

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-95674; File No. SR-LCH SA-2022-007)

September 6, 2022

Self-Regulatory Organizations; LCH SA; Notice of Filing of Proposed Rule Change
Relating to Providing Clearing Services for Additional Index and Single Name CDS

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 29, 2022, Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change (“Proposed Rule Change”) described in Items I, II and III below, which Items have been primarily prepared 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 expand its CDSClear service to provide clearing services for additional index and single name credit default swaps (“CDS”). Specifically, LCH SA is proposing to provide clearing services with regard to the iTraxx Asia ex Japan Index, the Markit CDX Emerging Markets (“CDX.EM”) Index and the single names that comprise each index, as well as a list of additional sovereign single names which are not constituent of an index (all together the “New Products”). To expand its clearing services in this way, LCH SA is proposing to amend its CDS Clearing Supplement (the

¹ 15 U.S.C. 78s(b)(1).

² 17 C.F.R. § 240.19b-4.

“**Supplement**”) and Section 2 of the CDS Clearing Procedures (the “**Procedures**”) to accommodate these additional indices and single names. LCH SA is further proposing to amend its CDS Margin Framework and CDS Default Fund Methodology (Guide Stress Testing) to reflect the addition of the New Products in the scope of instruments eligible for clearing by members of LCH SA CDSClear service.

The text of the Proposed Rule Change is in Exhibit 5.³

The launch of the various initiatives reflected in the Proposed Rule Change will be contingent upon LCH SA’s receipt of all necessary regulatory approvals, including the approval by the Commission of the Proposed Rule Change described herein.

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

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

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

1. Purpose

The Proposed Rule change is being adopted to expand LCH SA’s CDSClear service to provide clearing services for additional index and single name CDS. Specifically, LCH SA is proposing to provide clearing services with regard to the iTraxx

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

Asia ex Japan Index, the CDX.EM Index and the single names that comprise each index, as well as a list of additional sovereign single names which are not constituent of an index.

LCH SA has determined that the existing CDSClear risk model currently appropriately takes into account the risk associated with the New Products but is proposing to amend both its CDS Margin Framework and CDS Default Fund Methodology (Guide Stress testing) in order to reflect the addition of the New Products to the list of instruments eligible for clearing. To accommodate the New Products, LCH SA is further proposing to amend the Supplement and Section 2 of the Procedures.

(a) The CDS Clearing Supplement

To accommodate the New Products, LCH SA is proposing to amend the following definitions set out in Section 1.2 of Part B of the Supplement: (i) “Compression Cut-off Date”; (ii) “Novation Cut-off Date”; (iii) “Index Cleared Transaction Confirmation”; and (iv) “Transaction Business Day”.

Specifically, the definitions of “Compression Cut-off Date” and “Novation Cut-off Date” are each being amended to add two additional credit events that are taken into consideration in determining the “Compression Cut-off Date” and “Novation Cut-off Date”: (i) the “Obligation Acceleration Credit Event”; and (ii) the “Repudiation/Moratorium Credit Event”. These credit events, which are both standard under the 2014 ISDA Credit Derivatives Definitions, are not credit events that apply to any of the transaction types referenced by CDS that are currently eligible for clearing at LCH SA and, therefore, did not previously need to be addressed in the Supplement. These credit events apply to certain transaction types for sovereigns, and are proposed to

be added as a result of index comprising of and single name CDS referencing sovereign reference entities becoming eligible for clearing.

In addition, the definition of “Index Cleared Transaction Confirmation” is proposed to be revised to provide that: (i) with regard to any index cleared transaction that references a Markit iTraxx ex Japan Index Series [27] or above, the confirmation will be the form of confirmation that incorporates the iTraxx Asia/Pacific Untranch Standard Terms Supplement; and (ii) with regard to any index cleared transaction that references a Markit CDX.EM Index Series [27] or above, the form of confirmation that incorporates the CDX Emerging Markets Untranch Transactions Standard Terms Supplement, in each case being the latest version in force as published by Markit North America, Inc.

The definition of a “Transaction Business Day” is currently defined to mean a “Business Day”, as defined in the Index Cleared Transaction Confirmation or the Single Name Cleared Transaction Confirmation, as applicable. This term is proposed to be amended to take into account the situation where such confirmations could include different definitions of the term “Business Day” depending on the circumstances by providing that, “if the relevant Index Cleared Transaction Confirmation or Single Name Cleared Transaction Confirmation defines such term differently depending upon its use, such distinction shall also apply to the use of the term Transaction Business Day herein.”

In Section 2 of Part B of the Supplement, LCH SA is proposing to amend Section 2.2 (*Index Cleared Transaction Confirmation*) which specifies the manner in which an Index Cleared Transaction Confirmation is amended, supplemented and completed depending on the index CDS that is cleared to include, in addition to the indices currently

set out in the section, the iTraxx Asia ex Japan Index and the CDX.EM Index and provide for the necessary amendments to be made to the relevant confirmations depending on the index. Section 2.2 is also proposed to be amended to provide that “*The applicable Physical Settlement Matrix is the version of the Physical Settlement Matrix which is in force on the Clearing Day on which the Index Cleared Transaction is registered by LCH SA*” in a new indent (i) of paragraph (f). The purpose of this amendment is to ensure that the Additional Provisions for Certain Russian Entities published by ISDA on March 25, 2022 will apply to the relevant cleared trades, including the trades submitted through the backloading cycle that could have been entered into before the implementation date of these Additional Provisions and updated Physical Settlement Matrix and for which one of the parties, or both, did not adhere to the ISDA 2022 Russia Additional Provisions Protocol published by ISDA on March 29, 2022.

In Section 4 of Part B of the Supplement, LCH SA is proposing to amend Section 4.1(b) to add a “Repudiation/Moratorium Extension Notice” to the types of notices that neither LCH SA nor a clearing member is entitled to deliver with regard to an M(M)R Restructuring in accordance with the terms of any Restructuring Cleared Transaction. As above, a “Repudiation/Moratorium Extension Notice” is standard under the 2014 ISDA Credit Derivatives Definitions and is being proposed to be added as a result of index comprising of and single name CDS referencing sovereigns becoming eligible for clearing.⁴

⁴ For the same reason, “Repudiation/Moratorium Extension Notice” is proposed to be added to Section 5(b) of Appendix XIII of Part B of the Supplement (*CCM Client Transaction Requirements*).

In Section 6 of Part B of the Supplement, Section 6.5(c) is proposed to be amended to add “Package Observable Bond” to the types of asset packages that can be identified in a Notice of Physical Settlement (“**NOPS**”) or a NOPS Amendment Notice. The Package Observable Bond provisions in the 2014 ISDA Credit Derivatives Definitions only apply to transactions referencing sovereigns. As a result, they did not previously need to be referenced in the Supplement.

LCH SA is also proposing to add a new section 6.8(c) entitled “Buy-in of Bonds – Cap on Settlement” for the purposes of clarifying how the “60 Business Day Cap on Settlement”, which is relevant for transactions derived from the CDX EM Index amongst others, will apply to CCM Client Transactions in respect of the Matched Contracts of a Settlement Matched Pair. This proposed amendments consist in making an adjustment as to the manner in which Section 9.10 of the 2014 ISDA Credit Derivatives Definitions works between Matched Buyer and Matched Seller to ensure that the extension of the Termination Date provided for by Section 9.10 will apply when there has been a notice delivered to Matched Seller by its client under a CCM Client Transaction. This is to ensure that the Termination Date of the Cleared Transactions and related CCM Client Transaction is the same.⁵

⁵ For the same reason, the provisions of section 6.8(c) are effectively repeated in Section 7.8 and Section 7.18 of Appendix XIII of Part B of the Supplement (*CCM Client Transaction Requirements*). Separately, Section 7.15 of Appendix XIII, Alternative Procedures relating to Loans in respect of Matched Contracts, and Section 7.17 of Appendix XIII, Alternative Procedures relating to Assets Not Delivered, are proposed to be amended to remove as unnecessary the phrase “for the purposes of the Matched Contracts of the related Settlement Matched Pair” and also to use the correct defined term “Settlement Matched Pair”.

(b) Section 2 of the Procedures

LCH SA is also proposing to make one minor technical amendment to Section 2 of the Procedures (*Margin, NPV Payment and Price Alignment*). Specifically, the initial sentence of Section 2.7(c) currently provides, *inter alia*, that, where a Clearing Member is acting as a CDS Seller, Short Charge Margin will be required to cover the risk that the Clearing Member is subject to an event of default at the same time that a credit event occurs “with respect to a Reference Entity”. Recognizing that a credit event may occur with respect to more than one Reference Entity, this sentence is proposed to be revised to refer to “one or more Reference Entities”.

(c) The Reference Guide: CDS Margin Framework

LCH SA is proposing to amend the Margin Framework to reflect the addition of the new single names. For example, Section 3.4.5, Portfolio Margining, which, *inter alia*, lists the various combinations of instruments that can constitute an index basis package, is proposed to be revised to add to the list (i) the CDX.EM Index vs All Single Names Constituents of the index and (ii) the iTraxx Asia ex Japan vs All Single Names Constituents of the index. In addition, LCH SA is proposing to amend Section 3.1.1, Recovery Rate for Short Charge to note that the recovery rate for state-owned enterprises (“SOE”) is 70 percent. LCH is also proposing to move the provisions of current Section 3.5.2, Short Charge Calculation, to a new Section 3.5.3. A new Section 3.5.2, Sovereign Exposures, is proposed to be added, which notes the high level of correlation between SOEs and their sovereign entities. As a result, an SOE that is more than 50 percent owned by a sovereign entity would be defaulted jointly with its sovereign entity when the

positions are not risk reducing. Further, exposures for SOEs will be calculated using a fixed 70 percent recovery rate.

LCH SA is also proposing to amend Section 3.8.1, Offsets inter-region, to expand the regional pairs that LCH SA will consider in calculating wrong way risk to include: (i) Europe/US; (ii) Europe/Australia; (iii) Europe/Asia; (iv) US/Australia; (v) US/Asia; and (vi) Asia/Australia.

LCH SA is proposing to amend Section 4.1.1, Liquidity Charge for Linear Portfolio, to note that the liquidation cost of a sub-portfolio composed of a single 5 year position in the principal on the run index is simply the sum of the macro hedging cost. Further, single names without a parent index are considered a sub-portfolio for which LCH SA charges the cost of unwinding a non-hedged sub-portfolio. Finally, Section 4.1.2, Macro Hedging Phase, which, *inter alia*, sets out a list of sub-portfolios corresponding to indices and their components is proposed to be revised to add: (i) the CDX.EM sub-portfolio; (ii) the iTraxx Asia ex Japan IG sub-portfolio, and (iii) the No parent index sub-portfolio.

LCH SA is proposing to amend Section 4.1.7 to update the existing thresholds and include more cleared indexes in the table for volume thresholds based on calibrations done in December 2021. A dedicated liquidity grid has also been added for sovereign single names in order to reflect their tighter bid-ask spreads and higher liquidity profiles.

LCH SA is also proposing to amend the CDS Default Fund Methodology (Guide Stress Testing) in a number of sections, to reflect the extension of the product offer as well as to introduce a Sovereign Stressed Short Charge component aimed to capture a potential joint default of a member and its country:

- the last paragraph of section 2.2 adds to the list of index families covered to reflect the addition of CDX.EM and iTraxx Asia. It also adds iTraxx Australia, as this should have been updated when introducing that index.

- section 2.4.1 details how State-Owned Entities' exposures should be added to the exposure on the sovereign name only if risk increasing

- section 2.4.2 introduces a Sovereign Stressed Short Charge, considering jointly the top exposure across the portfolio and if relevant the exposure on the sovereign name corresponding to the member's jurisdiction

- section 2.4.3. and 2.7.2 describe the same Sovereign Stressed Short Charge with formulas instead of plain text

- section 2.6.1. and 2.6.3 extend the logic of exercise decisions to consider the Sovereign Stressed Short Charge when relevant

2. Statutory Basis

LCH SA believes that the Proposed Rule Change is consistent with the requirements of Section 17A of the Act⁶ and regulations thereunder applicable to it, including Commission Rule 17Ad-22(e).⁷ In particular, Section 17A(b)(3)(F) of the Act requires, *inter alia*, that the rules of a clearing agency be designed to “promote the prompt and accurate clearance and settlement of . . . derivatives agreements, contracts, and transactions”.⁸ By proposing to amend its CDS Clearing Supplement to authorize the expansion of LCH SA's CDSClear Service to provide clearing services with regard to the

⁶ 15 U.S.C. 78q-1.

⁷ 17 C.F.R. §240.17Ad-22.

⁸ 15 U.S.C. 78q-1(b)(3)(F).

New Products, on the terms and conditions set out in the Proposed Rule Change, LCH SA considers that this would encourage Clearing Members to clear additional indices and single name CDS through its CDSClear service, which, in turn, should promote the prompt and accurate clearance and settlement of those instruments within the meaning of Section 17A(b)(3)(F) of the Act.⁹ The Proposed Rule Change, in particular, the amendments to the CDS Clearing Supplement, therefore, are consistent with the requirements of Section 17A(b)(3)(F) of the Act.

Further, from the perspective of financial risk management and margin requirements, the clearing of the New Products would not require changes to LCH SA's existing margin methodology, default management policies and procedures and operational process, as LCH SA determined that the current margin framework for its CDSClear service already appropriately captures the risk associated to the New Products. The New Products would be cleared pursuant to LCH SA's existing clearing arrangements and related financial safeguards, protections and risk management procedures which are consistent with Exchange Act Rule 17Ad-22(e)(17),¹⁰ requiring a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to manage the covered clearing agency's operational risks by, among other things, identifying the plausible sources of operational risk, both internal and external, and mitigating their impact through the use of appropriate systems, policies, procedures, and controls.

⁹ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰ 17 CFR 240.17Ad-22(e)(17).

Adopting rules to facilitate the clearing of the New Products would also be consistent with other relevant requirements of Rule 17Ad-22(e),¹¹ as set forth in the following discussion.

Margin Requirements. Rule 17Ad-22(e)(4)¹² requires LCH SA 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, among other requirements. In terms of financial resources, LCH SA would apply its existing margin methodology to the New Products. LCH SA believes that the proposed rules that would apply this risk model to the New Products will provide sufficient margin requirements to cover its credit exposure to its clearing members from clearing such contracts, consistent with the requirements of Rule 17Ad-22I(4).¹³ [sic]

Financial Resources. Rule 17Ad-22I(4)(i)¹⁴ [sic] requires LCH SA 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 by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. To the extent not already maintained pursuant to paragraph

¹¹ 17 CFR 240.17Ad-22(e).

¹² 17 CFR 240.17Ad-22(e)(4).

¹³ 17 CFR 240.17Ad-22(e)4.

¹⁴ 17 CFR 240.17Ad-22(e)(4)(i).

(e)(4)(i), Rule 17Ad-22(e)(4)(ii)¹⁵ requires LCH SA's policies and procedures be reasonably designed to maintain additional financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions. As explained above, LCH SA is proposing to make some changes to its CDS Default Fund Methodology documentation (Guide Stress Testing) in order to reflect the extension of the product list as well as to introduce a Sovereign Stressed Short Charge component aimed to capture a potential joint default of a member and its country. LCH SA believes that with the proposed changes in its stress testing framework, its Default Fund will, together with the required margin, provide sufficient financial resources to support the clearing of the New Products, consistent with the requirements of Rules 17Ad22(e)(4)(i) and (ii).

Operational Resources. Rule 17Ad-22(e)(3)¹⁶ requires LCH SA to establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the covered clearing agency. LCH SA believes that its existing operational and risk management resources will be sufficient for clearing of the New Products, consistent with the requirements of Rule 17Ad-22(e)(3)¹⁷, as these new

¹⁵ 17 CFR 240.17Ad-22(e)(4)(ii).

¹⁶ 17 CFR 240.17Ad-22(e)(3).

¹⁷ 17 CFR 240.17Ad-22(e)(3).

contracts are substantially the same from an operational and risk management perspective as the existing CDS contracts cleared by LCH SA CDSClear.

LCH SA will also apply its existing default management policies and procedures for the New Products. As with current CDSClear products with similar risk profile, LCH SA believes that these procedures allow for it to take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of clearing member insolvencies or defaults in respect of the additional single names, in accordance with Rule 17Ad-22(e)(3).¹⁸

Exchange Act Rule 17Ad-22(e)(1)¹⁹ requires that a covered clearing agency establish, implement, maintain, and enforce written 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. As described above, the Proposed Change is also modifying the Supplement to take into account the New Products and provide for a clear and transparent legal basis for LCH SA's CDS Clearing rules consistent with the requirements of Exchange Act Rule 17Ad-22(e)(1)²⁰.

Credit default swap (CDS) is an over-the-counter (OTC) market on which participants can be active at any time in the context of market stress. The LCH SA CDSClear risk model is considering 5-d moves of unhedged portfolios and the back testing results confirmed that the margins for the New Products were sufficient to cover the exposure in the interval between the last margin collection and the close out of the

¹⁸ 17 CFR 240.17Ad-22(e)(3).

¹⁹ 17 CFR 240.17Ad-22(e)(1).

²⁰ 17 CFR 240.17Ad-22(e)(1).

portfolio a defaulting clearing member which is consistent with the requirements of SEC Rule 17Ad-22(e)(6)(iii)²¹.

B. Clearing Agency's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.²²

LCH SA does not believe that its proposed clearing of the New Products will adversely affect competition in the trading market for those contracts or CDS generally. By allowing LCH SA to clear the New Products, market participants will have additional choices on where to clear and which products to use for risk management purposes, which, in turn, will promote competition and further the development of CDS for risk management.

In addition, LCH SA will continue to apply its existing fair and open access criteria to the clearing of these additional products and will apply the same criteria to every clearing member or client who proposes to enter into this clearing activity.

Accordingly, LCH SA does not believe that the Proposed Rule Change would impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

²¹ 17 CFR 240.17Ad-22(e)(6)(iii).

²² 15 U.S.C. 78q-1(b)(3)(I).

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:

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-2022-007 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-2022-007. 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/rulebooks/proposed-rule-changes>.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-LCH SA-2022-007 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.²³

J. Matthew DeLesDernier,
Deputy Secretary.

²³ 17 CFR 200.30-3(a)(12).