

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-89760; File No. SR-LCH SA-2020-004)

September 3, 2020

Self-Regulatory Organizations; LCH SA; Notice of Filing of Proposed Rule Change Relating to the Clearing of Single Name Credit Default Swaps Referencing Monoline Insurance Companies and the Amendment of LCH SA's Rules in Accordance With its Risk Policies

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder² notice is hereby given that on August 28, 2020, 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

Banque Centrale de Compensation, which conducts business under the name LCH SA ("LCH SA"), is proposing to amend its rules to permit the clearing of single name credit default swaps ("CDS") referencing monoline insurance companies. LCH SA is also proposing to revise a number of its rules to incorporate new terms and to make conforming and clarifying amendments in order to implement a number of changes required by LCH Group Holdings Limited ("LCH Group") Risk Policies to which LCH SA adheres. The text of the proposed rule change has been annexed as Exhibit 5.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

In its filing with the Commission, LCH SA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. LCH SA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of these statements.

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

1. Purpose

The Proposed Rule Change will permit LCH SA to clear single name CDS referencing monoline insurance companies, *i.e.* an insurance company that provides coverage for a specific kind of insurable risk. Separately, by revising a number of LCH SA’s rules to incorporate new terms and to make conforming and clarifying amendments, the Proposed Rule Change will implement a number of changes required by LCH Group Holdings Limited (“**LCH Group**”) Risk Policies to which LCH SA adheres and further enhance certain aspects of the CDS Clearing Service, including the CDS Default Management Process.³

The LCH Group Risk Policies also include a few changes that apply only to LCH Ltd and because of that, those changes are not describes in this narrative.

³ The proposed amendments are set out in in the following: (i) CDS Clearing Rule Book (“**Rule Book**”); (ii) CDS Clearing Supplement (“**Supplement**”); (iii) CDS Clearing Procedures (“**Procedures**”); (iv) Reference Guide: CDS Margin Framework; and (v) CDSClear Default Fund Methodology (together with the Reference Guide: CDS Margin Framework, the “**CDSClear Risk Methodology**”). All capitalized terms not defined herein have the same definition as the Rule Book, Supplement or Procedures, as applicable.

(i) Single name CDS referencing a monoline insurance company

LCH SA is proposing to introduce clearing of single name CDS transactions referencing monoline insurance companies. Although indices (e.g. CDX.NA.IG and CDS.NA.HY) that contain monoline insurance companies as constituents are clearable by LCH SA, single name CDS transactions referencing monoline insurers currently are not eligible for clearing. To permit participants to submit for clearing single name CDS referencing a monoline insurance company, LCH SA proposes to modify its CDS Clearing Supplement and Section 4 of the CDS Clearing Procedures, Eligibility Requirements.

In this regard, in Part B of the Supplement, Section 2.3 (*Single Name Cleared Transaction Confirmation*), paragraph (g) is proposed to be amended to include a reference to the “Additional Provisions for Monoline Insurer Reference Entities”, published on September 15, 2014 (the “**Monoline Supplement**”) by the International Swaps and Derivatives Association, Inc. (“**ISDA**”). As a result of this change, the Monoline Supplement would be applicable to any Single Name Cleared Transaction that is a monoline insurer in the relevant confirmation.

In addition, Section 2.2 (*Index Cleared Transaction Confirmation*), paragraph (f), sub-paragraphs (iii) and (iv) are proposed to be amended to clarify that the “Monoline Supplement” will apply to each Index Cleared Transaction Confirmation referencing a Markit CDX in which the Reference Entity is identified as “monoline” in the Index Annex published by Markit Group Limited. Further, the relevant paragraph on “Monoline Insurer as Reference Entity” would be deleted from the applicable CDX Standard Terms Supplement and replaced with a direct reference to the Monoline

Supplement, which will apply to each relevant Reference Entity identified as a “monoline”. LCH SA is proposing this change for the avoidance of doubt, since it is not clear whether the Monoline Supplement is specified as “Applicable” in the Index Annex.

Finally, Section 4.1 of the Procedures, paragraph (c)(iii)(B)(5) is proposed to be amended to provide for an additional eligibility requirement, pursuant to which only single names which are “Standard North American Corporate” referencing a monoline insurance entity for which the Monoline Supplement is specified as “Applicable” are eligible for clearing by LCH SA.⁴

(ii) Implementation of LCH Group Risk Policies

LCH SA is proposing several actions to implement changes in LCH Group’s Risk policies (LCH Group Financial Resource Adequacy policy, LCH Group Collateral Risk policy, LCH Group Counterparty Credit Risk policy). In particular, LCH SA is proposing to introduce two new margins to address additional financial risks to which Clearing Members may be exposed in identified circumstances: (1) Legal Entity Identifier Margin; and (2) Stress Test Loss Over Additional Margin / Net Capital Ratio Margin. In addition, LCH SA is proposing to add a stress test to non-cash collateral.

(a) Legal Entity Identifier Margin

The LCH Group Financial Resource Adequacy policy (“FRAP”) requires that enough margins be held to cover the potential loss from any member (including clients of that member). Some members have for operational or historical reasons been set in LCH SA’s systems as two different members although the legal entity and legal membership

⁴ The proposed introduction of clearing single names CDS referencing a monoline insurer requires no change in LCH SA’s margin methodology and has no impact on either the Margin or the Stress Test framework of CDSClear.

are only one. In most cases, because margins are calculated by margin account, given the absence of netting between the two accounts, this would translate into superior margins. However, the current framework could potentially miss some concentration effects that would increase the overall liquidation costs as these two accounts would be liquidated simultaneously. In order to cover these cases, it was recommended by LCH SA Second Line Risk team to tackle existing shortfalls in the margin calculation in order to ensure an appropriate margin coverage in line with section 4 and 5 of the FRAP.

So, as described in Section 6.2 of the Reference Guide: CDS Margin Framework, CDSClear is proposing to introduce a legal Entity Identifier Margin (“**LEI Margin**”). The LEI Margin would cover that risk by charging the incremental risk, if any, to the House account of the Clearing Member. The LEI Margin is calculated using an algorithm, approved by the board of directors of LCH SA following consultation with the Risk Committee, based on the Open Positions registered in the Margin Accounts of one or more Clearing Members identified by the same LEI.

(b) Stress Test Loss Over Additional Margin / Net Capital Ratio Margin

The Counterparty Credit Risk policy requires that each clearing member and clearing member group be subject to a uncovered stress losses over net capital threshold. As a result, CDSClear is introducing this new margin in its section 6.3 of LCH SA Reference Guide: CDS Margin Framework, the purpose of Stress Test Loss Over Additional Margin / Net Capital Ratio Margin (“**STLOAM / Net Capital Ratio Margin**”) is to assure that Members have enough capital to absorb losses that could materialize under an extreme but plausible market risk scenario. As a matter of policy, LCH SA believes that stress risk of a Member over the Collateral already deposited (*i.e.*,

Initial Margin, Add-ons and Default Fund Contribution) should not exceed 30 percent (30%) of the Member's net capital. If it does, the difference is then charged to the Clearing Member under the "STLOAM / Net Capital Ratio Margin" to bring this ratio below 30 percent (30%).

In addition to the above amendments of the LCH SA Reference Guide CDS Margin Framework, to implement these two new margins, LCH SA also proposes to amend Section 1.1.1 of the Rule Book to add "Legal Entity Identifier Margin" and "Stress Test Loss Over Additional Margin / Net Capital Ratio Margin" as defined terms and to make a reference to these two defined terms in the current definition of "Margin".

As with other Margin, the LEI Margin and the STLOAM / Net Capital Ratio Margin are defined by making reference to the amount calculated in accordance with Section 2 of the Procedures. In this regard, therefore, Section 2 of the Procedures are proposed to be amended by adding new paragraphs 2.12 (*Legal Entity Identifier Margin*) and 2.14 (*Stress Test Loss Over Additional Margin / Net Capital Ratio Margin*), which provide describe these new margins and by adding a reference to these new margins in paragraph 2.2 (a) (*Margin Requirement*).

(c) Technical Amendments with regard to Margin

LCH SA is proposing to make corrections to Section 1.1.1 of the Rule Book by adding the definition of the "Liquidity and Concentration Risk Margin", which is an existing margin as described in Section 2 of the Procedures but was erroneously omitted in Section 1.1.1 of the Rule Book. A reference to Liquidity and Concentration Risk Margin will also be added to the definition of "Margin".

Further, LCH SA proposes to (1) add the definition of a new defined term “Vega Margin” to Section 1.1.1 of the Rule Book, (2) make a reference to the Vega Margin to the definitions of “Margin” and “Initial Margin” in the Rule Book, and (3) add the description of such margin in a new sub-paragraph (g) to Section 2.7 of the Procedures for consistency and to provide greater transparency to LCH SA’s Clearing Members. Vega Margin is currently captured by the description of the “Spread Margin” which provides that the volatility variations and fluctuations referred to in sub-paragraph (a) (*Spread Margin*) of Section 2.7 of the Procedures are at-the-money volatility variations. By separating Vega Margin from Spread Margin and other margins, the reports provided Clearing Members will be more detailed.

As described in proposed Section 2.7(g), Vega Margin “covers the risk of future price fluctuations of an Index Swaption Cleared Transaction in case of unfavorable deformations of the volatility surface, when liquidating a Default Clearing Member’s portfolio of House Cleared Transactions or Non-Ported Cleared Transactions.”

A reference to the Vega Margin is also added to paragraph 2.2 (a) (*Margin Requirement*) of Section 2 of the Procedures.

LCH SA also proposes to remove the defined term of “Margin Account Uncovered Risk” from Section 1.1.1 of the Rule Book, as this defined term is no longer used in the Rule Book and existing references to this defined term in Section 6 of the Procedures are redundant with the reference to the “Group Member Uncovered Risk”. References to the Margin Account Uncovered Risk will also be removed from paragraph 6.4 (*Calculation of the CDS Default Fund Amount*) of Section 6 of the Procedures.

Finally, the order in which the Margins are listed in the definition of “Margin” in Section 1.1.1 of the Rule Book and paragraph 2.2 (a) (*Margin Requirement*) of Section 2 of the Procedures will be amended to be consistent with the order of description of each Margin as provided for in paragraphs 2.7 *et seq.* of Section 2 of the Procedures.

(d) Non-Cash Collateral Stress Test

Following an examination of LCH SA, the ACPR recommended that LCH SA revise its policies and procedures to assure that sovereign debt risk would be better monitored and that non cash collateral be integrated in the stress scenarios. For this purpose, the Appendix 4 of the FRAP was amended to add “margin collateral” in the scope and definition of the Stress Test Loss (“STL”) in order to ensure that both clearing and collateral are stressed jointly in the cover 2 consideration. The FRAP is also amended to specify that the Stress Testing Regime must be independently validated and reviewed at least annually in consultation with the LCH SA Risk Committee. LCH Group Collateral Risk policy (Section 8 Paragraph 59) is also amended in order to include the reference to this modification and definition of the STL. LCH Group Collateral Risk policy is also including a number of minor changes for clarification purposes only

LCH SA decided to apply stress scenarios to non-cash collateral securities posted to cover margin requirements and include the potential stressed loss over the collateral haircut in the sizing of the Default Fund. Any stressed loss beyond the haircut already applied to collateral would be added into the Stress Test Loss Over Initial Margins calculation, and would be reflected in the CDSClear Default Fund calculation (Section 1.1 of the CDSClear Default Fund Methodology) as well the margins related to stress risk such as the Credit Quality Margin (Section 3.1 of the CDSClear Default Fund

Methodology) and the Default Fund Additional Margin (Section 3.3 of the CDS Clear Default Fund Methodology). To implement this added stress test, LCH SA also proposes to amend the definition of “Group Member Uncovered Risk” in Section 1.1.1 of the Rule Book by inserting a reference to the stress-tested potential loss that would be incurred in relation to Collateral (in addition to the existing reference to Open Positions). Group Member Uncovered Risk is used to calculate the funded portion of the CDS Default Fund Amount, in accordance with Article 4.4.1.2 of the Rule Book.

(e) Internal Credit Scores

The Appendix 4 of the FRAP is proposed to be modified to clarify that, in circumstances in which a Clearing Member group comprises affiliate members with different Internal Credit Scores (“**ICS**”), the Member group exposure as defined by the Credit Team will be subject to the ICS clearing limit associated with the largest exposure. The ICS of a Clearing Member is used as an input in different margin add-ons calculations (such as the Default Fund Additional Margin (“**DFAM**”), some of which are calculated at the group Clearing Member level. This proposed c clarifies that, in the event a Clearing Member group includes various affiliates having a different ICS, the margin add-on calculations will be made using the ICS of the affiliate having the largest exposure.

Section 4.3 of LCH Group Counterparty Credit Risk policy is modified to specify in the paragraph 27 that any change to Clearing Member’s ICS and application of any related additional margin are both approved by the LCH SA Executive Risk Committee (“**ERCo**”) with additional minor amendments clarifying that the LCH SA team referred to is the Credit Risk Team.

(f) CDS Default Management Process and Early Termination

LCH SA proposes to make a number of amendments to the Rule Book and Procedures for the purpose of enhancing some aspects of the CDS Default Management Process and Early Termination and making other amendments, corrections and clarifications. These amendments to LCH SA's internal governance relating to default management risk were identified following fire drills run by LCH SA.

Article 4.3.3.1 of the Rule Book identifies the resources available to LCH SA to be used to cover any Damage incurred by LCH SA in relation to an Event of Default arising in respect of a Clearing Member. LCH SA proposes to amend Article 4.3.3.1 by adding a new resource in a new indent (IV) of sub-paragraph (b) of paragraph (i), pursuant to which LCH SA will be entitled to use any remaining House collateral of the Defaulting Clearing Member transferred in respect of other LCH SA's clearing services to reduce or cover losses attributed to the liquidated Client Cleared Transactions of the Defaulting Clearing Member, to the extent such collateral is not applied in the context of such other clearing services in accordance with the rules applicable to such other clearing services. Indents of sub-paragraph (b) of paragraph (i) will be renumbered from (I) to (IV) and indents of sub-paragraph (a) of paragraph (i) from (I) to (II). LCH SA is also proposing to specify that the use of the resource described in indent (II) of sub-paragraph (b) of paragraph (i) is subject to the declaration of default of the relevant Clearing Member in respect of the other clearing services to be consistent with the provisions of indent (II) of sub-paragraph (a) of paragraph (i).

In addition, a reference to a Clearing Notice will be added to Clauses 4.3.1 and 4.3.2 of Appendix 1 (*CDS Default Management Process*) of the Rule Book. The

Clearing Notice describes the conditions applicable to the notification of the identity of the Client's Backup Clearing Member by a Client and the consent to be provided by the appointed Backup Clearing Member.

LCH SA also proposes to amend Clause 8 (*Early Termination*) of Appendix 1 of the Rule Book to introduce a number of enhancements and clarifications. Clause 8 of Appendix 1 provides for the service closure process in respect of the CDS Clearing Service which is the last step in the default management process applied by LCH SA in the event of a default occurring in respect of one or several Clearing Member(s). Since the calculation of the Margin Repayment Amounts occurs before the calculation of the LCH Repayments Amounts, Clause 8.5 and Clause 8.6 have been reorganized so that they adequately reflect the order in which these amounts are calculated. Consequently, Clause 5 will be entitled "Margin Repayment Amounts" and the provisions dealing with the calculation of the LCH Repayment Amounts will be moved to the following Clause 8.6, "LCH Repayment Amounts" including also notification details on the LCH Repayment Amounts.

LCH SA further proposes to provide for the possible liquidation in Euro of any Non-Defaulting Clearing Member's Collateral other than Euro denominated Cash Collateral provided that the CDS Repayment Amount calculated by LCH SA is a Negative CDS Repayment Amount and the relevant Non-Defaulting Clearing Member has not already paid such amount. Where there is a Positive CDS Repayment Amount or a Discounted CDS Repayment Amount, LCH SA will not liquidate the Collateral other than Euro denominated Cash Collateral and will redeliver or repay such Collateral in

accordance with the proposed amended Clauses 8.5 and 8.7 of Appendix 1 of the Rule Book.

LCH SA, therefore, is proposing to make a distinction in the calculation of the Margin Repayment Amounts which will include, or not, the Euro amount resulting from the liquidation in Euro of the non-Euro denominated Cash Collateral, depending on the calculated CDS Repayment Amount in accordance with the proposed amended Clause 8.5.2 of Appendix 1. In the case of a Positive CDS Repayment Amount or a Discounted CDS Repayment Amount, the Margin Repayment Amount will take into account the value of Euro denominated Cash Collateral recorded in the relevant Collateral Account since any Collateral other than Euro denominated Cash Collateral will be redelivered or repaid by LCH SA in accordance with amended Clause 8.7. In the case of a Negative CDS Repayment Amount, the Margin Repayment Amount will take into account the value of Euro denominated Cash Collateral recorded in the relevant Collateral Account and any Euro amount resulting from the liquidation in Euro of the Collateral other than Cash Collateral denominated in Euro. Clause 8.1.4 will be amended to reflect this change.

Since the Collateral other than Euro denominated Cash Collateral will be either liquidated in Euro and taken into account in the calculation of the relevant Margin Repayment Amount in accordance with proposed amended Clause 8.5 or repaid or redelivered to the Clearing Member in accordance with proposed amended Clause 8.7, the scope of Clause 8.10 on conversion is proposed to be limited to the calculation made under Clause 8.2 in respect of the CDS Repayment Amounts for which LCH SA may need to convert USD denominated amounts into Euro. The timing provided for Clause

8.10 is also proposed to be aligned with the timing provided for Clause 8.3 on the price sources to be used for the purpose of calculating CDS Repayment Amounts.

Clause 8.3 is proposed to be amended to change the order among price sources to reflect what would happen in practice. Finally, it is proposed to amend Clause 8.6 to correct an inconsistency between applicable timings provided for in Clauses 8.3 and 8.6. As a result, the notification of the LCH Repayment Amounts is proposed to be made by no later than the end of the second Business Day following the Early Termination Trigger Date. The current notification deadline could not be achieved in practice as it is set at 15.00 on the Early Termination Trigger Date or on the first Business Day following the Early Termination Trigger Date, whereas the calculation of a CDS Repayment Amount, which is taken into account in the calculation of a LCH Repayment Amount, is based on the prices determined as at the end of the Business Day following the Early Termination Trigger Date in accordance with Clause 8.3 of Appendix 1.

(g) Amendments related to disciplinary measures

LCH SA proposes to add a new measure, which would be available in the event of any repetitive failures to submit prices as part of the price submission procedure by a Clearing Member, in Section 8 of the Procedures. LCH SA's risk model depends on the accuracy of the market data that it receives from Clearing Members. Although the failure to submit prices is not an issue among the current eleven market-maker CDSClear Clearing Members, the amendment is intended to anticipate potential failures by Clearing Members admitted as General Members as their number grows and assure that LCH SA has the authority to discipline a Clearing Member that repeatedly fails to provide timely and accurate pricing data.

This additional measure consists in increasing the relevant Clearing Member's Contribution for the next monthly calculation of each Clearing Member's Contribution Requirement by an amount equal to the aggregate amount of fines to be incurred for such failures occurring each Price Contribution Day during the month following such monthly calculation. Paragraph 8.3 (*Immediate Measure*), paragraph (a) of Section 8 of the Procedures has therefore been amended to provide for this new measure in new indent (ii) and the provisions dealing with the fine that may be imposed for a failure to provide prices has been moved from the beginning of Paragraph 8.3 (a) to new indent (i). Paragraphs 8.3 (b) and (c) will be amended to take into account the changes made to paragraph (a), including the use of the new defined term "Price Alleged Breach".

A reference to Section 8 of the Procedures has been added at the beginning of Article 4.4.1.3 of the Rule Book as the calculation of a Clearing Member's Contribution could be impacted by the implementation of this new measure provided by Paragraph 8.3 (a) of Section 8 of the Procedures.

The amendments to Section 8 of the Procedures also contain typographical corrections.

(h) Corrections to the provisions related to the Clearing Members' Contribution Requirement

Following discussions on the default fund contribution payments to be made by Clearing Members that may move their positions from one entity to another one as part of the Brexit process, LCH SA proposes to clarify in Article 4.4.1.3 of the Rule Book that the Initial Margins to be taken into account for the purpose of the calculation of a Clearing Member's Contribution to the CDS Default Fund would be the available Initial

Margins for all Clearing Days if there is less than sixty Clearing Days of history available in respect of a Clearing Member's Account Structure.

The last paragraph of Article 4.4.1.8 of the Rule Book will be also removed. This paragraph states that LCH SA is not entitled to increase the Contribution Requirement of a Clearing Member whose aggregate amount of Initial Margins has not increased.

LCH SA has found that, in light of the netting in the calculation of the Initial Margin(s) provided by LCH SA through its portfolio margining framework, there may be circumstances in which a change in a Clearing Member's positions could lead to an increase of its Group Member Uncovered Risk but not of its Initial Margin(s). In this event, LCH SA has determined that it should have the authority to increase the Contribution Requirement of a Clearing Member. The amendment to Article 4.4.1.8 will implement this change.

Finally, Paragraph 6.6 (*Additional Contribution Amount*) of Section 6 of the Procedures will be amended to clarify when the Additional Contribution Amount is required to be paid upon a call by LCH SA. As proposed to be amended, Paragraph 6.6 confirms that, if the Clearing Member is notified on or before 14:00, the payment is to be made to LCH SA with Euro-denominated Cash Collateral through TARGET2 by 09:00 the next Business Day.⁵ If the call is made after 14:00, payment is required to be made at the payment window used for the purpose of the First Intraday Call on the next Business Day.

⁵ As defined in the Rule Book, "Business Day" means "any day that is not a holiday in the TARGET2 calendar".

(i) Miscellaneous Technical and Clarifying Amendments

LCH SA is proposing to make a general reference to reports referred to in Section 5 of the Procedures instead of making a specific reference to the Cleared Transaction Portfolio Report in paragraphs (c) (*Index Fungible*) of Sections 4.8 in Part A and Part B of the Supplement. The purpose of this amendment is to harmonise all of the references made to the reports in the Supplement and to avoid the need for modifying the Supplement if there is a change in the name of the reports provided for in Section 5 of the Procedures.

In addition, paragraph (c) of Sections 9.1 (*Occurrence of Clearing Member Self Referencing Transaction*) of Parts A and B of the Supplement will be aligned by removing the reference to the Clearing Member being the Reference Entity from Part B. This text is unnecessary as Section 9.1 only deals with Self Referencing Transactions for which the Clearing Member is the Reference Entity.

The amendments to the CDS Clearing Supplement also contain typographical corrections and amendments to incorrect used defined terms or incorrect cross-references.

(j) Correction to certain defined terms

The definition of “CDS Contractual Currency” in Section 1.1.1 of the CDS Clearing Rule Book will be amended to clarify that in respect of an Index Swaption, the CDS Contractual Currency shall mean the currency of the underlying transaction of an Index Swaption. The defined term “CDS Contractual Currency” is used in the context of the price contribution process as set out in Section 5 of the Procedures to determine the relevant applicable timings in respect of a credit default swap or an index swaption.

Since the proposed amended definition of “CDS Contractual Currency” refers to the term of “Underlying Index Transaction” which is defined in the Supplement, a definition of “Underlying Index Transaction” will be added to Section 1.1.1 of the Rule Book to refer to the definition as set out in Part C of the Supplement.

LCH SA proposes to remove the defined terms of “CDS Intraday Transaction” and “Index Swaption Intraday Transaction” from Section 1.1.1 of the Rule Book as there is no longer the need to make a distinction between these two types of Intraday Transactions. The current distinction was made initially when the CDS Clearing Service was extended to the clearing of Index Swaptions on an intraday basis only. The weekly backloading service is now available to Index Swaptions since last year and this distinction between intraday trades is no longer relevant from a drafting perspective. The defined term “Intraday Transaction” will be therefore amended to replace the references to “CDS Intraday Transaction” and “Index Swaption Intraday Transaction” by “CDS” and “Index Swaption” respectively. Consequently, the term “Index Swaption Intraday Transaction” will be replaced by “Index Swaption” in Article 3.1.6.1 and Section 4.1 (*Eligibility Requirements*) of the Procedures, paragraph (c) (iii) (C) will be amended to remove “Index Swaption Intraday Transaction” but also “Weekly Backloading Transaction” as there is no need to make such reference. Section 4.1 (*Eligibility Requirements*) of the Procedures, paragraph (c)(vii) will be amended to remove the references to “CDS Intraday Transaction” and “Index Swaption Intraday Transaction”.

It is proposed to amend the definitions of “FCM Client Margin Requirement”, “FCM House Margin Requirement” in Section 1.1.1 of the Rule Book to exclude Variation Margin from the Margins calculated by LCH SA as pursuant to Article

3.1.10.9, no Variation Margin is calculated for FCM Clearing Members as only STM Cleared Transaction are registered in their Account Structure(s).

The definition of “Procedures” in Section 1.1.1 of the Rule Book will be amended to clarify that such documents are issued by LCH SA and entitled “CDS Clearing Procedures”.

The reference to the defined term “Converting Clearing Member” will be removed from Article 3.1.10.8 of the Rule Book as there is the corresponding definition in Section 1.1.1.

Some of the defined terms in Section 1.1.1 of the Rule Book will be ranged in alphabetical order.

(k) Miscellaneous amendments

LCH SA proposes to amend Article 1.2.2.1 of the Rule Book by excluding the provisions of Articles 1.2.2.8 and 1.2.2.9 from its scope, since these two Articles deal with the publication of Clearing Notices and are part of the Section 1.2.2, which is contradictory to the last sentence of Article 1.2.2.1.

In addition, Section 4.2.7 of the Rule Book is proposed to be amended to remove any reference to the LCH Settlement Prices, defined as the settlement prices used in respect of Index Swaption Cleared Transactions, since the defined term of Markit LCH Settlement Prices will be amended to also cover these prices, in addition to the settlement prices used in respect of the Index Cleared Transactions and Single Name Cleared Transactions by making a general reference to Cleared Transactions. The defined term of LCH Settlement Price, therefore, will be removed from Section 1.1.1, Article 5.1.1.3 and Article 6.1.1.3 of the Rule Book.

LCH SA also proposes to clarify Article 5.1.1.3, indent (xiii)(a), of the Rule Book by making a reference to the CCM Client and extending the scope of this indent to cover any other purpose, in addition to the payment of the CDS Client Clearing Entitlement to the CCM Client. For example, in the event of an Event of Default occurring in respect of the CCM Client's Clearing Member, LCH SA would like to rely on the CCM Client's information provided by that Clearing Member in order to liaise with the CCM Client in relation to the transfer of the CCM Client's Relevant Client Cleared Transactions and Ported Collateral to a Backup Clearing Member.

In addition, Section 5 of the Procedures is proposed to be amended to remove any reference to bank holidays from Paragraph 5.18.3 (*Price Submission Procedure*) as the list is not exhaustive. When Clearing Members are required to submit prices at earlier times, LCH SA will notify them in advance in accordance with the provisions of this Paragraph. Paragraphs 5.18.3 and 5.18.5 are also proposed to be amended to clarify that the CDS Contractual Currency of the Index Swaptions is in Euro. The reference to "Clearing Day" in respect of the notification of execution of cross trades is not correct and is therefore proposed to be replaced by "Price Contribution Day" in indent (d) of Paragraph 5.18.5. The reference to "Clearing Day" in the paragraph is relevant for trades denominated in Euro but not in US Dollars since the definition of Clearing Day does not take into account bank holidays in the U.S., contrary to the definition of "Price Contribution Day". In Section 5 of the Procedures, LCH SA further proposes to specify that any reference to the "Operations department" is a reference to the "CDSClear Operations Department".

Finally, LCH SA proposes to remove all the Appendices of Section 5 of the Procedures, which are template forms to be used in the context of the Pre-Default Portability process as provided for in Paragraph 5.6 of Section 5 of the Procedures. The forms referred to in the CDS Clearing Rules are in general not appended to the rules and LCH SA would like to gain flexibility in amending them from time to time, for example to change contact details or make other minor changes to these forms without the need to amend Section 5 of the Procedures. The references to such Appendices will be removed from Paragraph 5.6 and the template forms will be available upon request pursuant to amended Paragraph 5.6.⁵

(b) Statutory Basis

LCH SA has determined that Proposed Rule Change is consistent with the requirements of Section 17A of the Securities Exchange Act (“Act”)⁶ and regulations thereunder applicable to it. Section 17A(b)(3)(F) of the Act requires, *inter alia*, that the rules of a clearing agency “promote the prompt and accurate clearance and settlement of securities transactions and . . . assure the safeguarding of securities and funds that are in its custody or control or for which it is responsible . . . and, in general, to protect investors and the public interest.”⁷

LCH SA has proposed amendments to introduce the clearing of single name CDS transactions referencing a monoline insurer constituent of certain indices such as the

⁵ The amendments to the Rule Book (including Appendix 1) and the Procedures also contain typographical corrections and amendments to incorrect defined terms or incorrect cross-references.

⁶ 15 U.S.C. 78q-1

⁷ 15 U.S.C. 78q-1(b)(3)(F).

CDX.NA IG and CDS.NA.HY. In doing so, LCH SA has assured that its existing risk management methodology, and in particular its Wrong Way Risk margin framework, is appropriate to manage the risk arising from the clearing of a single name CDS referencing a monoline insurer, including collecting and maintaining financial resources intended to cover the risks to which LCH SA is exposed in connection with offering such clearing services. As such LCH SA will be able to minimize the risk that the losses associated with the default of a participant (or participants) in the clearing service will extend to other participants in the service. By introducing the clearing of single name CDS transactions referencing a monoline insurer constituent of the CDX.NA IG and CDS.NA.HY indices, LCH SA is promoting the prompt and accurate clearance and settlement of derivatives transactions. As such, the clearing of single name CDS transactions referencing a monoline insurers is consistent with Section 17A(b) (3)(F) of the Act.

Regulation 17Ad-22(e)(3)(i) requires a “covered clearing agency”, *i.e.*, a clearing agency that is involved in activities with a more complex risk profile, such as providing services for security-based swaps, to maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing the risks that arise in or are borne by the covered clearing agency, including risk management policies, procedures, and systems designed to identify, measure, monitor, and manage the range of risks that arise in or are borne by the covered clearing agency.⁸

⁸ 17 C.F.R. § 240.17Ad-22(e)(3)(i).

As noted above, in introducing the clearing of single name CDS transactions referencing a monoline insurer, LCH SA made such amendments as are necessary to assure that its risk management methodology is appropriate to measure, monitor and manage the risk arising from the clearing of such single name CDS. As such, the clearing of single name CDS transactions referencing a monoline insurers is consistent with Regulation 17Ad-22(e)(3)(i).

Regulation 17dA-22(e)(4)(ii) requires a covered clearing agency to maintain and enforce written policies and procedures reasonably designed to effectively “measure, monitor, and manage its credit exposures from its payment, clearing and settlement processes” to assure that it maintains additional financial resources to enable it to cover a wide range of stress scenarios that include the default to two participant family clearing members that would potentially cause the largest aggregate liquidity exposure for the CCP in extreme but plausible market conditions.⁹

As discussed above, LCH SA is proposing to introduce two new margins to address additional financial risks to which Clearing Member may be exposed: (i) Legal Entity Identity Margin; and (ii) Stress Test Loss Over Additional Margin / Net Capital Ratio Margin. These additional margins are intended to assure that LCH SA has sufficient financial resources to manage the default of a Clearing Member with multiple margin accounts or which has accumulated positions at LCH SA that provide the Clearing Member high leverage versus its net capital amount.

Similarly, the proposal to apply stress test scenarios to non-cash collateral securities posted to cover margin requirements and to include the potential stressed loss

⁹ 17 C.F.R. § 240.17Ad-22(e)(4)(ii).

over the collateral haircut is intended to assure that LCH SA has enough financial resources to cover its liquidity needs in extreme but plausible market conditions.

The above proposals, therefore, are designed to enhance LCH SA's ability to measure, monitor, and manage its credit exposures from its payment, clearing and settlement processes to assure that it maintains additional financial resources to enable it to cover a wide range of stress scenarios the liquidity risk that may arise in connection with its activities as a covered clearing agency. As such the amendments creating two new margins and applying stress test scenarios to non-cash collateral are consistent with the requirements of Section 17A(b)(3)(F) of the Act and Regulation 17dA-22(e)(4)(ii).

Regulation 17Ad-22(e)(6)(iv)¹⁰ requires a covered clearing agency to establish a risk-based margin system that uses "reliable sources of timely price data and uses procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable". Further, Section 17A(b)(3)(G) of the Act provides that the participants of a clearing agency shall be appropriately disciplined for violation of any provision of the rules of the clearing agency by fine or any other fitting sanction. The addition of a new potential disciplinary measure available to LCH SA in the event of repetitive failures to submit prices (as part of the price submission procedure) by a Clearing Member is intended to assure the accuracy of the market data on which the CCP risk model relies and to appropriately discipline a Clearing Member that repeatedly fails to provide timely and accurate pricing data. As such, the proposed amendments to provide for the imposition of fines on Members that do not submit prices

¹⁰ 17 CFR 240.17Ad-22(e)(6)(iv).

as required are consistent with the provisions of Regulation 17Ad-22(e) and Section 17A(b)(3)(G) of the Securities Exchange Act.

Regulation 17Ad-22(e)(16)¹¹ requires a covered clearing agency to establish, maintain and enforce written policies and procedures designed to “[s]afeguard the covered clearing agency’s own and its participants’ assets, minimize the risk of loss and delay in access to these assets, and invest such assets in instruments with minimal credit, market, and liquidity risks.” As discussed above, LCH SA is proposing to amend its Rule Book to enhance its CDS Default Management Process by adding an additional resource in the event of the default of a Clearing Member. Specifically, LCH SA would be entitled to use any remaining house collateral transferred in respect of other LCH SA clearing services to reduce or cover losses linked to the liquidated Client Cleared Transactions of the Defaulting Clearing Member. By enhancing the assets available to LCH SA in the event of a CDS Clearing Member default, LCH SA is safeguarding its own and its participants’ assets. The proposal, therefore, is consistent with Regulation 17Ad-22(e)(16).

Regulation 17Ad-22(e)(13) provides that a clearing agency must establish, maintain and enforce written policies and procedures assure that the covered clearing agency “has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations”.¹² The proposed amendments to the early termination-related provisions set out in Clause 8 of Appendix 1 of the Rule Book are intended to clarify the applicable process by which LCH SA, in

¹¹ 17 CFR 240.17Ad-22(e)(16)

¹² 17 CFR 240.17Ad-22(e)(13).

the event of a Clearing Member default, may liquidate any Non-Defaulting Clearing Member's Collateral other than Euro denominated Cash Collateral when necessary to make required payments. The proposed amendments, therefore, are intended to assure that LCH SA has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations. As such, the proposed amendments are consistent with the provisions of Regulation 17Ad-22(e)(13).

Regulation 17Ad-22(e)(4)¹³ requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by including prefunded financial resources. LCH SA is proposing (i) to clarify that the Initial Margins to be taken into account for the purpose of the calculation of a Clearing Member's Contribution would be the available Initial Margins if there is less than sixty Clearing Days of history available and (ii) to remove the provisions preventing LCH SA from increasing the Contribution Requirement of a Clearing Member whose aggregate amount of Initial Margins has not increased.

For all these reasons, LCH SA believes that the Proposed Rule Change is consistent with the requirements of Section 17A of the Act and the regulations thereunder, including the standards under Rule 17Ad-22.

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

¹³ 15 U.S.C. 78q-1

purposes of the Act.¹⁴ LCH SA does not believe the Proposed Rule Change would have any impact, or impose any burden, on competition. The Proposed Rule Change does not address any competitive issue or have any impact on the competition among central counterparties. LCH SA operates an open access model, and the Proposed Rule Change will have no effect on this model.

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

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

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

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

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

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

IV. Solicitation of Comments

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

¹⁴ 15 U.S.C. 78q-1(b)(3)(I).

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-LCH SA-2020-004 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-LCH SA-2020-004. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of LCH SA and on LCH SA's website at: <https://www.lch.com/resources/rules-and-regulations/proposed-rule-changes-0>.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-LCH SA-2020-004 and should be submitted on or before [Commission to insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

J. Matthew DeLesDernier
Assistant Secretary

¹⁵ 17 CFR 200.30-3(a)(12).