

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-98009; File No. SR-LCH SA-2023-004)

July 27, 2023

Self-Regulatory Organizations; LCH SA; Order Approving Proposed Rule Change
Relating to Triparty Collateral Mechanism

I. Introduction

On May 30, 2023, Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change (“Proposed Rule Change”) to amend its Credit Default Swap Clearing Procedures (“Procedures”) and Credit Default Swap Clearing Rule Book (“Rule Book”) to reflect the introduction of a triparty collateral mechanism to the CDSClear service. The Proposed Rule Change was published for comment in the *Federal Register* on June 16, 2023.³ The Commission has not received any comments on the Proposed Rule Change. For the reasons discussed below, the Commission is approving the Proposed Rule Change.

II. Description of the Proposed Rule Change

LCH SA is a clearing agency registered with the Commission for the purpose of clearing security-based swaps (specifically, credit-default swaps or “CDS”). LCH SA has procedures in place to deal with the default of a clearing member who participates in its CDS clearing business. In order to minimize the contagion risk of such a default, LCH

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 97706 (June 12, 2023), 88 FR 39492 (June 16, 2023) (File No. SR-LCH-2023-004) (“Notice”).

SA calculates margin requirements for each clearing member and requires each member to transfer collateral to LCH SA to meet their respective margin requirements.

Currently, LCH SA requires members participating in its CDSClear service (the “Clearing Members”) to manage the pledging and transfer of collateral to LCH SA on a bilateral basis. For LCH SA’s non-U.S. business lines (*e.g.*, its repo clearing business), LCH SA offers a “triparty collateral” mechanism where LCH SA and a clearing member may authorize an agent to enter settlement instructions on the clearing member’s behalf into the LCH SA’s securities settlement system.⁴ LCH SA states that members benefit because such a triparty process is more efficient operationally.⁵ LCH SA members requested that LCH SA harmonize collateral management processes across business lines by introducing a triparty collateral management process into LCH SA’s CDS business.⁶

LCH SA now proposes to offer the triparty collateral mechanism to its members participating in CDSClear.⁷ LCH SA is not changing collateral eligibility or concentration limits, but rather, is merely providing for a different process for posting acceptable collateral. To effectuate the change, LCH SA proposes the following changes to its rules.

⁴ The agent’s ability to enter settlement instructions on the clearing member’s behalf would be done for the purposes of transferring collateral to LCH SA or releasing such collateral, and would affect movements of securities between a clearing member account and LCH SA by the relevant triparty agent on a full title transfer basis.

⁵ *See* Notice, 88 FR at 39493.

⁶ To facilitate the use of a triparty collateral mechanism, the clearing member, the relevant triparty agent, and LCH SA must enter into a specific contractual arrangement.

⁷ LCH SA is proposing to offer the triparty collateral mechanism as an optional collateral management tool, but does not intend to obligate its members to use the tri-party mechanism.

A. *Amendments to Rule Book*

LCH SA is proposing to modify Section 1.1.1 (Terms defined in the CDS Clearing Rule Book) to include a new term, “Triparty Documentation,” which refers to the documentation of the agreement entered into between LCH SA, the relevant triparty agent, and a Clearing Member having exercised its option to transfer Eligible Collateral⁸ on a full title transfer basis to LCH SA through a Triparty Documentation pursuant to Section 3 of the Procedures. Section 3 includes procedures related to collateral, variation margin, and cash payment.

LCH SA also proposes to amend section 2 of its Rule Book to add a new subsection (xxiv) to Section 2.2.1.1, to provide for a new membership requirement where the triparty applicant shall accept to comply with the performance of its obligations pursuant to a Triparty Documentation. Further, LCH SA proposes to amend Section 2.2.2.1 to add a new subsection (vii) to require a Clearing Member to comply with the performance of the obligations pursuant to a Triparty Documentation.⁹

LCH SA proposes to make several amendments to Section 4 of the Rule Book, which addresses risk management and collateral requirements. Since the Triparty Documentation will provide for the haircut that will apply to the relevant collateral, LCH SA proposes to add a reference to the Triparty Documentation in Section 4.2.6.4 which currently provides, among others, that LCH SA may apply haircuts to Eligible Collateral as set out on the LCH SA website. LCH SA also proposes to add the failure of a Clearing

⁸ Eligible Collateral is defined by LCH as “Such securities and other types of non Cash Collateral as are set out in Section 3 of the Procedures as being acceptable by LCH SA for the purposes of satisfying a Clearing Member’s Margin Requirements and/or novating Original Transactions, as applicable.”

⁹ The subsequent subsections would also need to be renumbered for both amendments.

Member to perform its obligations in accordance with, or a breach of, any Triparty Documentation to the list of Events provided for in Section 4.3.1.1, which describes events that might constitute a Clearing Member default, as this is currently the case in respect of the CDS Clearing Documentation and the Pledge Agreement.

LCH SA also proposes to make the following conforming Rule Book changes that are not related to the implementation of the Triparty Documentation solution for the CDSClear service. Specifically, the definition of “Pledged Eligible Collateral” in Section 1.1.1 (Terms defined in the CDS Clearing Rule Book) would be amended by removing a reference to a Clearing Notice, because the list of Eligible Currencies and collateral is already set out in Section 3 of the Procedures in accordance with Section 4.2.6.1, and the proposed amended Section 3 of the Procedures would provide where the list of collateral (including Pledged Eligible Collateral) could be found. Section 2.2.2.1 would be amended to correct a cross-reference in subsection (iv). Finally, LCH SA would amend Section 4.2.6.1 by making a reference to Section 3 of the Procedures regarding the conditions that will govern the notification of any change in eligible currencies and collateral.

B. *Amendments to Procedures*

LCH SA proposes to modify Section 3 of the Procedures, which covers the topics of collateral, variation margin, and cash payments, to incorporate terms for implementing the triparty collateral mechanism. The Proposed Rule Change amends Section 3.10 (Eligible Collateral transferred with full title) to include securities transferred pursuant to a Triparty Documentation, by adding a new paragraph to Section 3.10.2 (Eligible Collateral provided pursuant to a Triparty Documentation) and a new introductory

paragraph stating that Eligible Collateral transferred with full title may be provided by a Clearing Member either on a bilateral basis or pursuant to a Triparty Documentation in accordance.

The Proposed Change will move current Section 3.10 under a new paragraph in Section 3.10.1 entitled “Eligible Collateral provided on a bilateral basis,” and any reference to collateral provided with full title transfer in this new paragraph in Section 3.10.1 will be clarified by adding that such Eligible Collateral is provided on a bilateral basis. LCH SA proposes to replace any cross-reference to Section 3.10 in Section 3 of the Procedures with a cross-reference to a new paragraph in Section 3.10.1 where necessary. As a result of the new paragraph in Section 3.10.2, a cross-reference to subsection (d) will be added to each section referring to the return of any type of collateral. This cross-reference allows for Eligible Collateral to be transferred with full title pursuant to a Triparty Documentation.

The new paragraph in Section 3.10.2, as further described below, will mainly replicate the paragraph in Section 3.10.1, but will amend the content to refer to the Triparty Documentation. The new amendments would include the requirement for a Clearing Member to enter into the Triparty Documentation, as set out in a new subparagraph (a) and the reference to triparty accounts to be used by LCH SA. However, due to the use of a triparty agent for managing Clearing Member Collateral posted with LCH SA, there will be some differences in the timelines applicable to the Clearing Member for the purposes of transferring, or requesting return of, securities subject to the Triparty Documentation, as described below.

Subsection (a) of Section 3.10.2 (General information) states that the Clearing Member, a triparty agent (either Euroclear Bank or Euroclear France), and LCH SA may enter into the relevant Triparty Documentation, whose documentation is available upon request to the CDSClear Business Development & Relationship Management team. Under the Triparty Documentation, the relevant triparty agent will be authorized by LCH SA and the Clearing Member to enter settlement instructions on their behalf into the relevant securities settlement system to transfer with full title securities as Eligible Collateral between LCH SA and the Clearing Member.

Sub-paragraph (b) (Securities accounts) states that LCH SA will hold collateral in security accounts at the relevant triparty agent(s) as applicable for the Clearing Member's house activity, and separately, client activity (excluding any FCM Clients, since the provision of securities pursuant to this triparty collateral solution will not be permitted for FCM Clients pursuant to new sub-paragraph (c) of new paragraph 3.1.0.2, indent (ii)).¹⁰

Sub-paragraph (c) will include provisions describing the transfer of Eligible Collateral pursuant to a Triparty Documentation; the purpose of such transfer is either for transferring additional collateral or substituting such collateral for any alternative collateral recorded in its collateral accounts. To transfer collateral on a specific business day, a Clearing Member would need to notify LCH SA of its request to transfer such Eligible Collateral pursuant to a Triparty Documentation by no later than 16:00 CET on the prior business day. If the Clearing Member notifies LCH SA that the collateral will

¹⁰ LCH SA may invest eligible collateral provided to LCH SA with full title pursuant to a triparty arrangement in accordance with Paragraph 3.11(b).

move client accounts, the member must specify which client account shall record Eligible Collateral; otherwise, LCH SA will not accept the transfer request.¹¹

Sub-paragraph (d) addresses the applicable conditions for returning collateral to a Clearing Member. A Clearing Member must request a return of collateral no later than 12:00 CET on the business day before they want to receive the collateral. LCH SA would transfer the requested collateral between 12:25 and 12:55 CET on the requested day.¹² Any return request received by LCH SA shall be deemed firm and irrevocable. By 12:00 CET on the day the collateral is returned, LCH SA will re-calculate the value of the Eligible Collateral to be returned (the “Eligible Triparty Collateral Value”). If LCH SA holds sufficient collateral (other than that which is to be returned) to cover the relevant margin requirement, it will return the collateral. If LCH SA does not hold sufficient collateral (other than that which is to be returned) to cover the relevant margin requirement, LCH SA will attempt to debit an amount of Euros equal to the Eligible Triparty Collateral Value from the TARGET2¹³ Account(s) of the Clearing Member (or its TARGET2 Payment Agent), after which LCH SA would return the collateral.¹⁴ LCH SA would instruct the triparty agent(s) to return the collateral between 13:00 and 15:00 CET, in advance of the relevant Central Securities Depository/International Central

¹² LCH SA makes intra-day margin calls throughout the day. Whether the collateral will be taken into account with regard to a specific intra-day margin call is dependent on when LCH SA received confirmation from a Clearing Member’s triparty agent. Proposed section 3.10.02(c) describes how confirmation timing affects margin calculations in more detail.

¹² Section 3.7(c) of the Procedures defines the timing of collateral calls, and specifies the 12:25 to 12:55 CET period as a window to be use for the purpose of collateral substitutions upon a Clearing Member’s request, which LCH SA refers to as the “Additional Specific Collateral Slot.”

¹³ TARGET2 is the system known as Trans-European Automated Real-time Gross Settlement Express Transfer 2.

¹⁴ If LCH SA cannot debit the required amount of Euros, it would not return the requested collateral.

Securities Depository cut-off time (except in exceptional circumstances, as determined in an objective and commercially reasonable manner). The last paragraph of new paragraph 3.10.2 will provide for exceptional time limits for notification of transfer and return requests in cases of atypical market conditions.

Current Section 3.9 of the Procedures addresses Eligible Collateral. In this section, LCH SA proposes to insert language stating that additional eligibility criteria and concentration limits apply for Triparty Documentation.¹⁵ LCH SA also proposes to insert language stating that it may amend the list of eligible securities by publication of a Clearing Notice, and add new eligibility criteria and concentration limits for Eligible collateral transferred with full title pursuant to a Triparty Documentation, subject to the prior consent of the relevant triparty agent. As a result, the reference to a Clearing Notice mentioned in Section 3.13 applicable to Eligible Collateral pursuant to the Pledge Agreement will be removed, as there will be no Clearing Notice which describes such Eligible Collateral; all relevant information will be found on the LCH SA website.

LCH SA also proposes changes to Section 3.9 to clarify that Eligible Collateral transferred with full title may be provided on a bilateral or trilateral basis, where necessary. LCH SA is proposing to amend sub-paragraph (c) (Events affecting the eligibility of Eligible Collateral) to exclude securities transferred pursuant to the triparty collateral solution from the current management process applicable to Collateral Events.¹⁶ Such Collateral Events will be managed by the relevant triparty agent in

¹⁵ The triparty documentation would only be able to add requirements, and could not reduce the eligibility criteria or concentration limits specified in LCH SA's rules.

¹⁶ A "Collateral Event" is defined as either a suspension from trading of such security by an exchange or the public announcement of a take-over bid, public exchange offer, split or reverse split involving the entity issuing such security.

accordance with the Triparty Documentation. Consequently, the scope of Section 3.12 is reduced to Eligible Collateral transferred with full title on a bilateral basis.

LCH SA proposes other amendments to Section 3 of the Procedures in order to correct some cross-references or typographical errors.

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act requires the Commission to approve a proposed rule change of a self-regulatory organization if it finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the organization.¹⁷ For the reasons given below, the Commission finds that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act¹⁸ and Rule 17Ad-22(e)(21) thereunder.¹⁹

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

Under Section 17A(b)(3)(F) of the Act, LCH SA's rules, among other things, must be "designed to promote the prompt and accurate clearance and settlement of . . . derivative agreements, contracts, and transactions . . ." ²⁰ Based on its review of the record, and for the reasons discussed below, the Commission believes that LCH SA's changes are consistent with Section 17A(b)(3)(F) of the Act because LCH SA is offering an additional clearing mechanism to its members.

LCH SA is proposing to allow CDSClear Clearing Members to cover their margins with eligible securities through the use of a triparty agent. Clearing Members

¹⁷ 15 U.S.C. 78s(b)(2)(C).

¹⁸ 15 U.S.C. 78q-1(b)(3)(F).

¹⁹ 17 CFR 240.17Ad-22(e)(21).

²⁰ 15 U.S.C. 78q-1(b)(3)(F).

are under no obligation to use this solution. This change will broaden the solutions for Clearing Members to manage collateral posted to LCH SA. The introduction of the triparty mechanism would align collateral management practices for members across LCH SA business lines and enable the transfer of securities as collateral in a more efficient and automated way than on a bilateral basis. Offering a more efficient and automated process may, for members who choose to use it, reduce the overall cost of clearing. Reducing the overall cost of clearing could, in turn, lead Clearing Members to clear more products. Thus, these changes would contribute to the prompt and accurate clearance process and settlement of securities transactions and derivative agreements, contracts, and transactions and to assure the safeguarding of securities, which is consistent with the requirements of Section 17(A)(b)(3)(F).²¹

The Commission believes, therefore, that the Proposed Rule Change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.²²

B. *Consistency with Rule 17Ad-22(e)(21) under the Act*

Rule 17Ad-22(e)(21) requires covered clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to be efficient and effective in meeting the requirements of its participants and the markets it serves, and have the covered clearing agency's management regularly review the efficiency and effectiveness of its clearing and settlement arrangements; operating structure, including risk management policies, procedures, and systems; scope of products, cleared or settled; and use of technology and communication procedures.²³ In adopting Rule 17Ad-

²¹ 15 U.S.C. 78q-1(b)(3)(F).

²² 15 U.S.C. 78q-1(b)(3)(F).

²³ 17 CFR 240.17Ad-22(e)(21).

22(e)(21), the Commission provided guidance that a covered clearing agency generally should consider in establishing and maintaining policies and procedures that address efficiency and effectiveness, stating that it should consider whether its design meets the needs of its participants, particularly with regard to choice of operating structure and use of technology and procedures.²⁴

LCH SA's members expressed interest in using the triparty mechanism to the CDSClear business to harmonize their operational process across all clearing services of LCH SA.²⁵ The triparty collateral mechanism is an optional solution that would reduce the number of manual actions necessary in the processing of non-cash collateral deposit and release for both the clearing agency and the Clearing Members. Reliance on the triparty mechanism could reduce the manual steps necessary for a Clearing Member to allocate a basket of securities in LCH SA's system with an automatic process for the settlement of margin calls and handling of coupons. Such automation would increase efficiency and allows for additional use of technology with the settlement of margin call.

The Commission believes, therefore, that the Proposed Rule Change is consistent with the requirements of Rule 17Ad-22(e)(21) under the Act.²⁶

²⁴ See Standards for Covered Clearing Agencies, Securities Exchange Act Release No. 78961 (Sept. 28, 2016), 81 FR 70786, 70841 (Oct. 13, 2016).

²⁵ See Notice, 88 FR at 39493.

²⁶ 17 CFR 240.17Ad-22(e)(21).

IV. Conclusion

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act, and in particular, Section 17A(b)(3)(F) of the Act²⁷ and Rule 17Ad-22(e)(21) thereunder.²⁸

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act that the Proposed Rule Change (SR-LCH SA-2023-004) be, and hereby is, approved.²⁹

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.³⁰

Sherry R. Haywood,

Assistant Secretary.

²⁷ 15 U.S.C. 78q-1(b)(3)(F).

²⁸ 17 CFR 240.17Ad-22(e)(21).

²⁹ In approving the Proposed Rule Change, the Commission considered the proposal's impacts on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³⁰ 17 CFR 200.30-3(a)(12).