

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82675; File No. SR-LCH SA-2018-001)

February 9, 2018

Self-Regulatory Organizations; LCH SA; Notice of Filing of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice Relating to Self-Referencing Transactions

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 31, 2018, Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I, II, and III below, which items have been prepared 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

LCH SA is proposing to amend its CDS Clearing Supplement and Section 4 of the CDS Clearing Procedures in order to allow acceptance of client’s self-referencing transactions on their clearing broker. The text of the proposed rule change has been annexed as Exhibit 5.

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

---

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

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

the places specified in Item IV below. LCH SA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of these statements.

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

1. Purpose

In connection with the clearing of single name CDS referencing banks which are clearing members of CDSClear, LCH SA proposes to modify its eligibility requirements to allow for the clearing of clients "self-referencing transactions" on their clearing broker.

A "self-referencing transaction" refers to a single name CDS referencing a reference entity which is:

- In the case of a house transaction, either the clearing member itself or an affiliate of the clearing member;
- In the case of a client transaction, either the client itself or an affiliate of the client, or the clearing broker of the client or an affiliate of the clearing broker.

Currently, clearing of both house and client self-referencing transactions are prohibited by LCH SA whereas clients commonly trade single name CDS referencing banks in the uncleared world (as they face directly their counterparty). Not allowing for the clearing of those transactions as a consequence of the intermediation of a clearing member required for clients to clear would thus impact their ability to continue trading the financial CDS single name market, as well as restrict their choice for clearing brokers.

LCH SA is proposing to allow clients self-referencing transactions when the reference entity referenced by the single name CDS is either the client's clearing broker or an affiliate of the client's clearing broker.

The risk arising from clients self-referencing transactions on their clearing broker would be captured by the existing framework and more specifically by the Self-Referencing Margin

which charges the minimum between zero and the net Profit and Loss resulting from a credit event of the self-referenced name across all index, single name and index swaption transactions using a Recovery Rate of 0%. The net Profit and Loss calculation allows for netting of the exposures arising from index, index swaption and single name CDS transactions if they reference the same contractual definition and transaction type.

The proposed rule change will consist in amending the following provisions of the CDS Clearing Supplement and Section 4 of the Procedures:

- the eligibility requirement in respect of single names in Section 4 of the Procedures (paragraph 4.1(c)(iii)(B)(11)) to make the distinction between house and clients self-referencing transactions so as to allow clients to clear single name CDS transactions referencing their clearing broker or one of their affiliates but neither clients self-referencing transactions referencing the client itself nor house self-referencing transactions; and

- the provisions on the self referencing transactions in Part A and B of the CDS Clearing Supplement (Sections 1.2 and 9 and Appendix XIII of Parts A and B) to make a distinction between the remedies for house and client self-referencing transactions. More specifically, following the occurrence of a house self-referencing transaction, the clearing member shall notify LCH SA and the affected transactions could be auctioned and liquidated, whereas following the occurrence of a client self-referencing transaction, the clearing broker of such client shall only notify LCH SA when it is a self-referencing transaction on the client itself (or one of its affiliates) in which case the positions could be auctioned and liquidated, but if the self-referencing transactions reference the clearing broker, then no specific action is required from the clearing broker.

LCH SA is also taking this opportunity to make the following minor amendments to the CDS Clearing Supplement:

- adding a missing reference to the Standard European Financial Corporate transaction types (Section 2.3 of Part B); and

- adding a reference to the Standard European Senior Non Preferred Financial Corporate transaction type (Section 2.3 of Part B) for which no change is needed in LCH SA's risk methodology as the specific risks arising from adding Senior Non Preferred transactions will be captured by the exact same framework developed when HoldCo entities were added; and

- clarifying that the underlying index transaction of an index swaption is an LCH cleared index transaction (Sections 1.2 and 7.1 of Part C).

## 2. Statutory Basis.

LCH SA believes that the proposed rule change in connection with the clearing of clients self-referencing transactions referencing the clearing broker is consistent with the requirements of Section 17A of the Securities Exchange Act of 1934<sup>3</sup> (the "Act") and the regulations thereunder, including the standards under Rule 17Ad-22.<sup>4</sup>

Specifically, Section 17(A)(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts, and transactions and to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible<sup>5</sup>. As noted above, the current risk management framework and more specifically the Self-Referencing Margin, already appropriately manages the risk arising from the clearing of clients self-referencing transactions on their clearing broker such that the proposed rule change will have no impact on the safeguarding of securities and funds under control of LCH SA.

---

<sup>3</sup> 15 U.S.C. 78q-1.

<sup>4</sup> 17 CFR 240.17Ad-22.

<sup>5</sup> 15 U.S.C. 78q-1(b)(3)(F).

LCH SA believes that the proposed change satisfy the requirements of Rule 17Ad-22(b)(2), (b)(3), (e)(1), (e)(4), and (e)(6)<sup>6</sup>

Rule 17Ad-22(b)(2) requires a clearing agency to use margin requirements to limit its credit exposures to participants under normal market conditions and to use risk-based models and parameters to set margin requirements<sup>7</sup>. Rule 17Ad-22(b)(3) requires each clearing agency acting as a central counterparty for security-based swaps to maintain sufficient financial resources to withstand, at a minimum, a default by the two participant families to which it has the largest exposure in extreme but plausible market conditions (the “cover two standard”). Rule 17Ad-22(e)(4) requires a covered clearing agency to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing and settlement processes by maintaining sufficient financial resources<sup>8</sup>, and Rule 17Ad-22(e)(6) requires a covered clearing agency that provides central counterparty services to cover its credit exposures to its participants by establishing a risk-based margin system that meets certain minimum requirements<sup>9</sup>.

As described above, the Self-Referencing Margin in LCH SA current risk framework captures the worst potential Profit and Loss impact on a clearing member client portfolio resulting from the default of such clearing member which implies that the margin requirements set by LCH SA and use of such margin requirements limit LCH SA’s

---

<sup>6</sup> 17 CFR 240.17Ad-22(b)(2), (b)(3), (e)(1), (e)(4), and (e)(6).

<sup>7</sup> 17 CFR 240.17Ad-22(b)(22) [*sic*].

<sup>8</sup> 17 CFR 240.17Ad-22(e)(4)(i).

<sup>9</sup> 17 CFR 240.17Ad-22(e)(6)(i).

credit exposures to participants in clearing clients self-referencing transactions referencing their clearing broker under normal market conditions, consistent with Rule 17Ad-22(b)(2). LCH SA also believes that its current risk-based margin methodology, including the Self-Referencing Margin) takes into account, and generates margin levels commensurate with, the risks and particular attributes of clients self-referencing transactions on their clearing broker at the product and portfolio levels, appropriate to the relevant market it serves, consistent with Rule 17Ad-22(e)(6)(i) and (v). In addition, LCH SA believes that the margin calculation under the current CDSClear margin framework would sufficiently account for the 5-day liquidation period for house account portfolio and 7-day liquidation period for client portfolio and therefore, is reasonably designed to cover LCH SA's potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default, consistent with Rule 17Ad-22(e)(6)(iii).

Further, Rule 17Ad-22(b)(3) requires a clearing agency acting as a central counterparty for security-based swaps to establish policies and procedures reasonably designed to maintain the “cover two standard”.<sup>10</sup> Similarly, Rule 17Ad-22(e)(4)(ii) requires a covered clearing agency that provides central counterparty services for security-based swaps to maintain financial resources additional to margin to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, meeting the cover two standard.<sup>11</sup> LCH SA believes that its current Default Fund methodology will appropriately incorporate the risk of clearing clients self-referencing

---

<sup>10</sup> 17 CFR 240.17Ad-22(b)(3).

<sup>11</sup> 17 CFR 240.17Ad-22(e)(4)(ii).

transactions on their clearing broker, as together with the existing CDSClear margin framework (and more specifically the Self-Referencing Margin), will be reasonably designed to ensure that LCH SA maintains sufficient financial resources to meet the cover two standard, in accordance with Rule 17Ad-22(b)(3) and (e)(4)(ii).<sup>12</sup>

LCH SA also believes that the proposed rule change is consistent with Rule 17Ad-22(e)(1), which requires each covered clearing agency's policies and procedures reasonably designed to provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions<sup>13</sup>. As described above, the proposed rule change would make a clear distinction on the clearing eligibility and remedies for house versus clients self-referencing transactions. LCH SA believes that this change would provide for a clear and transparent legal basis for CDSClear clearing eligibility requirements, consistent with Rule 17Ad-22(e)(1).

For the reasons stated above, LCH SA believes that the proposed rule change is consistent with the requirements of prompt and accurate clearance and settlement of securities transactions and derivatives agreements, contracts and transactions, and assuring the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible, in accordance with Rule 17A(b)(3)(F) of the Act.<sup>14</sup>

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

---

<sup>12</sup> 17 CFR 240.17Ad-22(b)(3) and (e)(4)(ii).

<sup>13</sup> 17 CFR 240.17Ad-22(e)(1).

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

purposes of the Act.<sup>15</sup> LCH SA does not believe that the proposed rule change would impose burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Act.

Indeed, firstly the proposed rule change would apply equally to all CDSClear members and clients, and secondly it would give clients access to clearing of the same universe of products irrespective of their clearing broker.

Further, the proposed rule change does not adversely affect the ability of such clearing members or other market participants generally to engage in cleared transactions or to access clearing services offered by LCH SA.

Therefore, LCH SA does not believe that the proposed rule change imposes any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments relating to the proposed rule change have not been solicited or received. LCH SA will notify the Commission of any written comments received by LCH SA.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

---

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

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-LCH SA-2018-001 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-LCH SA-2018-001. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for

website viewing and printing in the Commission's Public Reference Room, 100 F Street, N.E., Washington, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of LCH SA and on LCH SA's website at <http://www.lch.com/asset-classes/cdsclear>.

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-2018-001 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.<sup>16</sup>

Eduardo A. Aleman  
Assistant Secretary

---

<sup>16</sup> 17 CFR 200.30-3(a)(12).