

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87649; File No. SR-LCH SA-2019-011)

December 3, 2019

Self-Regulatory Organizations; LCH SA; Notice of Filing of Proposed Rule Change Relating to amendments to CDS Clearing Supplement to reflect the ISDA NTCE Protocol and Supplement

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 November 21, 2019, Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I, II and III below, which Items have been prepared by LCH SA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), is proposing to amend its CDS Clearing Supplement (“**Supplement**”) to incorporate new terms and to make conforming, clarifying, and clean-up changes intended to: (1) incorporate the ISDA 2019 Narrowly Tailored Credit Event Protocol (the “**NTCE Protocol**”) into the Supplement, allowing parties to amend their legacy transactions to incorporate the 2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions (the “**NTCE Supplement**”); and (2) make certain clarifications as to the notion of Outstanding Principal Balance, which shall

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

always have the meaning set out in the ISDA 2003 and ISDA 2014 Credit Derivatives Definitions. 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.

The text of the proposed rule change has been annexed as Exhibit 5.³

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.

1. Purpose

LCH SA is proposing to amend its Supplement to reflect the NTCE Protocol, and the NTCE Supplement amending the 2014 ISDA Credit Derivatives Definitions addressing narrowly tailored credit events ("NTCEs"). NTCEs are arrangements with corporations that cause a credit event leading to settlement of CDS contracts while minimizing the impact on the corporation.

ISDA published a statement from its Board of Directors in April 2018 noting concerns with the impact of such events on the efficiency, reliability and fairness of the overall CDS market. The NTCE Protocol, due for implementation on 27 January 2020, incorporates the terms of the NTCE Supplement for legacy uncleared in-scope single

³ All capitalized terms not defined herein have the same definition as the Rule Book, Supplement or Procedures, as applicable.

name and index transactions to match the new trading standard. Yet, CCPs are expected to reflect the NTCE Protocol changes to the transactions they clear by an amendment to their clearing rules, and the final implementation date will be aligned so that the changes will go into effect for trades cleared at different CCPs and for uncleared trades at the same time.

As such, LCH SA has determined to file this proposed rule change in order to, among other things, amend its CDS Clearing Supplement to reflect the changes brought by the NTCE Protocol and NTCE Supplement. Such changes will therefore be incorporated for new trades on corporate and financial Reference Entities by updating the ISDA Credit Derivatives Physical Settlement Matrix.

a) **Amendments to reflect the NTCE Protocol for Cleared Transactions**

The updated CDS Clearing Rules will permit Clearing Members to match the new trading standard for their Index Cleared Transactions and their Single Name Cleared Transactions, without the need for LCH SA to adhere to the NTCE Protocol. To implement the ISDA NTCE Protocol and NTCE Supplement, the Supplement will be amended by adding new and amending existing provisions as described below.

In support of the above matter, LCH SA will add new provisions to the Supplement in each of Part B & Part C. Each of these changes in these two sections are substantially similar.

For Index Cleared Transactions and Single Name Transactions incorporating the 2014 ISDA Credit Derivatives Definitions :

- Part B, Section 1.2 Terms defined in the CDS Clearing Supplement – the definition of Index Cleared Transaction Confirmation will be updated with the date of the amended confirmation as published by Markit Group Limited,

both for references Markit iTraxx® Europe Index Series 22 or above (a) and Markit CDX™ Index Series 23 or above (b);

- Part B, Section 2.2 (g) and (h) will be added to the Supplement - The Index Cleared Transaction Confirmation will be amended for NTCE Protocol covered transactions by making the notions of Credit Deterioration Requirement and Fallback Discounting applicable, in accordance with the Relevant Physical Settlement Matrix and amended confirmation as published by Markit Group Limited;
- Part B, Section 2.3 (h) and (i) will be added to the Supplement - The Single Name Cleared Transaction Confirmation will be amended for NTCE Protocol covered transactions by making the notions of Credit Deterioration Requirement and Fallback Discounting applicable, in accordance with the Relevant Physical Settlement Matrix and amended confirmation as published by Markit Group Limited;
- Part B, Section 2.4 (e) will be added to the Supplement – The amendments brought by the NTCE Protocol and subsequent NTCE Supplement to the 2014 ISDA Credit Derivatives Definitions shall only be applicable where the Protocol Effectiveness Condition, as defined in the NTCE Protocol, is satisfied;
- Part B, APPENDIX XIII, Section 2.6 will be added to the Supplement – Mirroring the Part B, Section 2.4 (e) mentioned above, this addition ensures that the amendments brought by the NTCE Protocol and subsequent NTCE Supplement to the 2014 ISDA Credit Derivatives Definitions shall only be

applicable to CCM Client Transactions where the Protocol Effectiveness Condition, as defined in the NTCE Protocol, is satisfied.

For Credit Index Swaptions:

- Part C, Section 1.2 Terms defined in the CDS Clearing Supplement – the definition of iTraxx® Europe Untranchéd Transactions Swaption Standard Terms Supplement will be updated with the date of the amended iTraxx® Europe Untranchéd Transactions Swaption Standard Terms Supplement as published by Markit Indices Limited;
- Part C, Section 2.2 (f) and (g) will be added to the Supplement - The Index Swaption Cleared Transaction Confirmation will be amended for NTCE Protocol covered transactions by making the notions of Credit Deterioration Requirement and Fallback Discounting applicable, in accordance with the Relevant Physical Settlement Matrix;
- Part C, Section 2.3 (b) will be added to the Supplement – The amendments brought by the NTCE Protocol and subsequent NTCE Supplement to the 2014 ISDA Credit Derivatives Definitions shall only be applicable where the Protocol Effectiveness Condition, as defined in the NTCE Protocol, is satisfied;
- Part C, APPENDIX VIII, Section 1 will be updated with the date of the amended iTraxx® Europe Untranchéd Transactions Swaption Standard Terms Supplement as published by Markit Indices Limited;
- Part C, APPENDIX VIII, Section 2.4 will be added to the Supplement – Mirroring the Part C, Section 2.3 (b) mentioned above, this addition ensures

that the amendments brought by the NTCE Protocol and subsequent NTCE Supplement to the 2014 ISDA Credit Derivatives Definitions shall only be applicable to CCM Client Transactions where the Protocol Effectiveness Condition, as defined in the NTCE Protocol, is satisfied

b) **Amendments to harmonize the use and definition of Outstanding Principal Balance**

LCH has noticed that the term “Outstanding Principal Balance” appears throughout the Supplement using both small and capitalized letters. The entire Supplement will be harmonized in that sense that any reference to an Outstanding Principal Balance shall be with capitalized letters, so as to refer to the Outstanding Principal Balance defined, for Part A of the Supplement, in the ISDA 2003 Credit Derivatives Definitions, and for Parts B & C, in the ISDA 2014 Credit Derivatives Definitions.

2. **Statutory Basis.**

LCH SA believes that the proposed rule change in connection with the ISDA NTCE Protocol and NTCE Supplement is consistent with the requirements of Section 17A of the Securities Exchange Act of 1934⁴ (the “Act”) and the regulations thereunder, including the standards under Rule 17Ad-22⁵. In particular, Section 17(A)(b)(3)(F)⁶ of the Act 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 derivatives agreements, contracts, and transactions cleared and to assure the safeguarding of securities and funds which are in the custody or control of the clearing

⁴ 15 U.S.C. 78q-1.

⁵ 17 CFR 240.17Ad-22.

agency or for which it is responsible and the protection of investors and the public interest.⁶

Further, Rule 17d-22(e)(1) requires a covered clearing agency to provide for a well-founded, clear, transparent and enforceable legal basis for each aspect of its activities in all relevant jurisdictions. Rule 17d-22(e)(iii) also requires to support the objectives of participants.

The ISDA 2019 NTCE Protocol and Supplement are a wide industry's response to the concerns raised by both market participants and regulators regarding NTCEs and their potential market on the CDS markets.

ISDA has expressed concern that “narrowly tailored defaults . . . could negatively impact the efficiency, reliability and fairness of the overall CDS market.” Regulators have also expressed concern with narrowly tailored or manufactured credit events, including a joint statement by the heads of the Commission, the Commodity Futures Trading Commission and the UK Financial Conduct Authority that such strategies “may adversely affect the integrity, confidence and reputation of the credit derivatives markets, as well as markets more generally. These opportunistic strategies raise various issues under securities, derivatives, conduct and antifraud laws, as well as policy concerns.”⁷

It was understood that the heads of the Commission, the Commodity Futures Trading Commission and the UK Financial Conduct Authority have stated that they

⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁷ Securities and Exchange Commission, Commodity Futures Trading Commission and UK Financial Conduct Authority, Joint Statement on Opportunistic Strategies in the Credit Derivatives Markets (June 24, 2019); see also Update to June 2019 Joint CFTC-SEC-FCA Statement on Opportunistic Strategies in the Credit Derivatives Market (Sept. 19, 2019).

welcome the efforts to implement the amendments set out in the NTCE Supplement and NTCE Protocol.⁸

So, as all CCPs, LCH SA is expected to modify its rules so that the NTCE Supplement's terms will also apply to all cleared CDS transactions entered into after the implementation date.

The LCH SA CDSClear proposed rule change is fully consistent with the amendments of the ISDA credit derivatives documentation and incorporates changes to the standard terms of CDS Contracts widely adopted by market participants.

For all the reasons above, LCH SA believes that the proposed rule change is consistent with the requirements of Section 17A of the Securities Exchange Act of 1934⁹ (the "Act") and the regulations thereunder, including the standards under Rule 17Ad-22¹⁰.

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.¹¹

As mentioned above, the LCH SA CDSClear proposed rule change is reflecting the ISDA 2019 NTCE Protocol and Supplement that is an industry response and initiative applicable to all CDS market participants.

⁸ Update to June 2019 Joint CFTC-SEC-FCA Statement on Opportunistic Strategies in the Credit Derivatives Markets (Sept. 19, 2019).

⁹ 15 U.S.C. 78q-1.

¹⁰ 17 CFR 240.17Ad-22.

¹¹ 15 U.S.C. 78q-1(b)(3)(I).

The proposed rule change would apply equally to all Clearing Members and their Clients and would not adversely affect the ability of such members or other market participants generally to engage in cleared transactions or to access LCH SA's clearing services.

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.

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.

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-2019-011 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549-1090.

All submissions should refer to File Number SR-LCH SA-2019-011. 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, N.E., Washington, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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-2019-011 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.¹²

Jill M. Peterson
Assistant Secretary

¹² 17 CFR 200.30-3(a)(12).