure(s) or "CCM Individual Segregated Account Structure(s)" where previously it only referred to a structure.

Title V, Chapter 2, Section 5.2.1, Article 5.2.2.1 will be modified to permit LCH SA to open one or more CCM Client Trade Accounts(s) for each CCM Omnibus Segregated Account Client; one CCM Client Trade Account for each CCM Individual Segregated Account Structure; and one or more CCM Client Trade Account(s) for each CCM Indirect Client belonging to a CCM Indirect Client Segregated Account Structure.

Title V, Chapter 2, Section 5.2.3, Article 5.2.3.1 will be modified to substitute the concept of a client account structure in place of the existing concept of a client, thereby permitting more than one account structure for a single client.

Title V, Chapter 2, Section 5.2.3, Article 5.2.4.3 will be modified to substitute the concept of an account structure in place of the existing concept of a client in Article 5.2.4.3(i) and (iv). In addition, changes to this article make clarifying amendments to the sentence structure.

ii. **Procedures**

Procedures at Section 5.3(f) will be modified to refer to the ability for CCMs to have several account structures and trade accounts by adding the word "relevant" to the last paragraph of the section in reference to Client Trade Accounts and Client Margin Accounts. The same modification will be brought to Section 5.5. In addition, Procedures at Section 5.6(b)(i) and (iv) will be modified to refer to "a" rather than "the" CCM Client

Trade Account and "a" rather than "the" CCM Gross Omnibus Single Sub-Account structure.

3. **Amendments to Permit Select Members Clearing for Affiliated Firms**

i. **Rule Book**

In order to permit Select Members to provide client clearing services to certain affiliates, "Affiliated Firm" will now be included as a defined term in the Rule Book and will be added into the definition of "Select Member" as a category of persons to whom Select Members are permitted to provide client clearing services. The definition of Affiliated Firm will also be augmented into other defined terms as appropriate. Certain conforming changes are also proposed to Title II, Chapter 2; Title IV, Chapter 2; Title V, Chapter 1; and Title VI, Chapter 1 of the Rule Book and to the Procedures at Section 5.11(c).

With respect to a Clearing Member, an Affiliated Firm is any Affiliate or any entity that is otherwise member to the same institutional protection scheme (as defined in the CRR¹⁴) as the Clearing Member. The Rule Book currently defines Affiliate with respect to a Clearing Member, as any entity that controls, directly or indirectly, the Clearing Member, any entity controlled, directly or indirectly, by the Clearing Member or any entity directly or indirectly under common control with such Clearing Member.

¹⁴ CRR refers to Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 and all delegated regulatory and implementing technical standards adopted pursuant to Regulation (EU) No. 575/2013 and published in the Official Journal of the European Union from time-to-time.

The term "Select Member" will be amended to permit a Select Member to provide clearing services to their Affiliated Firms whereas currently Select Members are not permitted to provide clearing services to any third-party.

The term "CCM" will be amended to permit Clearing Members to provide CDS CCM Client Clearing Services to their Affiliated Firms without qualifying as General Members.

The term "FCM Clearing Member" will also be amended to permit Clearing Members to provide CDS FCM Client Clearing Services to Affiliated Firms without qualifying as General Members.

The terms "CCM Indirect Gross Segregated Account Client", "CCM Indirect Net Segregated Account Client", and "CCM Individual Segregated Account Client" will be amended to expand the definitions to capture the new defined term Affiliated Firm.

The term "FCM Client" will be amended to include a specific reference to the new defined term Affiliated Firm as an additional category of persons who are deemed to be FCM Clients.

Rule Book Article 2.2.0.4 will be modified to ensure that Select Members account for Product Families held by both the Select Members and any Affiliated Firms to which the Select Member provides CDS Client Clearing Services. The Membership Requirements in Article 2.2.1.1, Continuing Obligations in Article 2.2.2.1, Markit LCH Settlement Price and LCH Settlement Price authorization in 4.2.7.2 are broadened to apply to Select Members who intend to provide CDS Client Clearing Services to Affiliated Firms. Article 5.1.1.1 and Article 5.1.1.2 are modified to permit Select Members to provide CDS Client Clearing Services to Affiliated Firms. Article 6.1.1.2 is

modified to permit FCM Clearing Members to provide CDS Client Clearing services to Affiliated Firms.

ii. **Procedures**

Finally, Procedures at Section 5.11(c) will be modified to ensure that the change to Rule Book Article 2.2.0.4 regarding Product Families is incorporated into the procedures for updating the Product Family Form and thus operationalized by Select Members and LCH SA's personnel when updating Product Family Forms.

4. **Onboarding Procedures Clarifications**

LCH SA is also proposing to make updates to Procedures Section 1 to account for normal course of business changes to its current onboarding process. These modifications will ensure that Section 1 of the Procedures accurately reflects the current processes for onboarding applicants ("Applicants") to CDSClear. Section 1.1(b) and (c) will be updated to consolidate certain steps that were previously characterized as a stand-alone "initial review" into the overall "application process." Whereas previously, the CDSClear Admission Form was only completed after an initial review, it will now be submitted prior to the initial review. Section 1.1 is further amended to adjust the operational timing of the review steps undertaken during the 30 days of the application process. Section 1.1(d) (formerly Section 1.1(e)) is updated to permit more flexibility for LCH SA to use its discretion to determine if a site visit is appropriate when evaluating applications. Language setting a target to review applications within 30 Business Days, or 40 Business Days where a legal opinion is required, is removed from the Procedure as the overall timeline to either (i) reject or (ii) accept an application is described in Section 1.1(b) (formerly 1.1(c)).

Section 1.1(f) previously described LCH SA's ability to impose conditions or limitations on the exercise of certain rights under the CDS Clearing Documentation. This section will be clarified to eliminate the concept of "conditions" but the Procedure will continue to permit LCH SA to impose limitations following approval. A recently approved Applicant, before the submission of its first Original Transaction, shall make its initial Contribution into the CDS Default Fund and shall also post sufficient Collateral before the submission of its first Intraday Transaction, which LCH SA believes is consistent with its regulatory obligations to manage risk.

Finally, Section 1.1(g) will now reference a Clearing Member's possible obligation to put in place a Power of Attorney in respect of Bank of New York Mellon for the purposes of posting Collateral, transferring Variation Margin, and making Cash Payments when submitting its first Client Clearing Form.

5. **Technical Amendments**

The amendments to the Procedures, Rule Book, and Supplement also contain typographical corrections, clean-up changes, and similar technical corrections as well as various conforming references to the new or revised defined terms. Specifically, the reference to CFTC Regulation 1.3(y) was amended to CFTC Regulation 1.3 based on comments from the CFTC. The description of the Clearing Member Restructuring Pair File in the Procedures Section 5.16(a)(i)(H) will be revised to reference an M(M)R Restructuring rather than a Restructuring Credit Event. Later, the Procedures Section 5.17 which describes Regulatory Reporting obligations are updated to remove the reference to the name of a specific trade repository. Finally, corresponding changes to provision numbering throughout each document have been made as necessary and in compliance the US law and regulatory guidance.

(b) **Statutory Basis**

As more fully discussed below, LCH SA believes that the proposed rule changes in connection with (1) implementing settled-to-market as a method to mitigate counterparty credit risk related to changes in the market value of transactions; (2) permitting Clearing Members to create multiple account structures for a single Client and multiple trade accounts per Client within a single omnibus account structure; (3) permitting Select Members to provide client clearing services to their Affiliated Firms; and (4) making clarifications and enhancements to the existing onboarding procedures to better reflect current business practices, are consistent with the requirements of Section 17A of the Securities Exchange Act of 1934¹⁵ (the "**Exchange Act**") and the regulations thereunder, including the standards under Exchange Act Rule 17Ad-22.¹⁶

1. **Amendments to Permit Settled-to-Market treatment for Cleared Transactions**

LCH SA believes that the proposed amendments to the CDS Clearing Rules to permit STM Variation Margin treatment for Cleared Transactions are consistent with the requirements of Section 17A of the Exchange Act.¹⁷ Section 17A(b)(3)(F) of the Exchange Act¹⁸ requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions.

¹⁵ 15 U.S.C. 78q-1.

¹⁶ 17 CFR 240.17Ad-22.

¹⁷ 15 U.S.C. 78q-1.

¹⁸ 15 U.S.C. 78q-1(b)(3)(F).

LCH SA's proposed amendments and resulting operating model is similar to other clearing agencies servicing US counterparties who have implemented STM variation margin treatment. For example, ICE Clear Credit LLC ("ICC") adopted changes to its clearing rules to clearly characterize margin payments as STM. ICC acknowledged that, prior to the ICC's August 2018 changes, its clearing rules were not entirely clear about some aspects of its operational procedures which were already treating transactions as STM.¹⁹ In its order approving ICC's rule changes, the SEC confirmed that the operational practice of treating payments made under an STM model as settlement payments is consistent with an overall clearing program designed to "assure the safeguarding of securities and funds which are in the control of the ICC or for which it is responsible...the [f]ramework would, in general, protect investors and the public interest."²⁰

LCH SA's proposed rule changes will align with the requirements of Exchange Act Rule 17Ad-22(e)(8) which requires each covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to "define the point at which settlement is final to be no later than the end of the day on which the payment or obligation is due and, where necessary or appropriate, intraday or in real time."²¹ In adopting Exchange Act Rule 17Ad-22(e)(8), the SEC recognized that

¹⁹ Self-Regulatory Organizations; ICE Clear Credit LLC; Order Approving Proposed Rule Change Relating To Amending the ICC Clearing Rules Regarding Mark-to-Market Margin, Securities Exchange Act Release No. 34-83832; File No. SR-ICC-2018-006 (June 29, 2018), 83 FR 41118 (Aug. 13, 2018) (available at <https://www.govinfo.gov/content/pkg/FR-2018-08-17/pdf/2018-17741.pdf>).

²⁰ *Id.* at 41120.

²¹ 17 CFR 240.17Ad-22(e)(8).

there may be a number of ways to address compliance, highlighting three factors: (i) whether a clearing agency's policies and procedures clearly define the point at which settlement is final; (ii) whether a clearing agency completes final settlement no later than the end of the value date, and preferably intraday or in real time; and (iii) whether a clearing agency clearly defines the point after which unsettled payments, transfer instructions, or other obligations may not be revoked by a participant.²²

The proposed rule changes with respect to the STM model transparently outline a specific process by which STM transactions will be facilitated, including the operational steps that LCH SA will follow once STM is implemented to ensure finality is achieved. The CDS Clearing Rules will clearly describe the daily mandatory STM processes for FCMs and US Clearing Members, as well as the optional processes for non-FCMs and non-US Clearing Members to convert to and maintain STM accounts. Under the proposed STM model, the daily transfer of NPV Payments and PAA constitutes a final settlement of the outstanding exposure between the counterparties. All Clearing Members using the STM model will make applicable payments each day, thereby achieving a final settlement for that day. Each subsequent day, the outstanding exposure will change, and new payments will be needed to settle the exposure. The STM model is in contrast to the CTM model where transfers of collateral are made between the counterparties, with associated rights to reclaim such collateral. Under the CTM model, exposure between the counterparties carries forward through the life of the contract. Implementation of the STM model aligns LCH SA's operations with the requirements of Exchange Act Rule

²² Securities and Exchange Commission; Standards for Covered Clearing Agencies, Exchange Act Release No. 3478961; File No. S7-03-14 (Sept. 28, 2016), 81 FR 70786 (Oct. 13, 2016) (available at: <https://www.sec.gov/rules/final/2016/34-78961.pdf>).

17Ad-22(e)(8) by clearly defining a daily settlement cycle and settling each amount on the day that it is due.

Thus, the proposed rule changes to implement STM variation margin treatment, which includes daily settlement under the STM model and achieves finality with respect to STM positions each day, will promote the prompt and accurate settlement of securities transactions and derivative agreements, contracts, and transactions and assuring the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible and, therefore, will be consistent with Section 17A of the Exchange Act and the rules promulgated thereunder.

2. Amendments to permit multiple Account Structures; Amendments to Permit Select Member's clearing for Affiliated Firms; and onboarding procedures clarifications

In the SEC's Order as of December 29, 2016 Granting Application for Registration as a Clearing Agency and Request for Exemptive Relief²³ ("**2016 Order**"), the SEC evaluated LCH SA's membership standards against the requirements of Section 17A(b)(3)(B) of the Exchange Act which provides that the rules of a clearing agency must permit certain categories of persons to be eligible for membership including: registered brokers or dealers, registered clearing agencies, registered investment companies, banks, and insurance companies.²⁴ The 2016 Order went on to explain that a clearing agency is permitted to deny, or condition participation of, any member or any

²³ Self-Regulatory Organizations; LCH SA; Order Granting Application for Registration as a Clearing Agency and Request for Exemptive Relief, Order, Securities Exchange Act Release No. 34-79707; File No. 600-36 (Dec. 29, 2016), 82 FR 1398 (Jan. 5, 2017) (available at <https://www.govinfo.gov/content/pkg/FR-2017-01-05/pdf/2016-31940.pdf>).

²⁴ 15 U.S.C. 78q-1(b)(3)(B).

category of members listed in Section 17A(b)(3)(B) if such persons do not meet the financial responsibility, operational capability, experience, and competence standards set forth set by the clearing agency.²⁵ In addition, Exchange Act Rules 17Ad-22(b)(5)-(6) require a clearing agency to establish, implement, maintain, and enforce written policies and procedures that do not limit membership to dealers and do not impose any specific portfolio size or transaction volume minimums.²⁶ Exchange Act Rule 17Ad-22(b)(7) requires that a clearing agency establish, implement, maintain, and enforce written policies and procedures that "*provide[s] a person that maintains net capital equal to greater than \$50 million with the ability to obtain membership at the clearing agency, provided that such persons are able to comply with other reasonable membership standards, with any net capital requirements being scalable so that they are proportional to the risks posed by the participants activities ...*"²⁷ among other requirements. Finally, the 2016 Order considered Exchange Act Rule 17Ad-22(d)(2) which requires a registered clearing agency to establish, implement, maintain, and enforce written policies and procedures that require participants to have sufficient financial resources and robust operational capacity to meet the obligations arising from participating in the clearing agency; have procedures in place to monitor that participation requirements are met on an ongoing basis; and have participation requirements that are objective and publicly disclosed, and permit fair and open access.²⁸

²⁵ 2016 Order at 82 FR 1402; 15 U.S.C. 78q-1(b)(4)(B).

²⁶ 17 CFR 240.17Ad-22(b)(5)-(6).

²⁷ 17 CFR 240.17Ad-22(b)(7).

²⁸ 2016 Order at 82 FR 1402; 17 CFR 240.17Ad-22(d)(2).

Similarly, Exchange Act Section 17A(b)(3)(A) requires a clearing agency to have the capacity to facilitate the prompt and accurate clearance and settlement and the safeguarding of securities and funds.²⁹ Exchange Act Rule 17Ad-22(e)(17) requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to identify the plausible sources of operational risk, both internal and external and mitigate their impact through the use of appropriate systems, policies, procedures and controls; ensure that the system have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity; and establish and maintain business continuity plans that address events posing a significant risk of disrupting operations.³⁰

The modifications proposed to the Procedures Section 1 enhance and clarify LCH SA's existing onboarding procedure. The proposed changes will consolidate certain steps that were previously characterized as a stand-alone "initial review" into the overall "application process"; refine certain timing for review and approvals; and refine how LCH SA goes about imposing limitations on Clearing Members under certain circumstances, among other refinements. These enhancements reflect LCH SA's commitment to ensuring the effectiveness of its overall Clearing Members onboarding program and take into account learning by LCH SA on these subjects since the 2016 Order.

LCH SA has considered its proposal to permit Select Members to provide clearing services to Affiliated Firms and the proposal to modify its operational Account Structure

²⁹ 15 U.S.C. 78q-1(b)(3)(A).

³⁰ 17 CFR 240.17Ad-22(e)(17).

model against the requirements to minimize operational risk and maintain reliable, resilient, and secure systems. Permitting Clearing Members to create multiple account structures and multiple trade accounts per Client within a single omnibus account structure will promote flexibility, would permit Clearing Members to manage and mitigate risks in a manner that is more closely tailored to their needs and the needs of their customers. Similarly, permitting Select Members to provide clearing services to Affiliated Firms will decrease barriers to entry for accessing cleared markets and thus result in a larger number of cleared transactions which are carried out in a clear and transparent manner. Based on LCH SA's significant experience operating a clearing agency, and its associated systems and controls, it believes that these new client-focused features are appropriate and will enhance, not reduce, the level of customer protection under the current CDS Clearing Rules for Clearing Members and their Clients. As such, LCH SA believes that the modifications to the account structures and onboarding procedures, and addition of Client clearing for Select Members for their Affiliated Firms are consistent with the requirements of Section 17A of the Exchange Act and Exchange Act Rule 17Ad-22 described above.

B. Clearing Agency's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.³¹ LCH SA does not believe that the proposed rule change would impose burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Act. Specifically, the proposed changes to the Rule Book, Supplement,

³¹ 15 U.S.C. 78q-1(b)(3)(I).

and Procedures would apply equally to all Clearing Members and their Clients. For FCMs and US persons, the STM business model will apply to all Clearing Members and their customers. Non-FCMs and non-US Clearing Members will be given the option to elect to operate under the STM business model.

The proposed rule change and implementation of STM will require FCMs and US Clearing Members to utilize the STM business model when making use of LCH SA's clearing services which may impose burdens on those Clearing Members and their Clients, but such burdens are necessary and appropriate to comply with recent CFTC guidance which is applicable to LCH SA and its FCMs and US Clearing Members.³² Therefore, LCH SA does not believe that the proposed rule change would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

Further, as described above, LCH SA's proposed rule change to permit Select Members to provide clearing services to Affiliated Firms will generally improve the ability of such market participants to engage in cleared transactions or to access clearing services.

C. Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments relating to the proposed rule change have not been solicited or received. LCH SA will notify the Commission of any written comments received by LCH SA.

³² CFTC Staff Letter No. 17-51 at 2.

D. Extension of Time Period for Commission Action

LCH SA does not consent to the extension of the time period listed in Section 19(b)(2) of the Securities Exchange Act of 1934 for Commission action.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-LCH SA-2019-003 on the subject line.

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 SR-LCH SA-2019-003. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing 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. Copies of the filing also will be available for inspection and copying at the principal office of LCH SA and on LCH SA's website at: <https://www.lch.com/resources/rules-and-regulations/proposed-rule-changes-0>.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-LCH SA-2019-003 and should be submitted on or before [Commission to insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³³

Eduardo A. Aleman
Deputy Secretary

³³ 17 CFR 200.30-3(a)(12).