

Via CFTC Portal

1 July 2022

**Mr Christopher J. Kirkpatrick**  
**Office of the Secretariat**  
**Commodity Futures Trading Commission**  
**Three Lafayette Centre**  
**1155 21<sup>st</sup> Street NW**  
**Washington, DC 20581**

**Re:** Proposed amendments to LCH SA CDS Clearing Rules – Itraxx Australia and WWR margin instability

Dear Mr. Kirkpatrick,

Pursuant to CFTC regulation §40.6(a), LCH SA (“**LCH SA**”), a derivatives clearing organization (“**DCO**”) registered with the Commodity Futures Trading Commission (the “**CFTC**”), is submitting for self-certification the proposed amendments to its CDS Clearing framework to enhance and expand its clearing services (the “**Proposed Rule Change**”).<sup>1</sup>

The Proposed Rule Change is expected to be effective by early September, 2022 however, in no event, will either be implemented earlier than 10 business days after the proposed changes are filed with the CFTC.

The text of the Proposed Rule Change is attached hereto as Appendix.

**Part I: Explanation and Analysis**

LCH SA is proposing to revise its CDS Clearing risk methodology, rules, procedures and supplement to (i) permit the clearing of Markit iTraxx® Australia indices and the associated single name constituents and (ii) provide a remediation to one independent model validation recommendation regarding the Wrong Way Risk (“**WWR**”) margin instability.

**Part II: Description of Rule Changes**

As specified in Appendix, the purpose of the Proposed Rule Change is to (i) permit the clearing of Markit iTraxx® Australia indices and the associated single name constituents and (ii) provide the remediation to the WWR margin instability as follows :

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<sup>1</sup> Capitalized terms used but not defined herein shall have the meaning specified in LCH SA’s existing CDS Clearing Rule Book or Clearing Supplement.

**1. Proposed amendments to permit the clearing of Markit iTraxx® Australia indices**

**a) Amendments to the Clearing Supplement**

The Clearing Supplement has been amended in order to include the relevant provisions to allow the clearing of the new Markit iTraxx® Australia indices.

In Part B of the Clearing Supplement, Section 1.2 (Terms defined in the CDS Clearing Supplement) has been amended to include a new sub-paragraph (a) to the definition of an “Index Cleared Transaction Confirmation” in order to make a reference to the form of confirmation which incorporates the iTraxx® Asia/Pacific Untranch Standard Terms Supplement. As a consequence, the following sub-paragraphs have been renumbered.

Section 2.2 (Index Cleared Transaction Confirmation) of Part B of the Clearing Supplement has been also amended to make appropriate references to any Index Cleared Transaction that is a Markit iTraxx Australia Index in paragraphs (a) (i), (b) (i), (c)(i) and (f)(i).

**b) Proposed amendments to the CDS Clear Risk Methodology documentation**

LCH SA is proposing to amend its CDS Clear Risk methodology documentation under Section 2.1.1.1 to proceed with the removal of the interest rate curve name used with the ISDA pricer that doesn't need to be clearly specified in a such risk documentation. The objective now is to refer to the original website when the market moves to the new Risk Free Rates.

The second proposed change specified under section 3.4.5 is intending to add iTraxx Australia to the list of indices on which index basis packages can be cleared.

As there are financial single name constituents in the iTraxx Australia index family, positions on this index will be subject to the Wrong Way Risk margin. This coupled with the need to address a recommendation raised by the independent risk model validation on the instability of the Wrong Way Risk margin component result in LCH SA also proposing to amend the provisions under section 3.8 about the Wrong Way Risk margin to introduce the following updates:

- one is the introduction of the shocks applied to Australian entities, alongside the ones given for existing products.

- a second one is to describe the way the shocks on indices are defined, being derived directly from the shocks applied on constituents. This would apply to iTraxx Australia as well as other indices containing financial names, although no financial impact is expected.

- an additional change, specifying that the contribution to the spread margin used to derive the spread\_SM under sections 3.8.1.5 and 3.8.1.6 is now considering the contribution of a single tenor, instead of the joint contribution of all tenors on a given product, to address the instability observed with curve trades.

- the last update is to introduce iTraxx Australia alongside other regions under section 3.8.1 when aggregating Wrong way and Right way across regions.

Further, the liquidity charge section is updated, to specify that iTraxx Australia will be used for hedging and would define an additional sub-portfolio when considering liquidation costs.

Finally, LCH SA is also taking this opportunity to make changes for consistency purposes by removing from its CDSClear risk methodology documentation any reference to IBOR curves.

### **Part III: Core Principle Compliance**

LCH SA has reviewed the Proposed Rule Changes against the requirements of Commission' regulations and DCO Core Principles, and finds that these changes will continue to comply with all the requirements and standards therein and in particular with the following principles and Commission's regulations including, but not limited to § 30.13 and 39.27.

**DCO Core Principle D – Risk management.** CFTC Regulation 39.13 requires a DCO to ensure that it possesses the ability to manage the risks associated with discharging the responsibilities of the derivatives clearing organization through the use of appropriate tools and procedures. From a financial risk management and margin requirements, clearing of the new iTraxx Australia index and the associated single name constituents would not require changes to the existing margin methodology, default management policies and procedures and operational process as the proposed products do not include any new risk factor compared to the Corporates and Financials indices or single names already cleared by LCH SA CDSClear service. LCH SA will also apply its existing clearing arrangements and related financial safeguards, protections and risk management procedures for iTraxx Australia transactions to be cleared in accordance with the requirements of Core Principle D and § 39.13.

**DCO Core Principle R – Legal risk considerations.** LCH SA has determined that the Proposed Rule Changes are consistent with the requirements of CFTC Regulation 39.27 to remain in good standing at all times in the relevant jurisdictions and to operate pursuant to a well-founded, transparent, and enforceable legal framework that addresses each aspect of its activities. As described above, the CDSClear framework for indices and single names CDS was modified to take into account the new product iTraxx® Australia indices and the associated single name constituents and provide for a clear and transparent legal basis for LCH SA's CDS Clearing rules which is fully consistent with the requirements of Core Principle R and § 39.27.

### **Part IV: Public Information**

LCH SA has posted a notice of pending certifications with the CFTC and a copy of the submission on LCH's website at: <https://www.lch.com/resources/rulebooks/proposed-rule-changes>

### **Part V: Opposing Views**

There were no opposing views expressed to LCH SA by governing board or committee members, members of LCH SA that were not incorporated into the rule.

### **Certification**

LCH SA hereby certifies to the CFTC, pursuant to the procedures set forth in the Commission regulation § 40.6, that attached changes submission complies with the Commodity Exchange Act, as amended, and the regulations promulgated there under.

Should you have any questions please contact me.

A handwritten signature in blue ink, appearing to read 'Faure', with a long horizontal stroke underneath.

**Francois Faure**  
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**APPENDIX**

Proposed Rule changes to LCH SA CDS Clearing framework:

- 1) CDS Clearing Supplement
- 2) LCH SA Reference Guide: CDS Margin Framework - V3.13 **(to be filed separately with the CFTC under Confidential Treatment request)**