

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-86376; File No. SR-LCH SA-2019-003)

July 15, 2019

Self-Regulatory Organizations; LCH SA; Order Approving 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

I. Introduction

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”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its rules regarding settled-to-market treatment of variation margin and make other changes. 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.<sup>3</sup> The proposed rule change, as modified by Amendments No. 1 and 2, was published for comment in the Federal Register on May 31, 2019.<sup>4</sup> The Commission did not receive comments on the proposed rule change, as modified by Amendments No. 1 and 2. For the reasons discussed below, the Commission is approving the proposed rule change, as modified by Amendments No. 1 and 2.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 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.

<sup>4</sup> Securities Exchange Act Release No. 85940 (May 24, 2019), 84 FR 25318 (May 31, 2019) (SR-LCH-SA-2019-003) (“Notice”).

## II. Description of the Proposed Rule Change

### A. Introduction

The proposed rule change would amend LCH SA's (i) CDS Clearing Rule Book ("Rule Book"), (ii) CDS Clearing Supplement ("Supplement"), and (iii) CDS Clearing Procedures ("Procedures") (collectively the "CDS Clearing Rules") to make the changes discussed below.<sup>5</sup>

First, the proposed rule change would make conforming, clarifying, and clean-up changes intended to implement a settled-to-market treatment of variation margin.

Second, the proposed rule change would permit Clearing Members<sup>6</sup> to create multiple account structures for a single client and multiple trade accounts per client within a single omnibus account structure.

Third, the proposed rule change would permit Select Members<sup>7</sup> to provide client clearing services to their Affiliated Firms.

Fourth, the proposed rule change would make certain clarifications and enhancements to LCH SA's existing onboarding procedures.

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<sup>5</sup> Capitalized terms not otherwise defined herein have the meanings assigned to them in the CDS Clearing Rules. This description summarizes the description found in the Notice, 84 FR at 25318.

<sup>6</sup> Clearing Members at LCH SA include Select Members and General Members. At LCH SA, a member may be a "CCM" (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" (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 but has not elected to become a CCM).

<sup>7</sup> A Select Member is a CCM or an FCM Clearing Member that does not provide CDS Client Clearing Services to Clients other than Affiliated Firms and has been admitted by LCH SA as a Select Member.

Fifth and finally, the proposed rule change would also correct typographical errors, make clean-up changes, and update references to new or revised defined terms.

B. Amendments to Permit Settled-to-Market Treatment for Cleared Transactions

Variation margin is margin exchanged by parties to a CDS transaction as a result of a change in market value of that CDS transaction. The CDS Clearing Rules currently treat variation margin as collateralized-to-market. Under the collateralized-to-market model, parties to a CDS transaction make daily payments of variation margin, and these payments are treated as a transfer of collateral. Parties receiving variation margin pay Price Alignment Interest on the variation margin to the party that paid the variation margin.

The proposed rule change would amend the CDS Clearing Rules to add settled-to-market as a model of characterizing variation margin. Under the settled-to-market model, counterparties to a CDS transaction would make daily payments of variation margin, called “NPV Payments”, and payments called “Price Alignment Amount”. The Price Alignment Amount would be economically equivalent to Price Alignment Interest, and would represent the amount that would have been paid if the variation margin were treated as collateral as opposed to a settled amount. Unlike collateralized-to-market payments, settled-to-market payments would be treated as final, not collateral, and the payments would settle the outstanding exposure of the counterparties.

The proposed rule change would permit Clearing Members to classify each of their Trade Accounts as either collateralized-to-market or settled-to-market. The proposed rule change would, as a default, treat Trade Accounts as CTM Trade Accounts where a Clearing Member does not make an election and the Clearing Member is not an FCM or otherwise established under US law. Where the Clearing Member is an FCM or otherwise established under US law, LCH SA would treat its transactions as settled-to-market because, in LCH SA’s view, such an

approach would be consistent with US regulatory requirements.<sup>8</sup> LCH SA would otherwise classify cleared transactions registered within a Trade Account the same as the Trade Account itself. Moreover, Trade Accounts would only comprise CTM Cleared Transactions or STM Cleared Transactions, but not both simultaneously.

The proposed rule change would allow Clearing Members to request conversion of their collateralized-to-market transactions into settled-to-market transactions by converting the underlying account from a CTM Trade Account into an STM Trade Account. The proposed rule change would only allow such a conversion where: (i) the Converting Clearing Member is not a Defaulting Clearing Member; (ii) the relevant transactions to be converted are not subject to an early termination date; (iii) the conversion request does not violate applicable laws or regulations; (iv) the Converting Clearing Member has satisfied all of its obligations to pay cash and transfer Variation Margin and Collateral; and (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 has determined must be paid to ensure that the net present value of each transaction to be converted equals zero on the date of the conversion. The proposed rule change would only allow such a conversion once and would not allow the conversion to be reversed or revoked.

Under the proposed rule change, settled-to-market processing and payments would operate in the same way they do for collateralized-to-market under the current rules. Specifically, for STM Cleared Transactions, either the Clearing Member or LCH SA, as appropriate and described in more detail below, would make a payment, called the NPV

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<sup>8</sup> See Notice, 84 FR at 25319 (“The proposed 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.”).

Amount, to account for the variation of the market value of the CDS. LCH SA would calculate the NPV Amount based on the net present value of the transaction, and LCH SA would derive this value from the End of Day Contributed Prices provided to LCH SA. Unless otherwise agreed between the Clearing Member and LCH SA, the net present value of the transaction would begin at zero. After determining the net present value of the transaction, LCH SA would then reset the net present of the transaction back to zero.

If LCH SA determines that the value of the STM Cleared Transaction has increased, LCH SA would pay cash to the Clearing Member (the NPV Amount) denominated in the same currency as the transaction and equal to the amount of the increase in the net present value. If the net present value has decreased, then the Clearing Member would make a corresponding payment to LCH SA. If there is no change in net present value, then no payments would be required. The proposed rule change would clarify that, for the avoidance of doubt, an “increase” in the net present value would mean the value of an STM Cleared Transaction has moved in favor of the Clearing Member since the immediately preceding reset, while a “decrease” would mean the value of an STM Cleared Transaction has moved against the Clearing Member since the immediately preceding reset.

In addition to specifying payment of the NPV Amount, the proposed rule change would outline the specific operational steps required to facilitate accounting for the Price Alignment Amount in a settled-to-market transaction. As discussed above, the Price Alignment Amount would be identical to Price Alignment Interest in a collateralized-to-market transaction, and the two payments would serve the same functional purpose, although the legal status of the two payments would be different. Under the proposed rule change, if LCH SA determines that the Cumulative Net Present Value is greater than zero, the applicable Price Alignment Amount

would immediately become payable to LCH SA by the Clearing Member in the same currency as the transaction. If LCH SA determines that the Cumulative Net Present Value is less than zero, the applicable Price Alignment Amount would immediately become payable to the Clearing Member by LCH SA in the same currency as the transaction. Finally, if the Price Alignment Amount payable by a party on a Cash Payment Day is a negative amount, then the proposed rule change would specify that the Price Alignment Amount payable by that party would be deemed to be zero, and the other party would pay to that party the absolute value of the negative Price Alignment Amount on such Cash Payment Day.

The proposed rule change would define Cumulative Net Present Value as 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. LCH SA would compute the Price Alignment Amount on each Cash Payment Day after initiation of a transaction. The Price Alignment Amount would be 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. The Price Alignment Amount Rate would be the applicable prevailing interest rate of the Cash Payment Date.

To carry through these requirements to the terms of cleared CDS transactions, the proposed rule change would add new provisions to the Clearing Supplement to establish the “STM Cleared Terms” for each of the following categories of transactions: Index Cleared Transactions and Single Name Transactions incorporating the 2003 ISDA Credit Derivatives

Definitions; Index Cleared Transactions and Single Name Transactions incorporating the 2014 ISDA Credit Derivatives Definitions; and Credit Index Swaptions.

The proposed rule change would also make a number of other changes designed to help ensure the functional operation of the settled-to-market model. For example, the proposed rule change would specify the timing requirements for the payment of the NPV Amount and Price Alignment Amount. Moreover, the proposed rule change would clarify that satisfaction of the payment obligation arising under the NPV Payment Requirement would discharge any such obligation required to settle outstanding exposure under an STM Cleared Transaction. The proposed rule change would also clarify that LCH SA's risk calculations, including the calculation of Margin Requirements, would include the calculation of the Variation Margin Requirement and NPV Payment Requirement. Finally, the proposed rule change would update a number of reports generated and used by LCH SA to incorporate and take into consideration the settled-to-market model.

The proposed rule change would make certain other changes designed to maintain collateralized-to-market as a model for non-FCMs and non-US Clearing Members. Specifically, the proposed rule change would define the Variation Margin Requirement as the requirement to transfer Variation Margin to or receive Variation Margin from LCH SA to satisfy the Client Variation Margin Requirement and / or House Variation Margin Requirement. LCH SA or a Clearing Member would satisfy the Variation Margin Requirement by making a Variation Margin Collateral Transfer, meaning an amount of cash transferred by way of full title transfer. The proposed rule change would also specify that Variation Margin is applicable to CTM Cleared Transactions. The proposed rule change would further define Price Alignment Interest as applicable to the receipt of Variation Margin Collateral Transfers and which is related to CTM

Cleared Transactions. In addition, the proposed rule change would provide that if the applicable Price Alignment Interest rate is negative, LCH SA would 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. The proposed rule change would provide that, in case of the default of a Clearing Member, LCH SA would be authorized to convert the Variation Margin Collateral Transfer obligations into cash payment obligations. This change would ensure that in the case of default, LCH SA would apply Variation Margin in the same way as an NPV Payment (*i.e.*, as a cash payment). This treatment would be consistent with how LCH SA currently treats Variation Margin.

Finally, the proposed rule change would make a number of conforming changes and clarifications to the CDS Clearing Rules, including the addition of defined terms and the amendment of existing defined terms, to carry out the changes discussed above.

C. Amendments to Permit Multiple Account Structures

The proposed rule change would make a number of changes 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. Specifically, the proposed rule change would eliminate from the Rule Book existing language that restricts a CCM Client from being allocated to more than one account structure at the same time and add language to permit LCH SA to open one or more trade accounts. Similarly, the proposed rule change would add language to allow clients to configure account allocations and configure multiple accounts. The proposed rule change additionally would replace the concept of a “client” with a “client account structure” and refer to the ability of clients to have several account structures and trade accounts, thereby permitting more than one account structure for a single client. Finally, the proposed rule change

would add new defined terms, and revise existing defined terms, to account for multiple account structures.

D. Amendments to Permit Select Members Clearing for Affiliated Firms

To permit Select Members to provide client clearing services to certain affiliates, the proposed rule change would add a new defined term for “Affiliated Firm.” The proposed rule change would define “Affiliated Firm” as any Affiliate or any entity that is otherwise member to the same institutional protection scheme<sup>9</sup> as the Clearing Member. The proposed rule change would add Affiliated Firm into the definition of “Select Member” as a category of persons to whom Select Members are permitted to provide client clearing services. The proposed rule change would make similar conforming changes to other defined terms, and to the Rule Book and Procedures.

The proposed rule change would make other amendments resulting from the ability of Select Members to provide CDS Client Clearing Services for Affiliated Firms. Specifically, the proposed rule change would update a Select Member’s ability to add or remove products it clears through LCH SA, to account for products held by any Affiliated Firms to which the Select Member provides CDS Client Clearing Services. The proposed rule change also would make a related change to the form used to notify LCH SA of such changes. Additionally, the proposed rule change would make conforming amendments to LCH SA’s Membership Requirements to recognize the ability of ability of Select Members to provide CDS Client Clearing Services for Affiliated Firms. Finally, the proposed rule change would formally amend the CDS Clearing Rules to permit Select Members to provide CDS Client Clearing Services to Affiliated Firms and

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<sup>9</sup> Under the proposed rule change, the term “institutional protection scheme” would be defined as that term is set forth in Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2016 on prudential requirements for credit institutions and investment firms.

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

E. Clarifications to Onboarding Procedures

Currently, an applicant for clearing membership (“Applicant”) begins the application process by submitting an inquiry to LCH SA and providing its most recent financial statements. LCH SA conducts an initial review of the Applicant’s credit risk. LCH SA attempts to complete the initial review within 5 Business Days from receipt of the documentation but is not required to do so. Following the initial review, LCH SA either confirms that the Applicant may then complete and submit the CDSClear Application Form or refuses admission to the Applicant. If the application continues, LCH SA then proceeds with further due diligence, including a possible site visit. Under the current process, LCH SA attempts to complete the review and make a determination within 30 Business Days (or 40 Business Days where a legal opinion is required regarding the country of incorporation of the Applicant), but is not required to do so.

As revised, the proposed rule change would require that Applicants submit the CDSClear Application Form as part of their initial inquiry. As under the current process, Applicants would also be required to submit their most recent financial statements. Upon receipt of these documents, LCH SA would conduct an initial review of the Applicant’s CDSClear Application Form and credit risk. As under the current process, LCH SA would attempt to complete the initial review within 5 Business Days from receipt of the documentation but would not be required to do so.

Following completion of the initial review of the Applicant’s credit risk and CDSClear Application Form, LCH SA would either confirm that the application may continue or refuse admission to the Applicant. If the application continues, LCH SA would then proceed with further due diligence, including a possible site visit. At the end of this further review, LCH SA

would accept or reject the Applicant. Under the proposed revised process, LCH SA would be required to accept or reject the Applicant by the 30th Business Day (or 40th Business Days where a legal opinion is required regarding the country of incorporation of the Applicant) following receipt of the CDSClear Application Form and all required supporting documents by LCH SA. Thus, unlike the current process, under the proposed revised process LCH SA would be required to complete its review in 30 business days (or 40 business days where a legal opinion is required). Moreover, because under the revised process Applicants would submit their CDSClear Application Form as part of the initial inquiry beginning the initial review and the timeline would begin upon receipt of the CDSClear Application Form, LCH SA's timeline for approving or disapproving an applicant would effectively begin upon the start of LCH SA's initial review.

Moreover, the Procedures currently state that as part of the review process an Applicant may expect at least one visit to the Applicant's operations office by one or more representatives of LCH SA. The proposed rule change would modify this provision by stating that, instead, as part of the review process one or more LCH SA's representatives may carry out one or more on-site visits to the Applicant's operations office. Thus, the proposed rule change would give LCH SA discretion to carry out an on-site visit as needed rather than creating an expectation that Applicants may expect an on-site visit.

Additionally, the proposed rule change would clarify LCH SA's ability to impose limitations on Applicants. Specifically, the Procedures currently state that LCH SA may impose conditions or limitations on the exercise of certain rights under the CDS Clearing Documentation. The proposed rule change would simplify this concept by eliminating the use of the term "conditions" and instead permitting LCH SA to impose limitations following approval

of an Applicant. Thus, under the proposed rule change, LCH SA would be able to impose limitations, but not conditions, on the exercise of certain rights under the CDS Clearing Documentation. This proposed change would simplify the documentation in the Procedures but would not impose any substantive change on LCH SA's ability to, as needed, limit an Applicant's exercise of certain rights under the CDS Clearing Documentation. Moreover, the proposed rule change would clarify that an Applicant must make its initial Contribution into the CDS Default Fund before the submission of its first Original Transaction and post sufficient Collateral before the submission of its first Intraday Transaction.

Finally, the existing Procedures state that LCH SA's timeline to approve or reject an Applicant is subject to the Applicant providing a Power of Attorney with respect to its TARGET2 Accounts that enables LCH SA to directly debit or credit such accounts. The proposed rule change would modify the Procedures to state that LCH SA's timeline to approve or reject an Applicant is subject to the Applicant providing such a Power of Attorney with respect to its TARGET2 Accounts or Bank of New York Mellon accounts, for the purposes of posting Collateral, transferring Variation Margin, and making Cash Payments. This proposed change would further facilitate the settled-to-market model, as discussed above, by allowing LCH SA to obtain a Power of Attorney with respect to an Applicant's Bank of New York Mellon accounts for the purposes of posting Collateral, transferring Variation Margin, and making Cash Payments.

F. Technical Amendments

The proposed rule change would also correct certain typographical errors, make clean-up changes, and correct various conforming references in the Procedures, Rule Book, and Supplement.

### III. Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the organization.<sup>10</sup> For the reasons given below, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act<sup>11</sup> and Rules 17Ad-22(e)(1), (e)(6)(ii), (e)(8), and (e)(18) thereunder.<sup>12</sup>

#### A. Consistency with Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of LCH SA be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, to assure the safeguarding of securities and funds which are in the custody or control of LCH SA or for which it is responsible, and, in general, to protect investors and the public interest.<sup>13</sup>

As described above, the proposed rule change would amend the CDS Clearing Rules to require FCMs and U.S. Clearing Members to treat variation margin as settled-to-market, while permitting non-FCMs and non-U.S. Clearing Members to treat variation margin as either collateralized-to-market or settled-to-market. To implement and facilitate these amendments, the proposed rule change would introduce new definitions, update existing definitions, and update the terminology used in certain rules in light of the new settled-to-market treatment of variation

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<sup>10</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>11</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>12</sup> 17 CFR 240.17Ad-22(e)(1), (e)(6)(ii), (e)(8), and (e)(18).

<sup>13</sup> 15 U.S.C. 78q-1(b)(3)(F).

margin. To facilitate Clearing Members' ability to operationalize these changes, the proposed rule change would permit certain Clearing Members to classify each of their Trade Accounts as either a CTM Trade Account or an STM Trade Account, and to convert transactions between the two in certain circumstances. The proposed rule change would also amend the Procedures to describe how LCH SA would account for settled-to-market transactions, as well as calculate and make the payments associated with settled-to-market transactions. Finally, the proposed rule change would amend the Clearing Supplement to establish the standard contractual terms for CDS transactions that LCH SA would clear pursuant to the settled-to-market model.

The Commission believes that by establishing settled-to-market treatment for variation margin in CDS transactions, the proposed rule change would help ensure that variation margin is treated as settled payments rather than collateral, consistent with the intention of Clearing Members that elect, or are required to elect, settled-to-market treatment. In doing so, the Commission further believes the proposed rule change would clarify that LCH SA has all rights and outright title to settled-to-market payments made to LCH SA, thereby supporting LCH SA's ability to use such settled-to-market payments to cover credit and market losses. The Commission further believes that in establishing the operational aspects of settled-to-market treatment of variation margin, including how LCH SA would account for settled-to-market transactions and would calculate and make the payments associated with settled-to-market transactions, the proposed rule change would help ensure the effective operation of the settled-to-market model for variation margin, thereby helping to improve the operation and effectiveness of LCH SA's margin system. Similarly, the Commission believes that in establishing the standard contractual terms for CDS transactions that LCH SA clears pursuant to the settled-to-market

model, the proposed rule change would help ensure that variation margin for CDS transactions is treated as settled-to-market.

Given that an effective margin system is necessary to manage LCH SA's credit exposures to its CPs and the risks associated with clearing security based swap-related portfolios, the Commission believes that the proposed rule change would help improve LCH SA's ability to avoid potential losses that could result from the mismanagement of credit exposures and the risks associated with clearing security based swap-related portfolios. Because such losses could disrupt LCH SA's ability to promptly and accurately clear security based swap transactions, the Commission believes that the proposed rule change, by improving the operation and effectiveness of LCH SA's margin system, would thereby help promote the prompt and accurate clearance and settlement of securities transactions.

Similarly, given that mismanagement of LCH SA's credit exposures to its Clearing Members and the risks associated with clearing security based swap-related portfolios could cause LCH SA to realize losses on such portfolios and threaten LCH SA's ability to operate, thereby threatening access to securities and funds in LCH SA's control, the Commission believes that the proposed rule change would help assure the safeguarding of securities and funds which are in the custody or control of the LCH SA or for which it is responsible. Finally, for both of these reasons, the Commission believes the proposed rule change would, in general, protect investors and the public interest.

In addition, as discussed above, the proposed rule change would permit Clearing Members to create multiple account structures for a single client and multiple trade accounts per client within a single omnibus account structure and permit Select Members to provide client clearing services to their Affiliated Firms. The Commission believes that, by allowing clients to

create more than one account and allowing Select Members to clear trades for their Affiliated Firms, both of these changes would expand the clearing services that LCH SA currently offers and therefore potentially clear more trades. The Commission believes that both of these proposed changes would help expand LCH SA's provision of clearing services, which would thereby promote the prompt and accurate clearance and settlement of securities transactions.

As discussed above, the proposed rule change would also make certain clarifications and enhancements to LCH SA's existing onboarding procedures. The Commission believes that these enhancements would help ensure that Applicants are fit for clearing transactions at LCH SA and able to satisfy the requirements and obligations associated with clearing membership. Because LCH SA cannot clear and settle transactions if its Clearing Members do not satisfy their related requirements and obligations, such as posting margin and timely submitting prices, the Commission believes that that this aspect of the proposed rule change also would promote the prompt and accurate clearance and settlement of securities transactions.

Finally, as discussed above, the proposed rule change would correct typographical errors, make clean-up changes, and update references to new and revised defined terms in the CDS Clearing Rules. The Commission believes that these changes would help to ensure that the CDS Clearing Rules are clear and operate effectively, consistent with LCH SA's intent. The Commission further believes that clear and effective CDS Clearing Rules are necessary for LCH SA to promptly and accurately clear and settle CDS transactions, and therefore that this aspect of the proposed rule change also would promote the prompt and accurate clearance and settlement of securities transactions.

Therefore, the Commission finds that the proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions, assure the safeguarding

of securities and funds in LCH SA's custody and control, and in general, protect investors and the public interest, consistent with the Section 17A(b)(3)(F) of the Act.<sup>14</sup>

B. Consistency with Rule 17Ad-22(e)(1)

Rule 17Ad-22(e)(1) requires, in relevant part, that LCH SA establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.<sup>15</sup> The Commission believes that the proposed rule change, in introducing new definitions, updating existing definitions, and updating the terminology used in certain rules in light of the new settled-to-market treatment of variation margin, as well as correcting typographical errors and updating references, would help to ensure that LCH SA's CDS Clearing Rules provide a consistent and enforceable legal basis for the settled-to-market treatment of variation margin. Similarly, the Commission believes that the proposed rule change, in amending the Clearing Supplement to establish the standard contractual terms for CDS transactions that LCH SA clears pursuant to the settled-to-market model, would help to establish a clear and enforceable legal basis for the settled-to-market treatment of variation margin in cleared transactions. Therefore, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(1).<sup>16</sup>

C. Consistency with Rule 17Ad-22(e)(6)(ii)

Rule 17Ad-22(e)(6)(ii) requires, among other things, that LCH SA establish, implement, maintain, and enforce written policies and procedures reasonably designed to cover its credit

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<sup>14</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>15</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>16</sup> Id.

exposures to its participants by establishing a risk-based margin system that, at a minimum marks participant positions to market and collects margin, including variation margin or equivalent charges if relevant, at least daily.<sup>17</sup>

The Commission believes that the proposed rule change, in amending the Procedures to operationalize the settled-to-market model for FCMs and US Clearing Members while maintaining collateralized-to-market as a model for non-FCMs and non-US Clearing Members, would help to ensure that LCH SA's margin system marks participant positions to market and collects variation margin, for both settled-to-market and collateralized-to-market transactions. Specifically, in specifying how LCH SA would account for settled-to-market transactions and would calculate and make the payments associated with settled-to-market transactions, the Commission believes the proposed rule change would help to ensure that LCH SA marks positions to market daily in settled-to-market transactions. Moreover, in establishing the timelines and legal obligations for making variation margin payments and Price Alignment Amounts in settled-to-market transactions, the Commission believes that the proposed rule change would help to ensure that LCH SA and Clearing Members collect and make variation margin payments associated with settled-to-market transactions daily.

Therefore, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(6)(ii).<sup>18</sup>

D. Consistency with Rule 17Ad-22(e)(8)

Rule 17Ad-22(e)(8) requires, in relevant part, that LCH SA establish, implement, maintain, and enforce written policies and procedures reasonably designed to define the point at

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<sup>17</sup> 17 CFR 240.17Ad-22(e)(6)(ii).

<sup>18</sup> Id.

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.<sup>19</sup>

As discussed above, the proposed rule change would specify that under the settled-to-market model, the daily transfer of NPV Payments and Price Alignment Amounts would constitute a final settlement of the outstanding exposure between the counterparties. The proposed rule change would also specify that all Clearing Members using the settled-to-market model would make applicable payments each day, thereby achieving a final settlement for that day. Each subsequent day, the outstanding exposure would change, and new payments would be needed to settle the exposure. The Commission believes that in making these changes, the proposed rule change would define the point at which settlement would be final under the settled-to-market model.

Therefore, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(8).<sup>20</sup>

E. Consistency with Rule 17Ad-22(e)(18)

Rule 17Ad-22(e)(18) requires, among other things, that LCH SA establish, implement, maintain, and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation which permit fair and open access by direct and, where relevant, indirect participants and other financial market utilities.<sup>21</sup>

The Commission believes that the proposed rule change, in enhancing LCH's procedures for reviewing and admitting Applicants, would contribute to LCH SA's establishment and

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<sup>19</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>20</sup> 17 CFR 240.17Ad-22(e)(8).

<sup>21</sup> 17 CFR 240.17Ad-22 (e)(18).

implementation of objective and risk-based policies and procedures for participation. Specifically, by requiring that Applicants submit the CDSClear Application Form as part of their initial query and prior to LCH SA beginning the initial review, the Commission believes that the proposed rule change would increase the information available to LCH SA during the initial review, thereby improving LCH SA's ability to review and assess Applicants and, if necessary and appropriate, disapprove Applicants not suited for clearing membership. Moreover, in requiring that LCH SA either reject or accept the Applicant no later than 30 business days after receipt of the CDSClear Application Form and all required supporting documents by LCH SA, the Commission believes the proposed rule change would establish a clear and objective process and timeline for admission or denial of Applicants. Additionally, in clarifying that LCH SA may carry out one or more on-site visits as part of the application process, and that an Applicant must make its Initial Contribution into the CDS Default Fund before the submission of its first Original Transaction and post sufficient Collateral before the submission of its first Intraday Transaction, the Commission believes the proposed rule change would enhance LCH SA's ability to screen applicants and establish objective, risk-based standards for performance that all Applicants must satisfy.

Finally, the Commission believes that, by permitting Clearing Members to create multiple account structures for a single client and multiple trade accounts per client within a single omnibus account structure, and permitting Select Members to provide client clearing services to their Affiliated Firms, the proposed rule change would permit fair and open access by indirect participants. Specifically, the Commission believes that these proposed changes would expand access by clients by permitting multiple account structures, and expand access by firms by permitting Select Members to provide client clearing services to their Affiliated Firms.

Therefore, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(18).<sup>22</sup>

#### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change, as modified by Amendments No. 1 and 2, is consistent with the requirements of the Act, and in particular, with the requirements of Section 17A(b)(3)(F) of the Act<sup>23</sup> and Rules 17Ad-22(e)(1), (e)(6)(ii), (e)(8), and (e)(18) thereunder.<sup>24</sup>

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act<sup>25</sup> that the proposed rule change, as modified by Amendments No. 1 and 2 (SR-LCH-SA-2019-003), be, and hereby is, approved.<sup>26</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>27</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>22</sup> 17 CFR 240.17Ad-22(e)(18).

<sup>23</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>24</sup> 17 CFR 240.17Ad-22(e)(1), (e)(6)(ii), (e)(8), and (e)(18).

<sup>25</sup> 15 U.S.C. 78s(b)(2).

<sup>26</sup> In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>27</sup> 17 CFR 200.30-3(a)(12).