

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-92723; File No. SR-LCH SA-2021-002)

August 23, 2021

Self-Regulatory Organizations; LCH SA; Notice of Filing of Proposed Rule Change
Relating to Eligible Collateral and Liquidity Risk Management

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 18, 2021, 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 (“**Proposed Rule Change**”) described in Items I, II and III below, which Items have been primarily prepared primarily 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

(a) Banque Centrale de Compensation, which conducts business under the name LCH SA, is proposing to expand the non-cash collateral that a Clearing Member³ may post with LCH SA to meet the member’s margin requirements (the “**Eligible Collateral**”) to include certain additional non-Euro government bonds by (i) amending its CDS Clearing Rulebook (the “**Rule Book**”) to clarify that such additional non-Euro government bonds are excluded from the Pledged Eligible Collateral, and (ii) publishing

¹ 15 U.S.C. 78s(b)(1).

² 17 C.F.R. § 240.19b-4.

³ Capitalized terms used but not defined herein shall have the meaning specified in the Rule Book, the Clearing Supplement, the Procedures and the Clearing Regulations, as applicable.

a new Clearing Notice, in accordance with Article 4.2.6.1 of the CDS Clearing Rule Book, specifying the additional acceptable non-Euro government bonds. LCH SA is also proposing to expand the custodians at which Clearing Members may deposit Eligible Collateral by adding Clearstream Banking Luxembourg as a central securities depository for LCH SA in Section 3 of the CDS Clearing Procedures – Collateral, Variation Margin and Cash Payment. Finally, LCH SA is proposing to amend its Liquidity Risk Modelling Framework (the “**Framework**”) to take into account the expanded list of Eligible Collateral.

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 such statements.

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

1. Purpose

The Proposed Rule Change is being adopted to expand the non-Euro government bonds that a Clearing Member may post with LCH SA in order to satisfy the clearing member’s margin requirements. Currently, the only non-Euro Eligible Collateral are Gilts, issued by the United Kingdom, and Treasury Bills, issued by the United States. LCH SA is proposing to expand the list of Eligible Collateral in response to clearing member requests and in order to harmonize permitted Eligible Collateral with the Eligible

Collateral permitted to satisfy clearing member margin requirements at LCH SA's affiliate LCH Limited.⁴

To effect this change, LCH SA is proposing to issue a new Clearing Notice identifying the additional non-Euro Eligible Collateral, defined as "New Instruments" in the Clearing Notice⁵. LCH SA has determined that (i) each of the non-Euro jurisdictions whose bonds have been added have a high credit score, and (ii) each of the New Instruments has sufficient liquidity.⁶ However, because the European Central Bank will not convert the additional non-Euro Eligible Collateral to Euros and LCH SA currently does not otherwise have the operational capacity to convert the additional non-Euro Eligible Collateral to Euros, the Clearing Notice will also provide that non-Euro Eligible Collateral may satisfy no more than 15 percent (15%) of a Clearing Member's total margin requirements.

In addition, the Clearing Notice will provide that the New Instruments will not be eligible as "Pledged Eligible Collateral" and, therefore, may not be pledged in accordance

⁴ LCH Limited is a recognized central counterparty supervised in the United Kingdom by the Bank of England and a derivatives clearing organization registered with the Commodity Futures Trading Commission.

⁵ The additional non-Euro Eligible Collateral, identified as "New Instruments" in the Clearing Notice, include: (i) Australian Treasury Bills and Government Bonds; (ii) Canadian Treasury Bills and Government Bonds; (iii) Danish Treasury Bills and Government Bonds; (iv) Japanese Treasury Bills, Treasury Discount Bills, and Government Bonds; (v) Norwegian Treasury Bills and Government Bonds; (vi) Swedish Treasury Bills and Government Bonds; and (vii) Swiss Treasury Bills and Government Bonds. The complete list of Eligible Collateral, together with all applicable haircuts, is also found on LCH SA's Website as set out in Paragraph 3.9 of the Procedures.

⁶ Only instruments with a minimum outstanding amount of €500 million or greater will be eligible to be posted with LCH SA.

with a pledge agreement entered into between LCH SA and a clearing member having exercised its option to transfer Eligible Collateral to LCH SA through a Belgian law security interest. Accordingly, the definition of “Pledged Eligible Collateral” in Section 1.1.1 of the CDS Clearing Rule Book will be revised to provide that the term “Pledged Eligible Collateral” means “Eligible Collateral as described in a Clearing Notice which is pledged in accordance with a Pledge Agreement.”

Separately, LCH SA is proposing to revise Section 3 of its CDS Clearing Procedures – Collateral, Variation Margin and Cash Payment, in several places to add Clearstream Banking Luxembourg as a central securities depository for LCH SA.⁷

Finally, as noted above, LCH SA is also proposing to amend the Framework to take into account the expanded list of Eligible Collateral. The Framework is one of several policies and procedures that LCH SA maintains to manage its liquidity risk, *i.e.*, the risk that LCH SA will not have enough cash available, in extreme but plausible circumstances, to settle margin payments or delivery obligations when they become due, in particular upon the default of a clearing member. The Framework describes the Liquidity Stress Testing framework by which the Collateral and Liquidity Risk Management department (“**CaLRM**”) of LCH Group Holdings Limited (“**LCH Group**”) assures that LCH SA has enough cash available to meet any financial obligations, both expected and unexpected, that may arise over the liquidation period for each of the clearing services that LCH SA offers.⁸

⁷ See, Paragraph 3.4(d)(i); Paragraph 3.10(a), (b) and (c); and Paragraph 3.12(b) of Section 3 of the CDS Clearing Procedures.

⁸ In addition to its CDSClear service, LCH SA provides clearing services in connection with cash equities and derivatives listed for trading on Euronext

In particular, because the European Central Bank will not convert the additional non-Euro Eligible Collateral to Euros and LCH SA currently does not otherwise have the operational capacity to convert the additional non-Euro Eligible Collateral to Euros, LCH SA is proposing to amend Section 4.1.3 and Section 4.1.4 of the Framework to make clear that the additional non-Euro Eligible Collateral will be excluded from the calculation of LCH SA's liquidity resources.⁹

Unrelated to the expansion of non-Euro Eligible Collateral, LCH SA is also proposing to amend the Framework to clarify certain Sections and update certain tables and formula. In this regard:

- Section 4.1.1, Description of sources of liquidity, will be revised to clarify that, with limited exceptions,¹⁰ LCH SA generally receives Collateral on a full title transfer basis, which permits LCH SA to use such collateral, to offset it with all related claims and to consider such Collateral available for liquidity purposes.
- Section 4.1.3, Assessment of assets' liquidity, will be revised to clarify that Collateral deposited under the pledge regime may be used for liquidity purposes only if the clearing member pledging such Collateral has defaulted.¹¹

(EquityClear), commodity derivatives listed for trading on Euronext (CommodityClear), and triparty and bilateral Repo transactions (EuroGC+ and RepoClear).

⁹ See, also, Section 5.2.1.1, Assumptions, footnotes 20 and 2; Section 5.3.5, LCR Calculation, footnote 26; and Section 5.4.3, CC&G LCR Calculation.

¹⁰ The two exceptions are: (i) Collateral deposited under the regime of pledge; and (ii) Collateral deposited through a central bank guarantee.

¹¹ This clarification is repeated in Section 4.1.4, Synthesis.

- Section 4.2.1.4, Update of the figures of the liquidity injected in the settlement system to smooth settlement activity. Figures are updated periodically in line with the flow observed on the CSD and ICSD.
- Section 5.1.1, Overview of the Monitoring liquidity, will be revised to clarify that LCH SA has a group policy that allows LCH SA to perform an extraordinary margin call if liquidity deteriorates.
- Section 5.3.1, Liquidity Coverage Ratio (LCR), Overview, will be revised to explain that the LCR is an internal ratio similar, but not equivalent, to the banking metric defined in the Basel III framework and is used to ensure compliance with EMIR.
- Section 5.3.1.1, Liquidity requirements Assumptions per clearing services RepoClear, will be revised to update the formula for calculating market risk in RepoClear transactions.
- Section 5.3.1.3, Cash Equity, will be revised to clarify the treatment of settlement risk to account for early exercise of American-style options.
- Sections 5.3.1.4, Listed derivatives, 5.3.1.5, Credit Default Swaps, and 5.3.4, Cover 2 selection, will be revised to clarify that the calculation of LCR liability components include spread shifts and implied volatility shifts.
- Section 5.3.4, Clarification that for cover 2 selection the calculation of stressed VM for Cash Equity and Listed Derivatives includes scenario based on price shifts and implied volatility shifts.
- Section 5.3.5, A note will be added to specify that the new non cash securities will be excluded from the LCR assets, in line with amendment in section 4.1.3.

- Section 5.4.3, A will be added to specify that in line with general Cover 2 LCR also for the CC&G LCR the new non euro securities will be excluded from the liquid assets, in line amendments in sections 4.1.3. and 5.3.5.
- Section 5.5, A duplicated sentence was deleted.
- Section 5.5.1, will be revised to clarify that Non Euro non cash collateral are not European Central Bank eligible assets and that when considering multiple defaults the clearing members with the worst credit quality are assumed defaulting first.
- Appendix 3 and 5 will be updated to add of the overdraft facility in place with Citibank that allows the CCP to source non Euro currencies in case of liquidity needs.

2. Statutory Basis

LCH SA has determined that the Proposed Rule Change is consistent with the requirements of Section 17A of the Act¹² and regulations thereunder applicable to it. Section 17A(b)(3)(F) of the Act requires, *inter alia*, that the rules of a clearing agency should be designed to “assure the safeguarding of securities and funds that are in its custody or control or for which it is responsible.”¹³ In addition, Regulation 17Ad-22(e)(4)(ii) requires a central counterparty (“CCP”) that is involved in activities with a more complex risk profile, *e.g.*, that provides CCP services for security-based swaps, to maintain and enforce written policies and procedures reasonably designed to effectively “measure, monitor, and manage its credit exposures from its payment, clearing and

¹² 15 U.S.C. 78q-1.

¹³ 15 U.S.C. 78q-1(b)(3)(F).

settlement processes” to assure that it maintains additional financial resources to enable it to cover a wide range of stress scenarios that include the default of two participant family clearing members that would potentially cause the largest aggregate liquidity exposure for the CCP in extreme but plausible market conditions.¹⁴ Further, Regulation 17Ad-22(e)(5) requires a CCP to limit the assets that it accepts as collateral “to those with low credit, liquidity and market risks and enforce appropriately conservative haircuts and concentration limits”.¹⁵

The additional non-Euro Eligible Collateral that LCH SA is proposing to permit clearing members to post with LCH SA to satisfy the clearing member’s margin requirements is limited to sovereign debt that is issued by jurisdictions that have a high credit score and subject to conservative haircuts. Further, LCH SA has determined that non-Euro Eligible Collateral may be taken into account to satisfy no more than 15 percent (15%) of a clearing member’s total margin requirements and, importantly, will be excluded from the calculation of LCH SA’s liquidity resources.¹⁶ As such, the amendments to Section 3 of the CDS Clearing Procedures and, in particular, the Framework continue to assure that LCH SA (i) maintains additional financial resources to enable it to cover a wide range of stress scenarios, and (ii) limits the assets that it accepts as collateral to those with low credit, liquidity and market risks and appropriately conservative haircuts and concentration limits. Therefore, the amendments are consistent

¹⁴ 17 C.F.R. §240.17Ad-22(e)(4)(ii).

¹⁵ 17 C.F.R. § 240.17Ad-22(e)(5).

¹⁶ Because non-Euro Eligible Collateral may be taken into account to satisfy no more than 15 percent (15%) of a clearing member’s total margin requirements, LCH SA has determined that specific concentration limits are unnecessary.

with the requirements of Section 17A(b)(3)(F) of the Act and Regulation 17Ad-22(e)(4)(ii) and Regulation 17Ad-22(e)(5).

As noted above, Section 17A(b)(3)(F) of the Act requires, *inter alia*, that the rules of a clearing agency “assure the safeguarding of securities and funds that are in its custody or control or for which it is responsible.”¹⁷ The amendments to the Framework unrelated to the expansion of non-Euro Eligible Collateral clarify certain Sections and update certain tables and formula. As such, the clarifications set out in the amended Framework enhance LCH SA’s ability to assure the safeguarding of securities and funds that are in its custody or control or for which it is responsible. For example, the amendments clarify that: (i) LCH SA generally receives Collateral on a full title transfer basis, which permits LCH SA to use such collateral, to offset it with all related claims and to consider such Collateral available for liquidity purposes; (ii) Collateral deposited under the pledge regime may be used for liquidity purposes only if the clearing member pledging such Collateral has defaulted; (iii) LCH SA is able to perform an extraordinary margin call if liquidity deteriorates; and (iv) the calculation of LCR liability components include spread shifts and implied volatility shifts. The amendments to the Framework, therefore, are consistent with the requirements of Section 17A(b)(3)(F) of the Act.

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.¹⁸ LCH SA does not believe the Proposed Rule Change would have

¹⁷ 15 U.S.C. 78q-1(b)(3)(F).

¹⁸ 15 U.S.C. 78q-1(b)(3)(I).

any impact, or impose any burden, on competition. The Proposed Rule Change does not address any competitive issue or have any impact on the competition among central counterparties. LCH SA operates an open access model, and the Proposed Rule Change will have no effect on this model.

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:

- 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-2021-002 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-2021-002. 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 such filings will also 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/rulebooks/proposed-rule-changes>.

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-2021-002 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

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Assistant Secretary

¹⁹ 17 C.F.R. § 200.30-3(a)(12).