

Via CFTC Portal

7 October 2021

**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 LCH SA Initiative – Extension of Eligible Collateral to Non Euro Government Bonds (N€NC)

Dear Mr. Kirkpatrick,

Pursuant to CFTC regulation §40.6(a), LCH SA, a derivatives clearing organization (“**DCO**”) registered with the Commodity Futures Trading Commission (the “**CFTC**”), is submitting for self-certification the proposed amendments required to expand the non-cash collateral that a Clearing Member may post with LCH SA to meet the clearing member’s initial and additional margin requirements (the “**Proposed Rule Change**”).

The intended date of implementation of this initiative is on November 1<sup>st</sup>, 2021, subject to any relevant regulatory review or approval process duly completed and in no event will the proposed changes will be implemented earlier than ten (10) business days after the formal filing with the CFTC.

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

**Part I: Explanation and Analysis**

The Proposed Rule Change is being adopted to expand the non-Euro government bonds that a Clearing Member may post with LCH SA in order to satisfy the clearing member’s margin requirements.

Currently, the only non-Euro Eligible Collateral are Gilts, issued by the United Kingdom, and Treasury Bills, issued by the United States.

In response to clearing member requests and in order to harmonize permitted Eligible Collateral with the Eligible Collateral permitted to satisfy clearing member margin requirements at LCH SA’s affiliate LCH Limited, LCH SA is proposing to expand the non-cash collateral that a Clearing Member may post with LCH SA to meet the member’s margin requirements (the “**Eligible Collateral**”) to include certain additional non-Euro government bonds by (i) amending its CDS Clearing Rulebook (the “**Rule Book**”) to clarify that such additional non-Euro government bonds are excluded from the Pledge Eligible Collateral, and (ii) publishing a new Clearing Notice, in accordance with Article 4.2.6.1 of the CDS Clearing Rule Book, specifying the additional acceptable non-Euro government bonds. The new scope of securities

eligible as collateral are government bonds issued by the following states and denominated in their domestic currencies : Australia, Canada, Denmark, Japan, Norway, Sweden and Switzerland;

LCH SA is also proposing to expand the custodians at which Clearing Members may deposit Eligible Collateral by adding Clearstream Banking Luxembourg (**CBL**) as a central securities depository for LCH SA in Section 3 of the CDS Clearing Procedures – Collateral, Variation Margin and Cash Payment. In accordance with the provisions of paragraph 3.4 (d) i) of Section 3 of the CDS Clearing Procedures, FCM customer funds, including securities, will not be held at CBL as this possibility is offered to FCMs for their house activity only.

Finally, LCH SA is proposing to amend its Liquidity Risk Modelling Framework (the “**Risk Framework**”) to take into account the expanded list of Eligible Collateral<sup>1</sup>.

## **Part II: Description of Rule changes**

In order to effect the Proposed Rule Change, LCH SA is proposing to issue a new Clearing Notice identifying the additional non-Euro Eligible Collateral, defined as “New Instruments” in the Clearing Notice. LCH SA has determined that (i) each of the non-Euro jurisdictions whose bonds have been added have a high credit score, and (ii) each of the New Instruments has sufficient liquidity. However, because the European Central Bank will not convert the additional non-Euro Eligible Collateral to Euros and LCH SA currently does not otherwise have the operational capacity to convert the additional non-Euro Eligible Collateral to Euros, the Clearing Notice will also provide that non-Euro Eligible Collateral may satisfy no more than 15 percent (15%) of a Clearing Member’s total margin requirements.

In addition, the Clearing Notice will provide that the New Instruments will not be eligible as “Pledged Eligible Collateral” and, therefore, may not be pledged in accordance with a pledge agreement entered into between LCH SA and a clearing member having exercised its option to transfer Eligible Collateral to LCH SA through a Belgian law security interest. Accordingly, the definition of “Pledged Eligible Collateral” in Section 1.1.1 of the CDS Clearing Rule Book will be revised to provide that the term “Pledged Eligible Collateral” means “Eligible Collateral as described in a Clearing Notice which is pledged in accordance with a Pledge Agreement.”

Separately, LCH SA is proposing to revise Section 3 of its CDS Clearing Procedures – Collateral, Variation Margin and Cash Payment, in several places to add Clearstream Banking Luxembourg as a central securities depository for LCH SA.

Finally, as noted above, LCH SA is also proposing to amend the Risk Framework to take into account the expanded list of Eligible Collateral. The Risk Framework is one of several policies and procedures that LCH SA maintains to manage its liquidity risk, i.e., the risk that LCH SA will not have enough cash available, in extreme but plausible circumstances, to settle margin payments or delivery obligations when they become due, in particular upon the default of a clearing member. The Risk Framework describes the Liquidity Stress Testing framework by which the Collateral and Liquidity Risk Management department

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<sup>1</sup> All capitalized terms not defined herein have the same definition as the LCH SA CDS Clearing Rule Book, Supplement or Procedures, as applicable.

("CaLRM") of LCH Group Holdings Limited assures that LCH SA has enough cash available to meet any financial obligations, both expected and unexpected, that may arise over the liquidation period for each of the clearing services that LCH SA offers.

In particular, because the European Central Bank will not convert the additional non-Euro Eligible Collateral to Euros and LCH SA currently does not otherwise have the operational capacity to convert the additional non-Euro Eligible Collateral to Euros, LCH SA is proposing to amend Section 4.1.3 and Section 4.1.4 of the Risk Framework to make clear that the additional non-Euro Eligible Collateral will be excluded from the calculation of LCH SA's liquidity resources.

Unrelated to the expansion of non-Euro Eligible Collateral, LCH SA is also proposing to amend the Risk Framework to clarify certain Sections and update certain tables and formula.

In this regard:

- Section 4.1.1, Description of sources of liquidity, will be revised to clarify that, with limited exceptions, LCH SA generally receives Collateral on a full title transfer basis, which permits LCH SA to use such collateral, to offset it with all related claims and to consider such Collateral available for liquidity purposes.
- Section 4.1.3, Assessment of assets' liquidity, will be revised to clarify that Collateral deposited under the pledge regime may be used for liquidity purposes only if the clearing member pledging such Collateral has defaulted.
- Section 5.1.1, Overview of the Monitoring liquidity, will be revised to clarify that LCH SA has a group policy that allows LCH SA to perform an extraordinary margin call if liquidity deteriorates.
- Section 5.3.1, Liquidity Coverage Ratio (LCR), Overview, will be revised to explain that the LCR framework is an internal ratio similar, but not equivalent, to the banking metric defined in the Basel III framework and is used to ensure compliance with EMIR.
- Section 5.3.1.1, Liquidity requirements Assumptions per clearing services RepoClear, will be revised to update the formula for calculating market risk in RepoClear transactions.
- Section 5.3.1.3, Cash Equity, will be revised to clarify the treatment settlement risk to account for early exercise of American-style options.
- Sections 5.3.1.4, Listed derivatives, 5.3.1.5, Credit Default Swaps, and 5.3.4, Cover 2 selection, will be revised to clarify that the calculation of LCR liability components include spread shifts and implied volatility shifts.

### **Part III: Core Principles 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 § 39.13, 39.15, 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.

The additional non-Euro Eligible Collateral that LCH SA is proposing to permit clearing members to post with LCH SA to satisfy the clearing member's margin requirements is limited to sovereign debt that is issued by jurisdictions that have a high credit score and subject to conservative haircuts in line with LCH SA's collateral eligibility criteria and risk management framework. Indeed, LCH SA has determined that non-Euro Eligible Collateral may be taken into account to satisfy no more than 15 percent (15%) of a clearing member's total margin requirements and, importantly, will be excluded from the calculation of LCH SA's funding liquidity resources. The 15% cap has been defined in order to ensure the CCP liquidity coverage ratio remains robust, while conservatively excluding the new debts non cash collateral from funding resources.

Further, apart from the addition of Clearstream Banking Luxembourg as a CSD where Clearing Members' securities collateral could be deposited (to harmonize with the current possibilities offered to our CMFs in other business lines), changes to Section 3 of CDS Procedures only add references to a new Notice excluding (for the time being) the new eligible bonds from the definition of Eligible Pledged Collateral, and therefore from the pledge mechanism. The CCP is already and very much remains able, under the proposed changes, to control the collateral it accepts as well as to manage the associated risk through the haircuts it applies and the legal regime used to receive it (full title transfer vs pledge vs Central Bank guarantee).

**DCO Core Principle F – Treatment of funds.** CFTC Regulation 39.15 requires a DCO to establish standards and procedures that are designed to protect and ensure the safety of funds and assets belonging to clearing members and their customers. In expanding the non-cash collateral that a Clearing Member may post with LCH SA, the DCO will apply its existing rules, policies and procedures with respect to the segregation requirements or to the portability of accounts from Defaulting Clearing Members to an appointed Backup Clearing Member, allowing the protection of collateral from Clearing Member default or insolvency which is compliant with Core Principle F and the requirements of § 39.15(d) regarding the transfer of customer positions.

**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. In accordance with the CDS Clearing Rule Book (art 4.2.6.1), and for transparency and clarity purposes, LCH SA wishes to notify Clearing Members of changes to what constitutes Eligible Currencies or Eligible Collateral by publication of a Clearing Notice. As such, the list of new bonds expanding the current list of securities eligible as collateral has been created in a Clearing Notice, which outlines the conditions under which these can be accepted by the CCP and expressly excludes these bonds from the Pledge mechanism. Amendment to CDS Procedure Section 3 aims at referring directly to this Notice and therefore draw attention of our Clearing Members on this new offering and the legal regime applicable to it. As such, this Proposed Rule Change would modify LCH SA's existing rules and legal framework to clearly specify the additional non-Euro Eligible Collateral which is 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/rules-and-regulations/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 rules.

**Certification**

LCH SA hereby certifies to the CFTC, pursuant to the procedures set forth in the Commission regulation §40.6, that this change 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', is written over a horizontal line.

**Francois Faure**  
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## APPENDIX

### Text of the Proposed Rule Change

- 1) CDS Clearing Rule Book
- 2) Section 3 of the CDS Clearing Procedures
- 3) New CDS Clearing Notice in relation to the list of Eligible Collateral
- 4) LCH SA Liquidity Risk Modelling Framework [***To be filed separately with the CFTC under Confidential Treatment Request***]