

Via CFTC Portal

30 November 2020

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

Re: Proposed Amendments to LCH SA Liquidity Risk Modelling Framework

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 amendments to its Liquidity Risk Modelling Framework (the “**Framework**”) in order to address more accurately the liquidity requirements in the event of the assignment and exercise of Equity American options (the “**Proposed Rule Change**”).

The intended date of implementation is on or after December 12, 2020, subject to any relevant regulatory review or approval process duly completed and in no event, the changes will be implemented earlier than ten (10) business days after the formal filing with the CFTC.

The proposed changes made to the Rules are attached hereto as Appendix¹ and filed separately with the CFTC under Confidential Treatment request.

Part I: Explanation and Analysis

On February 25, 2020, LCH SA submitted to the CFTC for self-certification a number of amendments to its Framework.²

LCH is now proposing to amend the Framework in order to address one recommendation made by the independent model validation team during the 2018/2019 review.

The purpose of the enhancement is to include, from a liquidity perspective, the funding risk arising from the physical settlement linked to the exercise of American options under stressed liquidity conditions.

¹ All capitalized terms not defined herein have the same definition as the Rule Book, Supplement or Procedures, as applicable.

² https://www.lch.com/system/files/media_root/LCH%20SA_LCR%20Framework_CFTC%20SelfCert_Formal_25%20Feb%202020.pdf

This is an extension of the scope as American and European options exercise at expiry is already covered by the current approved Framework.

There is a risk of assignment and exercise of American Equity options at any time when the Cover2 members may start facing liquidity issues. During that period, the DCO/Clearing Agency could, as a result, observe an increase in the liquidity needs linked to Equity's settlement. This concern needs to be modelled and tackled within the liquidity coverage ratio ("LCR").

This means that on a daily basis the LCR will identify all the potential positions that are in the money or at the money on the day of the computation and on the upcoming business day as well. Then, given the potential option exercise, it will generate a liquidity need.

In practice, the daily process will work as follows:

- Computation of the liquidity needs coming from the American equity options that are in-the-money or at-the-money, by applying no market stress.
- Computation of the liquidity needs coming from the options that are in-the-money or at-the-money, by applying a stress scenario to the equities.
- LCH SA will select the positions consistent with the Cover2 for both modes described above and will retain the most punitive one.
- This amount will then be added to the current cash equity settlement amount in the LCR.

A six month back test from May to November 2019 showed the impact on the LCR is less than 0.5% with the largest impact being 0.86% and occurred on the November 13, 2019.

Part II: Description of Rule changes

In order to introduce the Proposed Rule Change, LCH SA will need to slightly modify the Framework.

The term "expiry" will be replaced by "exercise" in both sections 5.3.1.3 and 5.3.4 and the term "at expiry" will be replaced by "anytime by defaulting members" in the paragraph Option Expiry of section 5.3.1.3.

No other changes will be made.

Part III: Core Principle Compliance

LCH SA will continue to comply with all Core Principles following the introduction of this change and has concluded that its compliance with the Core Principles would not be adversely affected by this change.

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 at: françois.faure@lch.com



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APPENDIX

- LCH SA Liquidity Risk Modelling Framework (V. 5.2) **(to be filed separately with the CFTC under Confidential Treatment request)**