

**By Electronic Mail**

9th August, 2016

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Re: Request for Exemptive Relief**

Dear Mr. Fields:

*Banque Centrale de Compensation*, doing business as LCH SA (“LCH SA”), is a clearing organization located in Paris, France that currently provides clearing services for equities, over-the-counter (“OTC”) derivatives and exchange-traded futures and options as well as fixed income instruments and commodity products traded on European exchanges and multilateral trading facilities.<sup>1</sup> LCH SA also operates a separate clearing service for credit default swaps (“CDSClear”) in respect of certain broad-based iTraxx and CDX indices (“Index CDS”) as well as on the individual reference entities contained therein (“Single-Name CDS”).

LCH SA has registered with the Commodity Futures Trading Commission (“CFTC”) as a derivatives clearing organization (“DCO”)<sup>2</sup> to provide its CDSClear service for Index CDS to clearing members located in the United States and their cleared swaps customers.<sup>3</sup> In connection with clearing Index CDS, LCH SA has received relief from SEC staff in order to

<sup>1</sup> LCH SA is a member of LCH.Clearnet Group Limited, the financial market’s leading independent clearing house group, serving major international exchanges and platforms, as well as a range of OTC markets.

<sup>2</sup> See in the Matter of the Application of LCH.Clearnet SA For Registration as a Derivatives Clearing Organization, Order of Registration (December 17, 2013).

<sup>3</sup> CDS on a broad-based index of reference entities, such as the Index CDS cleared by LCH SA, are “swaps” for purposes of the Dodd-Frank Act and are subject to regulation by the CFTC under the Commodity Exchange Act, as amended (the “CEA”). By contrast, Single-Name CDS are “security-based swaps” for purposes of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and are regulated by the Securities and Exchange Commission as “securities” under the US federal securities laws, including the Securities Exchange Act of 1934, as amended (the “Exchange Act”). See, e.g., Section 3(a)(68) of the Exchange Act, as amended by the Dodd-Frank Act.

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facilitate the management of a restructuring credit event occurring in respect of a specific reference entity included in the index underlying an Index CDS, where such reference entity is “spun out” of the relevant index.<sup>4</sup>

In addition, on or about the date of this letter, LCH SA has submitted to the Securities and Exchange Commission (“SEC”) an application for registration as a Clearing Agency in connection with providing its CDSClear service for Single-Name CDS to its clearing members located in the United States.<sup>5</sup> The relief requested herein is intended to facilitate the end-of-day price discovery as a necessary part of the clearing and risk management processes for CDS, to eliminate the need for LCH SA to comply with rule filing requirements under the Exchange Act with respect to LCH SA’s existing, non-U.S. businesses that do not involve any U.S. persons, to allow LCH SA to post its financial statements audited under PCAOB from 2016 onwards only including 2015 closing balance in order to present a seamless “chain” of opening and closing balances and to allow such financial statements to be posted at the end of the first quarter following LCH SA’s fiscal year-end.

## 1. RELIEF REQUESTED

LCH SA requests that, for the reasons set out in Section 2 below, and subject to the conditions set out in Section 3 below, the SEC issue an order pursuant to Section 36 of the Exchange Act that would:

- exempt LCH SA from the registration requirements of Section 5 and 6 of the Exchange Act and the rules and regulations thereunder in connection with LCH SA’s calculation of daily settlement prices for Single-Name CDS, including the “forced-trade” mechanism described more fully herein;
- exempt each of LCH SA’s BD-FCM Clearing Members from the requirements of Section 5 of the Exchange Act and the rules and regulations thereunder in connection with any such US clearing member’s use of the facilities of LCH SA to execute a “forced trade” in a Single-Name CDS, or to report any such “forced trade”, in connection with LCH SA’s clearance and risk management process for Single-Name CDS;

<sup>4</sup> A “spun out” Single-Name CDS (“**Spun-Out Component Transaction**”) is a security-based swap, and hence a security, subject to the SEC’s jurisdiction. See Letter from James R. Burns, Deputy Director, Division of Trading and Markets, SEC, to Mr. Christophe Hemon, CEO, LCH.Clearnet SA (September 27, 2013), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/2013/lch-clearnet-sa-092713.pdf> (granting LCH SA no-action relief from the clearing agency registration requirement in Section 17A of the Exchange Act with respect to Spun-Out Component Transactions that are proprietary positions of LCH SA’s US clearing members); and Letter from John Ramsay, Acting Director, Division of Trading and Markets, SEC, to Jean-Marie Boudet, Chief Risk Officer, LCH.Clearnet SA (December 30, 2013), available at: <http://www.sec.gov/divisions/marketreg/mr-noaction/2013/lch-clearnet-sa-123013.pdf> (permitting LCH SA to commingle Index CDS and Spun-Out Component Transactions in segregated accounts subject to Section 4d(f) of the CEA and CFTC Rules).

<sup>5</sup> Due to the differing regulatory regimes applicable to Index CDS and Single-Name CDS, U.S. clearing members of CDSClear that offer customer clearing services are required to be regulated with the CFTC as futures commission merchants and with the SEC as broker-dealers (each, a “**BD-FCM Clearing Member**”).

- exempt LCH SA from the requirement under Section 19(b) of the Exchange Act and Rule 19b-4 thereunder to file proposed rule changes that (i) primarily affect LCH SA's clearing operations with respect to the Non-U.S. Business (as defined below) and (ii) do not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using the CDSClear services;
- exempt LCH SA from certain requirements of Exchange Act Rule 17Ad-22(c)(2)(iii) in respect of its annual financial statements for 2014 and 2015;
- exempt LCH SA from the requirement of Exchange Act Rule 17Ad-22(c)(2) to post its annual audited financial statements on its website within 60 days of LCH SA's fiscal year-end, so as to permit LCH SA to post such financial statements at the end of the first quarter following LCH SA's fiscal year-end; and
- exempt LCH SA from certain requirements of Exchange Act Rule 17a-22 with respect to the Non-U.S. Business (as defined below) and further to permit LCH SA to file materials with the SEC electronically.

The relief requested herein, if granted, would be effective as of the date on which LCH SA registers with the SEC as a clearing agency for purposes of clearing security-based swaps for U.S. persons.

## 2. DISCUSSION

### 2.1 CDSClear "Forced-Trade" Mechanism

In order to calculate daily margin requirements for the cleared CDS transactions in its CDSClear service, including all Single-Name CDS, LCH SA has established an end-of-day contributed pricing model administered by Markit.<sup>6</sup> The central element of this model is the requirement for a Price Contribution Participant<sup>7</sup> to submit an end-of-day price on each Price Contribution Day<sup>8</sup> in respect of each position it maintains in a given Single-Name CDS contract. This obligation extends to the entire curve of maturities for the Single-Name CDS contract in question, even in a maturity where the Price Contribution Participant does not maintain a position.

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<sup>6</sup> Full details of this model are set out in Section 5.18 of the CDS Clearing Procedures and in Article 4.2.7.1 and 4.2.7.7 of the CDS Clearing Rule Book.

<sup>7</sup> Defined as each CDSClear clearing member or its "Price Contribution Delegate", which must be an affiliate as well as a CDSClear clearing Member in its own right and must be approved by LCH SA to act in such capacity. See Section 1.1.1 of the CDS Clearing Rule Book; see also Section 5 of the CDS Clearing Procedures.

<sup>8</sup> Defined as: (i) in respect of Euro-denominated CDS, a day that is not a holiday in the TARGET2 calendar and a day on which commercial banks in London are open for business ("Clearing Day"); or (ii) in respect of US dollar-denominated CDS, a Clearing Day that is a day on which commercial banks in New York are open for business.



The end-of-day contributed pricing model is an essential element of CDS Clear's risk management process, including for Single-Name CDS and, as noted above, serves as the basis on which margin requirements for Single Name CDS are set. To ensure the integrity of this pricing model, LCH SA has introduced a "forced trade" mechanism, pursuant to which a Price Contribution Participant submitting an off-market price to Markit may be required to enter into a "forced trade" in the relevant Single Name CDS at the off-market price. Forced trades may only be required on certain "Firm Days", defined as the final Clearing Day of each calendar quarter and thirty other Clearing Days during the calendar year chosen at LCH SA's sole discretion.<sup>9</sup> Failure by a Price Contribution Participant to submit end-of-day prices, or to enter into a forced trade when required, could lead to disciplinary proceedings.<sup>10</sup>

Absent the relief requested herein, the operation of CDS Clear's forced trade mechanism in respect of US clearing members could cause LCH SA to meet the definition of "exchange" under the Exchange Act.<sup>11</sup> Section 5 of the Exchange Act states that "it shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States to effect any transaction in a security, or to report any such transaction, unless such exchange...is registered as national securities exchange" (emphasis added). Both LCH SA as well as its BD-FCM Clearing Members could therefore be prohibited under Section 5 of the Exchange Act from participating in the forced trade mechanism. Section 6 of the Exchange Act sets out the procedures for an exchange to register as a national securities exchange.

The relief requested herein is consistent with the SEC's historical approach to similar forced trade models used by other CCPs and their broker-dealer participants in connection with clearing of Single-Name CDS.<sup>12</sup> Accordingly, LCH SA shall, in connection with the relief

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<sup>9</sup> The determination that a given Clearing Day is a Firm Day must be communicated by LCH SA to its CDS Clearing Members promptly following the end of the submission window for end-of-day prices to be submitted to Markit. See Section 5.18.5(a) of the CDS Clearing Procedures.

<sup>10</sup> See Section 5.18.6 of the CDS Clearing Procedures. Such a failure would not, however, permit LCH SA to declare an Event of Default in respect of the Price Contribution Participant.

<sup>11</sup> See Section 3(a)(1) of the Exchange Act (statutory definition of "exchange" as, *inter alia*, "any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers..."); see also Exchange Act Rule 3b-16(a) (confirming that the statutory definition of "exchange" applies where an organization, association or group of persons: (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established non-discretionary methods under which such orders interact with each other).

<sup>12</sup> See Exchange Act Release No. 64795, 76 Fed. Reg. 39927, 32933-36 (July 7, 2011) (extending earlier exemptive relief to ICE Trust U.S. LLC ("ICE Trust"), Chicago Mercantile Exchange, Inc. ("CME"), and ICE Clear Europe Limited ("ICE Clear Europe"), as well as their broker-dealer participants, from Sections 5 and 6 of the Exchange Act with respect to the forced trade mechanism used in their end-of-day settlement price models). For the prior exemptive relief granted to: (1) ICE Trust, see Exchange Act Release No. 59527, 74 Fed. Reg. 10791 (March 12, 2009); No. 61119, 74 Fed. Reg. 65554 (December 10, 2009); No. 61662, 75 Fed. Reg. 11589 (March 11, 2010); and No. 63387, 75 Fed. Reg. 75502 (December 3, 2010); (2) CME, see Securities Exchange Act Release No. 59578, 74 Fed. Reg. 11781 (March 19, 2009); No. 61164, 74 Fed. Reg. 67258 (December 18, 2009); No. 61803, 75 Fed. Reg. 17181 (April 5, 2010); and No. 63388, 75 Fed. Reg. 75522 (December 3, 2010); and (3) ICE Clear Europe, see Exchange Act Release No. 60372, 74 Fed. Reg. 37748 (July 29, 2009); No. 61973, 75 Fed. Reg. 22656 (April 29, 2010); and No. 63389, 75 Fed. Reg. 75520 (December 3, 2010) (collectively, "Prior Exemptive Relief").

requested herein, comply with the requirements set out in Section 3 below, which reflect the terms of the Prior Exemptive Relief previously granted by the SEC.

## 2.2 Requirement to File Certain Proposed Rule Changes

Pursuant to Section 19(b)(1) of the Exchange Act, all self-regulatory organizations, including registered clearing agencies, are required to file with the SEC copies of any proposed rule,<sup>13</sup> or any addition to or deletion from their existing rules (“proposed rule change”);<sup>14</sup> a proposed rule change generally may not take effect unless it is approved by the SEC or otherwise permitted to become effective under Section 19(b) of the Exchange Act. Section 19(b)(3) of the Exchange Act provides that certain enumerated proposed rule changes<sup>15</sup> may become effective upon filing with the SEC and gives the SEC the authority to designate by rule, consistent with the public interest and purposes of Section 19(b), such automatically-effective proposed rule changes. The SEC used this authority to adopt Exchange Act Rule 19b-4(f), which added categories of proposed rule changes that may take effect upon filing, including certain proposed rule changes of a registered clearing agency that have only limited impact on its securities-related clearing activities.<sup>16</sup>

The SEC has taken an entity-based approach to oversee Registered Clearing Agencies as a whole.<sup>17</sup> Therefore, a Registered Clearing Agency is required to file all proposed rule changes with the SEC, including those with respect to cleared products that do not fall within the SEC’s jurisdiction. The SEC has justified this approach on the basis that a failure to submit such rule changes would prevent the SEC from discharging its statutory responsibilities.<sup>18</sup>

The SEC amended Rule 19b-4 in 2011<sup>19</sup> and 2013<sup>20</sup> to adopt Rule 19b-4(f)(4)(ii) in order to facilitate the rule filing process effected by registered clearing agencies that also are registered with the CFTC as a DCO (“Dually-Registered Clearing Agencies”). The amendments pertain to proposed rule changes primarily affecting clearing activities with respect to swaps, futures, options on futures and forwards regulated by the CFTC, and that do not significantly affect any securities clearing operations of the clearing agency or the rights or obligations of the

<sup>13</sup> See Exchange Act Section 3(a)(27) (defining “rules of a clearing agency”) and Exchange Act Section 3(a)(28) (defining “rules of a self-regulatory organization”).

<sup>14</sup> See Exchange Act Section 19(b)(1) and Rule 19b-4(a)(4) thereunder (defining “proposed rule change”).

<sup>15</sup> This list includes proposed rule changes that: (i) constitute a stated policy, practice or interpretation with respect to the meaning, administration or enforcement of an existing rule; (ii) establish or change a due, fee or other charge; or (iii) are concerned solely with administration.

<sup>16</sup> See Exchange Act Rule 19b-4(f)(4).

<sup>17</sup> See, e.g., Amendment to Rule Filing Requirements for Dually-Registered Clearing Agencies, 78 Fed. Reg. 21046, 21050 (April 9, 2013), hereinafter referred to as “Dually Registered Clearing Agency Release”) (“The Commission’s oversight responsibility over [registered clearing agencies] extends to the clearing agency as a whole and is entity-based, rather than product based”).

<sup>18</sup> See 78 Fed. Reg. at p. 21050.

<sup>19</sup> See Exchange Act Release No. 64832, 76 Fed. Reg. 41056 (July 13, 2011).

<sup>20</sup> See Dually Registered Clearing Agency Release, 78 Fed. Reg. at 21048-21052.



clearing agency with respect to securities clearing or persons using such securities-clearing service. The objective of the amendments was to eliminate unnecessary delays that could arise due to the differences between the SEC's rule filing process and the CFTC's self-certification process, which generally allows rule changes to become effective either before or within ten business days after filing with the CFTC. Nonetheless, these amendments do not take into account the circumstances of a foreign clearing agency dually registered with the CFTC as a DCO for clearing index CDS that are swaps and with the SEC as clearing agency for clearing single-name CDS that are security-based swaps. Such foreign, Dually-Registered Clearing Agencies may have completely offshore business, consisting of providing clearing services to non-U.S. persons, outside the United States, for securities, exchange-traded futures and options and commodity products, which would not otherwise trigger the registration requirements of the SEC under the Exchange Act or of the CFTC under the Commodity Exchange Act.

Previously, a foreign clearing agency has triggered the registration requirement with the SEC only if it provides clearance and settlement services for U.S. securities directly to U.S. persons.<sup>21</sup> LCH SA currently provides clearing services for equities, and exchange-traded futures and options as well as fixed income instruments and commodity products traded on European exchanges and multilateral trading facilities in which no U.S. persons participate as clearing members (collectively, the "Non-U.S. Business").<sup>22</sup> The clearing activities that are part of LCH SA's Non-U.S. Business would not otherwise cause LCH SA to be required to register with the SEC as a clearing agency but for the fact that LCH SA intends to expand its CDSClear business to offer clearing services for single-name CDS to U.S. persons.

Since the rule filing requirements under Section 19(b) and Rule 19b-4 ("**Rule Filing Requirements**") apply to a registered clearing agency on an entity basis, if the SEC were to grant LCH SA's application for registration as a clearing agency, LCH SA would be required to file proposed rule changes with respect to its Non-U.S. Business. LCH SA does not believe that application of the Rule Filing Requirements to its Non-U.S. Business would serve the SEC's regulatory interest. On the other hand, LCH SA recognizes that applying a solely product-based approach with respect to the Rule Filing Requirements, i.e., only to LCH SA's CDSClear business, the sole basis for LCH SA's registration application with the SEC, would

<sup>21</sup> See Exchange Act Release Nos. 43775 (Dec. 28, 2000), 66 Fed. Reg. 819 (order exempting Euroclear Bank from clearing agency registration) and 39643 (Feb. 18, 1998), 63 Fed. Reg. 8232 (order exempting Euroclear Bank's predecessor, Morgan Guaranty Trust Company, as operator of the Euroclear system, from clearing agency registration); Exchange Act Release No. 38328 (Feb. 24, 1997), 62 FR 9225 (order exempting Clearstream Bank, formerly Cedel Bank, from clearing agency registration); and Exemption of Certain Foreign Brokers or Dealers, Proposed Rule, 73 Fed. Reg. 39182, 39198 (July 8, 2008) ("Previously, the [SEC] has required foreign clearing organizations to obtain an exemption from clearing agency registration only when the foreign clearing organization provides clearance and settlement services for U.S. securities directly to U.S. entities").

<sup>22</sup> LCH SA's Non-U.S. Business currently includes: (i) "EquityClear", which refers to clearing services in respect of equities, debt instruments and futures contracts traded on the Euronext, Equiduct and Bourse de Luxembourg trading platforms; (ii) "CommodityClear", which refers to clearing services in respect of futures and options for agricultural and energy products on Euronext; and (iii) "RepoClear", which refers to clearing services in respect of repo transactions on French, Italian and Spanish government debt as well as corporate debt, and also includes the Euro GC+ clearing service. LCH SA may expand its Non-U.S. Business to include other new services. At all times, the Non-U.S. Business does not and will not have any U.S. clearing members or extend membership to any U.S. persons.

be inconsistent with and potentially compromise the SEC's oversight responsibility over a registered clearing agency as a whole on an entity-wide basis. For example, this would be the case if rules that do not explicitly pertain to the CDSClear services, but have a significant impact on the CDSClear operations, were not filed with the SEC. Accordingly, for the reasons discussed in more detail below, LCH SA believes that the Rule Filing Requirements should not apply to a proposed rule change if such proposed rule change (i) primarily affects LCH SA's clearing operations with respect to the Non-U.S. Business and (ii) does not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using the CDSClear services (such proposed rule change, hereinafter referred to as "**Non-U.S. Business Rule Changes**"). Therefore, LCH SA respectfully submits that the SEC should exempt LCH SA from the Rule Filing Requirements with respect to Non-U.S. Business Rule Changes.

#### *2.2.1 Scope of the Rule Changes to be Exempted from the Rule Filing Requirements*

LCH SA believes that it is appropriate not to apply the Rule Filing Requirements to a Non-U.S. Business Rule Change, which constitutes a proposed rule change that (i) primarily affects LCH SA's clearing operations with respect to the Non-U.S. Business and (ii) does not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using the CDSClear services.

In adopting Rule 19b-4(f)(4)(ii), the SEC took into consideration the SEC's and CFTC's differing jurisdictions with respect to the products cleared by a Dually-Registered Clearing Agency. LCH SA believes that it is similarly appropriate to take into account the SEC's territorial jurisdiction when applying the Rule Filing Requirements to its Non-U.S. Business by following the approach the SEC took when adopting Rule 19b-4(f)(4)(ii).

In the Dually Registered Clearing Agency Release, the SEC states that a proposed rule change "primarily affects" a clearing agency's clearing operation with respect to products that are not securities "when it is targeted to matters related only to the clearing of those products."<sup>23</sup> Consistent with the SEC's interpretation of "primarily affects" in the context of adopting Rule 19b-4(f)(4)(ii), LCH SA believes that a proposed rule change primarily affects LCH SA's clearing operations with respect to its Non-U.S. Business when such a proposed rule change is targeted to matters related only to the clearing of the products offered by the services provided in the Non-U.S. Business. LCH SA would not consider rules of general applicability that would apply equally to CDSClear operations and Non-U.S. Business to be primarily affecting LCH SA's clearing operations with respect to the Non-U.S. Business and would file such rules of general applicability in accordance with Exchange Act Section 19(b) and Rule 19b-4. In addition, as the SEC stated in the Dually Registered Clearing Agency Release, changes to general provisions in the constitution, articles, or bylaws of the Registered Clearing Agency that address the operations of the entire clearing agency also would not be considered to

<sup>23</sup> See Dually Registered Clearing Agency Release, 78 Fed. Reg. at 21050.



primarily affect such Registered Clearing Agency's clearing operations with respect to products that are not securities.<sup>24</sup> Therefore, LCH SA will file any proposed rule changes to its constitution, articles or bylaws with the SEC in accordance with Exchange Act Section 19(b) and Rule 19b-4.

In addition, the SEC previously stated that it is appropriate to review proposed rule changes in accordance with the process set forth in Section 19(b)(2) of the Exchange Act whenever changes "significantly affect" any securities clearing operations of the clearing agency (unless there is another basis for the proposed rule change to be filed under Section 19(b)(3)(A)), even in circumstances when such effects may be indirect.<sup>25</sup> In light of the SEC's statement in the context of interpreting Rule 19b-4(f)(4)(ii), LCH SA believes that it is appropriate to file a proposed rule change that significantly affects its CDSClear operations with the SEC, even in circumstances when such proposed rule change primarily affects LCH SA's clearing operations with respect to the Non-U.S. Business.

#### *2.2.2 Filing Non-U.S. Business Rule Changes would Not Serve SEC's Regulatory Interest*

As stated above, the Non-U.S. Business does not provide clearing services to U.S. persons and LCH SA does not have any plans to extend Non-U.S. Business membership to U.S. person. LCH SA has separate memberships between CDSClear and other Non-US Business memberships and specific distinct application processes are being followed in each case. In addition, any new non EU membership requires a specific legal analysis and an authorization from the French authorities. There is no risk that a US person could use Non-US Business services without following this long and heavily controlled process. If, in the future a US person would apply to such services, the SEC staff will be informed and we will potentially review the scope of this exemption requirement.

In addition, LCH SA's CDSClear service has been deliberately structured as a "silo" separate and apart from LCH SA's Non-U.S. Business in order to segregate the risks of CDSClear from the Non-U.S. Business and vice versa. There are three principal attributes of this segregation: (1) separate rules, including policies and procedures; (2) separate financial safeguards and default arrangements; and (3) dedicated personnel and information technology ("IT") resources. As explained in detail below, because of such separation, proposed rule changes primarily affecting the Non-U.S. Business are not likely to significantly affect the CDSClear operations or any rights or obligations of LCH SA with respect to CDSClear or persons using the CDSClear service.

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<sup>24</sup> *Id.*

<sup>25</sup> *Id.*



### CDSClear Rules

LCH SA has established particular rules that are specifically designed for CDSClear and not applicable to the Non-U.S. Business.<sup>26</sup> Whilst it is possible to be a CDSClear clearing member as well as a member of one or more services provided by the Non-U.S. Business, the contractual, legal and procedural arrangements are entirely different between CDSClear and the Non-U.S. Business, and any candidate for membership of CDSClear must meet the specific CDSClear membership criteria regardless of its membership status in respect of the Non-U.S. Business.

### CDSClear Financial Safeguards and Default Arrangements

The margin and risk management framework for CDSClear is wholly separate and apart from the framework applicable to the Non-U.S. Business. In particular, LCH SA has established its own risk methodology and risk calculation systems for CDSClear.<sup>27</sup> This risk management framework does not rely on any of the other services provided by the Non-U.S. Business. In addition, there is no cross-margining in place between CDS products and any other instruments cleared by LCH SA, ensuring that there can be no mutualization of risk between CDSClear products and the products cleared through the other services provided by the Non-U.S. Business.

LCH SA maintains separate default arrangements for CDSClear, including a default management process (“**CDS DMP**”) set out in Appendix 1 of the CDS Clearing Rule Book. CDSClear has its own default management group (“**CDS DMG**”), comprised of representatives of CDS clearing members and chaired by the CDSClear Head of Risk, and which is given certain responsibilities in the event of a CDSClear clearing member default.<sup>28</sup> As discussed in greater detail below, in addition to the role of the CDS DMG, a CDSClear clearing member default will be managed operationally by CDSClear-specific risk and operational personnel.

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<sup>26</sup> In particular, LCH SA has adopted: a CDS Clearing Rule Book to govern the CDSClear service; a New York-law governed FCM CDS Clearing Regulations; an English-law governed CDS Clearing Supplement; nine separate sections of CDS Clearing Procedures; and a CDS Admission Agreement. For example, LCH SA’s CDS Clearing Rule Book is available at [http://www.lch.com/documents/731485/762705/cdsclear\\_rule\\_book\\_18.04.2016.pdf](http://www.lch.com/documents/731485/762705/cdsclear_rule_book_18.04.2016.pdf), whereas the English version of LCH SA’s rulebook applicable to the Non-U.S. Business is available at [http://www.lch.com/documents/731485/1141617/rb\\_va-2016-02-18.pdf](http://www.lch.com/documents/731485/1141617/rb_va-2016-02-18.pdf).

<sup>27</sup> The margin methodology and calculation of margin amounts applicable to CDSClear are set out in Title IV, Chapter 2 (Margin) of the CDS Clearing Rule Book and Section 2 of the CDS Clearing Procedures (Margin and Price Alignment Interest). By contrast, the margin arrangements for the other services provided by the Non-U.S. Business are set out in Title IV, Chapter 2 (Margin Requirements) of LCH SA’s Instructions as well as in Title IV, Chapter 2 (Margin Requirements) of the Clearing Rule Book (for EquityClear and CommodityClear) and Title V, Section 5.3.1 (Margin Requirements) of the Clearing Rule Book (for RepoClear).

<sup>28</sup> See Appendix 1, Clause 11 (Role and Constitution of the CDS Default Management Group) of the CDS Clearing Rule Book. LCH SA has also created a “CDS Default Management Committee” with ongoing oversight and review powers in respect of the CDS DMG and CDS DMP.

Finally, LCH SA has established a specific CDS Default Fund to support the CDSClear service.<sup>29</sup> The CDS Default Fund is maintained separately from the default funds supporting the other services provided by the Non-U.S. Business, and contributions of non-defaulting CDS clearing members to the CDS Default Fund cannot be used to manage the default of a clearing member in a service in the Non-U.S. Business.<sup>30</sup> LCH SA has also allocated a limited amount of “skin in the game” to the default waterfall, and the remainder of LCH SA’s capital is not at risk in the event of excess losses in a given clearing service.<sup>31</sup>

LCH SA has established these ring-fenced default management arrangements in order to ensure that, in the event of a major default in a given clearing service, LCH SA would only lose the portion of its “skin in the game” allocated to that clearing service. Where losses in a given clearing service are too great, LCH SA would wind down that service on a standalone basis, thereby preventing contagion between the failing clearing service and any other clearing service. Taken together, these arrangements serve to prevent any risk mutualisation between CDSClear (and its clearing members) and the other services in the Non-U.S. Business (and their clearing members).

#### CDSClear Dedicated Personnel & IT Resources

LCH SA has established dedicated personnel resources for CDSClear; these teams are located either in Paris or in London and are fully dedicated to CDSClear and do not provide support to the other services provided by the Non-U.S. Business.<sup>32</sup> Accordingly, none of the other services in the Non-U.S. Business are able to impact the operations of the CDSClear service. The personnel resources dedicated to CDSClear include the following:

- *Front-Line Risk Management.* The so-called “front-line” risk management team is responsible for the day-to-day monitoring of market activity, maintenance of margin parameters, pricing/valuation, margin calls and reporting. This team is also responsible for: (1) ensuring that CDSClear risk policies are met at all times; (2) coordinating risk focus group activities; (3) answering queries from CDSClear clearing members; and (4) designing and implementing new risk models and proposing them for approval in accordance with LCH SA’s risk governance framework.

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<sup>29</sup> See Title IV, Chapter 4 (CDS Default Fund) of the CDS Clearing Rule Book

<sup>30</sup> In the event of the default of a clearing member that participates in CDSClear as well as one or more services belonging to the Non-U.S. Business, LCH SA will run parallel default management plans in respect of each service. The defaulting clearing member’s margin and default fund contributions to each clearing service can be used to manage the default, however LCH SA is prohibited from using the contributions of non-defaulting clearing members to a given default fund to satisfy losses arising in respect of a clearing service supported by a separate default fund.

<sup>31</sup> This “skin in the game” is referred to in the CDS Clearing Rule Book as the “LCH.Clearmet SA Contribution”, and is limited to €20 million. See Article 4.3.3.1 of the CDS Clearing Rule Book.

<sup>32</sup> The sole exception to this statement relates to LCH SA’s head of operations, who is responsible for CDSClear’s operations as well as the operations of the Non-U.S. Business.

- *Operations Processing.* This team is responsible for the day-to-day clearing of CDSClear instruments, the correct integration and processing of transactions, and the operation of the “forced trade” mechanism where required. The operations team is also responsible for backloading, monitoring of intraday trades, credit events, compression and the operational aspects of managing a default.
- *Member Relationship Management/Client Services.* This team is responsible for providing support to existing and potential CDSClear clearing members, and for sales and marketing in respect of the CDSClear service.
- *Product Design.* The product design team is responsible for the design of new products and the relationship with cross-border industry groups dealing with CDS matters.
- *IT Development/Testing.* CDSClear maintains an independent IT development and testing resource dedicated solely to the CDSClear service. It either uses internal staff, contractors or suppliers under appropriate outsourcing agreements.

CDSClear also maintains a segregated set of IT systems, including in respect of trade processing (“CDSCore”) as well as risk calculations (“CDS GRI”).<sup>33</sup> These arrangements ensure that only Index CDS and Single-Name CDS can be cleared through CDSClear’s systems, and prevent any CDS products from being cleared through LCH SA’s other clearing systems. Similarly it is impossible for CDS IT systems to clear any Non-U.S. Business. Accordingly, the positions registered and maintained in the CDSClear systems are completely isolated from the Non-U.S. Business. Certain non-product specific IT resources are shared between CDSClear and the Non-U.S. Business, including common use of data centers (including disaster recovery centers); internal network; the clearing member portal; certain middleware; and treasury/ liquidity management systems.

As a conclusion, the Non-U.S. Business operates entirely outside the U.S. and does not have any U.S. persons as clearing members; in addition, because CDSClear’s rules, financial resources, default management and IT operations are completely separate from the Non-U.S. Business, there is no possibility of risk contagion or mutualization across different services or product lines in the event of a member default in the other services provided by the Non-U.S. Business. In other words, the rights and obligations of a U.S. person participating in the CDSClear services would not be affected by a member default or operational risk<sup>34</sup> occurring

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<sup>33</sup> Certain aspects of these IT systems are outsourced to affiliates or third parties through arm’s-length contractual arrangements.

<sup>34</sup> LCH SA has put in place a very strong operational risk and control framework to mitigate any risk of an operational loss. A recovery plan which includes high insurance coverage has been established to cover the extremely remote case where such a loss would threaten the financial stability of the company. The only area where a large loss could occur, although very unlikely given the highly secured investments, is related to a default in treasury management, for which we are not asking for an exemption and which is covered in the Shared Support Functions described below.



in the Non-U.S. Business. Therefore, filing a Non-U.S. Business Rule Change with the SEC would not serve the SEC's regulatory interest.

*2.2.3 Exempting Non-U.S. Business Rule Changes from the Rule Filing Requirements would Not Compromise the SEC's Oversight Responsibility Over a Registered Clearing Agency as a Whole on an Entity Basis*

Notwithstanding the resources dedicated to CDSClear identified above, LCH SA's overall governance framework applies equally to CDSClear as well as to the other services provided by the Non-U.S. Business.<sup>35</sup> In addition, LCH SA has adopted a risk management framework that requires certain functions to be shared across LCH SA's various business lines in order for risks to be adequately managed whilst maintaining an appropriate segregation of duties. Accordingly, CDSClear and the Non-U.S. Business jointly rely on the following resources (collectively, "**Shared Support Functions**"). This includes Second-Line Risk Management, Treasury/Liquidity Management, Legal and Compliance, Systems Safeguards / Security / Business Continuity, Internal Audit, Finance and HR.

The Shared Support Functions are essential for CDSClear as well as the Non-U.S. Business to provide clearing services to their respective clearing members. Accordingly, it is LCH SA's view that, to the extent a proposed rule change regarding the Shared Support Functions constitutes a rule of general applicability that would apply equally to CDSClear operations and the Non-U.S. Business, it would not be considered to primarily affect LCH SA's Non-U.S. Business and LCH SA would file such proposed rule change for the SEC's review in accordance with Section 19(b).<sup>36</sup> To the extent that a proposed rule change regarding the Shared Support Functions is targeted to matters related only to the Non-U.S. Business and therefore, primarily affects the clearing operations with respect to products that are in LCH SA's Non-U.S. Business, if such proposed rule change significantly affects the CDSClear service or any rights or obligations of LCH SA with respect to the CDSClear services or persons using the CDSClear services, it should fall within the scope of the SEC's supervisory oversight and be subject to the Rule Filing Requirements.

As a conclusion, LCH SA believes that exempting Non-U.S. Business Rule Changes that (i) primarily affect LCH SA's clearing operations with respect to the Non-U.S. Business and (ii) do not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using the CDSClear services from the Rule

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<sup>35</sup> LCH SA's board of directors ("**Board**") maintains overall responsibility for risk management of all clearing services; subcommittees of the Board, including the Audit Committee, Risk Committee and Remuneration Committee, exercise their functions across clearing services. In addition, LCH SA maintains an executive committee, known as the "Local Management Committee", which has overall responsibility for LCH SA's risk function. The LCH group has also established certain risk committees with joint oversight responsibility across LCH SA, LCH Limited and LCH LLC, including the Executive Risk Committee, Market Risk Management Committee, and Credit Risk Management Committee.

<sup>36</sup> This is consistent with the SEC's approach taken in the Dually Registered Clearing Agency Release, where the SEC states that "rules of general applicability that would apply equally to securities clearing operations, including security-based swaps, would not be considered to primarily affect a Registered Clearing Agency's non-securities clearing operations." See 78 Fed. Reg. at 21050.

Filing Requirements would not compromise or undercut the SEC's oversight over a registered clearing agency as a whole on an entity basis, consistent with the SEC's previous approach to regulation and supervision of registered clearing agencies with respect to dually registered clearing agencies. However, with due regard to the SEC's entity-level oversight, as a condition of this requested relief, LCH SA will provide notice to Commission staff of its Non-U.S. Business Rule Changes once duly approved by the national competent authorities.

### 2.3 PCAOB Audit Requirements

Exchange Act Rule 17Ad-22(c) sets out certain requirements applicable to a registered clearing agency's annual audited financial statements. These requirements permit a non-U.S. clearing agency to prepare its financial statements in accordance with International Financial Reporting Standards ("IFRS") rather than U.S. generally accepted accounting principles ("GAAP").<sup>37</sup> However, there is no such dispensation for non-U.S. clearing agencies from the obligation that such statements be audited in accordance with the standards of the Public Company Account Oversight Board ("PCAOB") by a suitably qualified public accounting firm.<sup>38</sup> Two years of financial statements must be made available on the registered clearing agency's website.<sup>39</sup>

LCH SA and its affiliates prepare their financial statements under IFRS.<sup>40</sup> These financial statements are audited in compliance with International Standards on Auditing ("ISA") rather than the PCAOB requirements set out in Exchange Act Rule 17Ad-22(c). In addition, as required by applicable French banking law, LCH SA maintains two statutory auditing firms that jointly sign the annual audited accounts. To bring its auditing arrangements into line with the requirements of Exchange Act Rule 17Ad-22, LCH SA has replaced one of its statutory auditors with a firm that meets the relevant PCAOB standards.

Therefore, from 2016 onwards, LCH SA's annual financial statements will be prepared in accordance with IFRS and audited in accordance with PCAOB standards and will be signed by auditors that meet the relevant PCAOB qualifications. However, Exchange Act Rule 17Ad-22(c)(2)(i) requires a registered clearing agency to publicly disclose the financial statements from its two most recent fiscal years. Accordingly, absent the relief requested herein, and notwithstanding that LCH SA does not anticipate onboarding any BD-FCM Clearing Members until 2017, LCH SA would be required to have its 2014 and 2015 annual financial statements audited in accordance with PCAOB standards upon its registration as a clearing agency.

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<sup>37</sup> See Rule 17Ad-22(c)(2)(ii).

<sup>38</sup> See Rule 17Ad-22(c)(2)(iii).

<sup>39</sup> See Rule 17Ad-22(c)(2)(i).

<sup>40</sup> LCH SA also prepares its financial statements under French GAAP, which are then published through the *BALO* (*Bulletin des Annonces Légales et Obligatoires*).



LCH SA has identified a number of significant challenges associated with auditing its 2014 and 2015 annual financial statements in accordance with PCAOB standards, including the following:

- events following the 2014 and 2015 financial records will need to be reanalyzed, meaning that accounting figures resulting from judgments correctly made at the time will have to be reviewed and replaced by the actual figures, which is likely to require the modification of otherwise correctly-closed accounts;
- there are practical, and possibly legal, challenges associated with re-opening the audit files of LCH SA's former statutory auditor that has been replaced with an auditor that meets the relevant PCAOB qualifications; and
- performing the additional procedures to reconcile ISA and PCAOB standards for the 2014 and 2015 financial statements, and to do so prior to the end of this calendar year, is likely to place material burdens on LCH SA, its staff and its auditors.

LCH SA also notes that these challenges would be augmented, rather than alleviated, if the SEC granted relief in respect of the 2014 audited annual financial accounts only. Auditing LCH's 2015 financial statements in isolation would cause the auditors to include observations in their auditing report as the opening balance corresponding to the 2014 accounting exercise would not have been audited. The well-after-the-fact inclusion of these observations is likely to raise unnecessary questions and concerns from LCH SA's non-U.S. clearing members, regulators and other stakeholders.

By contrast, auditing LCH SA's 2016 financial statements in accordance with PCAOB standards would necessarily require an assessment of the closing balance of LCH SA's 2015 financial statements. This assessment would *de facto* cover the 2015 financial statements within the ambit of the PCAOB-compliant audit of LCH SA's 2016 financial statements. Accordingly, granting LCH SA the relief requested herein would ensure a seamless "chain" of opening and closing balances from 2014 to 2015 (pre-PCAOB) and from 2015 to 2016 and onwards (in accordance with PCAOB standards). LCH SA believes that this approach strikes an appropriate balance between the significant costs and risks associated with re-opening and re-auditing LCH SA's 2014 and 2015 annual financial statements and providing potential BD-FCM Clearing Members sufficient information relating to LCH SA's finances.

Finally, LCH SA requests that the SEC grant an exemption from the provision in Exchange Act Rule 17Ad-22(c)(2) that would otherwise require LCH SA to publish its annual audited financial statements within 60 days of its fiscal year-end. LCH SA is an indirect, wholly-owned subsidiary of London Stock Exchange Group plc ("LSEG"), a public limited company



incorporated under English law.<sup>41</sup> LSEG, as a public company, must comply with the UK Listing Authority's Listing Rules,<sup>42</sup> and therefore is subject to specific requirements regarding the release of public information.

Pursuant to the Listing Rules, it is not possible to publish LCH SA's annual audited financial statements prior to the publication of LSEG's annual audited financial statements. Due to the scale of LSEG's business activities and the diversity of its stakeholders and subsidiaries, it is not possible for LSEG to publish its annual audited financial statements within 60 days of its fiscal year-end.

#### **2.4 Exchange Act Rule 17a-22 Filings**

Exchange Act Rule 17a-22 requires registered clearing agencies to file with the SEC three copies of "materials" (e.g., manuals, notices, circulars, bulletins, lists, or periodicals) within ten days of making such materials generally available to its members "or others with whom it has a significant relationship". In describing the filing obligations under Exchange Act Rule 17a-22, the SEC has explained that such copies are to be sent in paper format.<sup>43</sup>

LCH SA requests that the SEC treat LCH SA's filing obligations under Exchange Act 17a-22 as coextensive with its rule change filing obligations under Section 19(b) of the Exchange Act and Exchange Act Rule 19b-4 thereunder. For the reasons discussed in more detail in Section 2.2 above, LCH SA believes that exempting it from the filing requirements of Exchange Act Rule 17a-22 in respect of materials that primarily affect LCH SA's Non-U.S. Business and do not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using the CDSClear services would not compromise or undercut the SEC's oversight over a registered clearing agency as a whole on an entity basis, consistent with the SEC's previous approach to regulation and supervision of registered clearing agencies with respect to dually registered clearing agencies.

In addition, LCH SA respectfully requests that it be permitted to satisfy any filing obligations imposed on it pursuant to Exchange Act Rule 17a-22 electronically. The burdens of making numerous paper filings are substantially higher for a non-U.S. clearing agency than for a clearing agency located in the United States. Principally, the cost of making paper submissions is significantly higher due to international postage; in addition, paper submissions are less likely to arrive at the SEC's offices in a timely manner, again as a result

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<sup>41</sup> LSEG is the ultimate parent company of the LCH.Clearnet Group Limited ("Group"), with a total shareholding of 57.78% and is the largest entity in the group that prepares consolidated financial accounts. The immediate parent company of Group is London Stock Exchange (C) Limited, which does not prepare consolidated accounts. Group owns 100% of LCH SA.

<sup>42</sup> The UK Financial Conduct Authority ("FCA") performs the functions of the UK Listing Authority. The Listing Rules are set out in the FCA Handbook.

<sup>43</sup> See, e.g., Proposed Collection; Comment Request, 79 Fed. Reg. 862 (January 7, 2014) (describing the response burden under Exchange Act Rule 17a-22 as requiring "approximately .25 hours (fifteen minutes), which represents the time it takes for a staff person at the clearing agency to properly identify a document subject to the rule, print and makes copies, and mail that document to the Commission").

of the distances involved in using international mail. Expedited delivery services are available however, as noted above, they would cause LCH SA to incur disproportionately higher costs compared to U.S. clearing agencies. By contrast, it would be substantially more cost-effective, and faster, for LCH SA to make the necessary submissions electronically.

Permitting electronic submissions also accords with the SEC's embrace of using technological developments to facilitate filing requirements. Exchange Act Rule 17a-22 was originally adopted in 1980, prior to the advent of widespread electronic communication.<sup>44</sup> For example, in the 1990s, the SEC developed its Electronic Data Gathering, Analysis, and Retrieval (or "EDGAR") filing system, which is widely relied on by many securities market participants to meet their Exchange Act filing requirements. The SEC's rulemaking processes are largely electronic, and the SEC accepts submissions and comments via electronic mail as a matter of course. It would appear incongruous in such circumstances to insist that a non-U.S. clearing agency continue to make paper filings, where electronic filings would be both faster and less expensive.

### **3. TERMS AND CONDITIONS TO THE GRANTING OF EXEMPTIVE RELIEF**

The relief from Exchange Act Sections 5 and 6 requested herein is conditioned upon LCH SA complying with the following requirements:

- (a) LCH SA shall report to the SEC the following information with respect to its calculation of settlement prices for Single-Name CDS within thirty (30) calendar days of the end of each calendar quarter and electronically preserve such reports during a period of ten (10) years:
  - (1) the total volume of transactions executed during the quarter, broken down by reference entity, presented in Euro, and converted into US Dollars;
  - (2) the total unit volume and/or notional amount executed during the quarter, broken down by reference entity;
- (b) LCH SA shall establish and maintain adequate safeguards and procedures to protect its BD-FCM Clearing Members' confidential trading information, including:
  - (1) limiting access to the confidential trading information of members to LCH SA employees who operate the system or who are responsible for its compliance with this exemptive relief;

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<sup>44</sup> For the Exchange Act Rule 17a-22 adopting release, see 45 Fed. Reg. 73914 (November 7, 1980).

- (2) establishing and maintaining standards controlling LCH SA employees that trade for their own account;
- (c) LCH SA shall establish and maintain adequate oversight procedures to ensure that the safeguards and procedures established pursuant to (b) are followed;
- (d) LCH SA shall directly or indirectly make available to the public on terms that are fair and reasonable and not unreasonably discriminatory:
  - (1) all end-of-day settlement prices and any other prices with respect to Single-Name CDS that it may establish to calculate mark-to-market margin requirements for its clearing members; and
  - (2) any other pricing or valuation information with respect to Single-Name CDS as is published or distributed by LCH SA.

LCH SA understands that the Single-Name CDS processing and clearing services described herein may only be made available to U.S. persons meeting the definition of “eligible contract participant”, as defined in Section 1a(18) of the CEA and CFTC Rule 1.3(m).

The relief from Exchange Act Section 19(b) and Rule 19b-4 requested herein is conditioned upon LCH SA complying with the following requirements:

- (a) LCH SA will provide notice to Commission staff of its Non-U.S. Business Rule Changes once duly approved by the national competent authorities.

The relief from Exchange Act Rules 17Ad-22(c)(2) and 17Ad-22(c)(2)(iii) requested herein is conditioned upon LCH SA complying with the following requirements:

- (a) LCH SA shall post its annual audited financial statements on its website no later than the end of the first quarter following LCH SA’s fiscal year-end;
- (b) For the calendar years 2014 and 2015, LCH SA’s annual audited financial statements will be prepared in accordance with IFRS and audited in compliance with ISA rather than the PCAOB requirement set out in Rule 17Ad-22(c), with the exception that the closing balance of LCH SA’s 2015 financial statements will be audited in accordance with PCAOB standards; and
- (c) From 2016 onwards, LCH SA’s annual financial statements will be prepared in accordance with IFRS and audited in accordance with PCAOB standards and will be signed by auditors that meet the relevant PCAOB qualifications.

The relief from Exchange Act Rule 17a-22 requested herein is conditioned upon LCH SA complying with the following requirements:



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- (a) LCH SA shall file in electronic format with the SEC, within ten (10) calendar days after the date of issuing, or making generally available, to its participants or to other entities with whom it has a significant relationship, such as pledgees, transfer agents, or self-regulatory organizations, any material (including, for example, manuals, notices, circulars, bulletins, lists, or periodicals), with the exception of material that (i) primarily affects LCH SA's clearing operations with respect to the Non-U.S. Business and (ii) does not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using the CDSClear services.

Finally, in connection with the statutory and rule provisions discussed above and throughout this letter, from which exemptive relief is requested, LCH SA represents that, as a condition of such relief, LCH SA shall implement policies and procedures designed to ensure compliance with these terms and conditions, and to conduct periodic internal reviews related to its compliance program.

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Members of the SEC staff may contact the Chief Compliance Officer by phone at +33 1 70 37 65 96 or by email at [françois.faure@lch.com](mailto:françois.faure@lch.com) or LCH SA's outside counsel, Kevin Foley, by phone at +1 312 902 5372 or by email at [kevin.foley@kattenlaw.com](mailto:kevin.foley@kattenlaw.com) to ask questions or to obtain additional information.

Sincerely,



Christophe Hémon  
CEO  
LCH SA