

believe that the requested relief meets this standard because, as further explained in the Application, the Advisory Agreements will remain subject to shareholder approval, while the role of the Wholly-Owned Sub-Advisers is substantially similar to that of individual portfolio managers, so that requiring shareholder approval of Sub-Advisory Agreements would impose unnecessary delays and expenses on the Subadvised Series. Applicants believe that the requested relief from the Disclosure Requirements meets this standard because it will improve the Adviser's ability to negotiate fees paid to the Wholly-Owned Sub-Advisers that are more advantageous for the Subadvised Series.

For the Commission, by the Division of Investment Management, under delegated authority.

**Eduardo A. Aleman,**  
Assistant Secretary.

[FR Doc. 2016-31938 Filed 1-4-17; 8:45 am]

BILLING CODE 8011-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-79707; File No. 600-36]

### Self-Regulatory Organizations; LCH SA; Order Granting Application for Registration as a Clearing Agency and Request for Exemptive Relief

December 29, 2016.

#### I. Introduction

On July 5, 2016, Banque Centrale de Compensation, which conducts business under the name LCH SA ("LCH SA"), filed with the Securities and Exchange Commission ("Commission") a Form CA-1 seeking registration as a clearing agency under Section 17A of the Securities Exchange Act of 1934<sup>1</sup> ("Exchange Act" or "Act") and Rule 17Ab2-1 thereunder.<sup>2</sup> LCH SA is seeking to provide central counterparty ("CCP") services for U.S. persons for security-based swaps, in particular single-name credit default swaps ("CDS"), through its CDSClear business unit.

Along with its Form CA-1, LCH SA submitted a request for exemptive relief (i) from Sections 5 and 6 of the Act<sup>3</sup> with respect to its end-of-day pricing process; (ii) from Section 19(b) of the Act<sup>4</sup> and Rule 19b-4 thereunder<sup>5</sup> with respect to filing certain proposed rule

changes relating to its Non-U.S. Business (as defined below); (iii) from the requirements set forth in the introductory paragraph of Rule 17Ad-22(c)(2) and from Rule 17Ad-22(c)(2)(iii)<sup>6</sup> with respect to its annual audited financial statements; and (iv) Rule 17a-22<sup>7</sup> with respect to requirements to provide the Commission with physical copies of certain materials.<sup>8</sup> Notice of the application and request for exemptive relief was published in the **Federal Register** on October 3, 2016 ("Notice").<sup>9</sup> The Commission received no comments on the Notice. This Order approves LCH SA's application for registration as a clearing agency and grants LCH SA's request for exemptive relief.

#### II. Overview of LCH SA's Application

LCH SA maintains its principal office in Paris, France and is a wholly-owned subsidiary of LCH.Clearnet Group Limited ("LCH Group").<sup>10</sup> LCH SA is regulated as a bank and as a CCP under French law by the Autorité des Marchés Financiers, Autorité de Contrôle Prudentiel et de Résolution, and Banque de France.<sup>11</sup> In addition, LCH SA is a CCP authorized to offer clearing services in the European Union pursuant to the European Market Infrastructure Regulation ("EMIR") and is also registered with the U.S. Commodity Futures Trading Commission ("CFTC") as a derivatives clearing organization ("DCO") to provide clearing services for broad-based index CDS to U.S. members and their customers.<sup>12</sup>

In addition to LCH SA's CDSClear service, LCH SA offers clearing services for derivatives, exchange-traded futures and options, cash equities, fixed income, and energy instruments through three lines of CCP services: EquityClear, CommodityClear, and RepoClear.<sup>13</sup> These three services constitute LCH SA's non-U.S. business in that they operate entirely outside the United States and do not have any U.S. clearing members ("Non-U.S. Business"). LCH SA's CDS clearing services are entirely located in the CDSClear business unit. LCH SA's Non-U.S. Business does not

provide CDS services. The following sections describe relevant portions of LCH SA's Form CA-1 application.<sup>14</sup>

#### A. Membership Standards

LCH SA has established requirements concerning membership, which include standards for financial responsibility, operational capacity, business experience, and creditworthiness.<sup>15</sup> Members must comply with these requirements on an ongoing basis.<sup>16</sup>

With respect to financial responsibility, LCH SA's CDSClear Rulebook contains net capital requirements that, among other things, establish minimum net capital requirements for members that are scalable based on the risk the members introduce to LCH SA. To assess a member's creditworthiness, LCH SA uses an internal credit scoring framework to determine the member's credit risk based on financial and qualitative factors.<sup>17</sup>

Regarding operational capacity and business experience requirements, a member must be able to demonstrate that it has sufficient expertise in clearing activities. This demonstration includes, among other things, that a member's systems and operations are sufficiently reliable and capable of supporting the performance of the member in meeting its obligations (including having sufficient facilities, equipment, personnel, hardware and software systems). Similarly, any prospective member of LCH SA must also demonstrate that it has appropriate banking arrangements.<sup>18</sup>

LCH SA ensures ongoing compliance with membership obligations by monitoring its members and imposing several reporting obligations on them. LCH SA monitors certain indicators on an ongoing basis, including but not limited, financial ratios, operational capabilities, external ratings, and market implied ratings. In addition, each member is required to notify LCH SA in writing of material changes to itself or its operations, such as changes in the direct or indirect controlling ownership, reduction in capital of more than 10%, the occurrence of insolvency proceedings, the default of any of the member's customers, and any change to the member's systems or operations that materially impact the member's ability

<sup>14</sup> The titles of the cited rules specify whether the rules are associated with CDSClear, LCH SA, or others.

<sup>15</sup> See LCH SA Form CA-1, Exhibit E-4 (CDSClear CDS Clearing Rule Book), Section 2.2.1 (hereinafter, "CDSClear Rulebook").

<sup>16</sup> See *id.* at Section 2.2.2.

<sup>17</sup> See *id.* at Article 2.2.4.1.

<sup>18</sup> See *id.* at Section 2.2.1.

<sup>6</sup> 17 CFR 240.17Ad-22(c)(2) and 17 CFR

240.17Ad-22(c)(2)(iii).

<sup>7</sup> 17 CFR 240.17a-22.

<sup>8</sup> See Letter from Christophe Hémon, CEO, LCH SA, to Brent J. Fields, Secretary, Securities and Exchange Commission (August 9, 2016) (hereinafter "Request for Exemptive Relief").

<sup>9</sup> Securities Exchange Act Release No. 34-78941 (September 27, 2016), 81 FR 68074 (October 3, 2016) (File No. 600-36).

<sup>10</sup> See LCH SA Form CA-1, Exhibit A, 1.

<sup>11</sup> See LCH SA Form CA-1, Exhibit J-3 (CDSClear Service Description), Section 2.3.

<sup>12</sup> *Id.*

<sup>13</sup> See Request for Exemptive Relief at 4.

<sup>1</sup> 15 U.S.C. 78q-1.

<sup>2</sup> 17 CFR 240.17Ab2-1.

<sup>3</sup> 15 U.S.C. 78e and 78f.

<sup>4</sup> 15 U.S.C. 78s(b).

<sup>5</sup> 17 CFR 240.19b-4.

to meet its obligations as a member. Furthermore, members are required to provide LCH SA with audited financial statements on an annual basis, as well as interim financial statements during the course of the year.<sup>19</sup>

### *B. Capacity To Enforce Rules and Discipline Members in Accordance With Fair Procedures*

LCH SA has established CDS Clear rules and procedures to monitor for breaches of its membership standards and rules, enforce its rules, and discipline members. The members are required to notify LCH SA of certain breaches relating to financial or operational capacity, and are required to submit to inspections and audits by LCH SA.<sup>20</sup> In the event that a member breaches its obligations, LCH SA may impose certain risk-reducing measures, including restricting a member's ability to submit additional transactions for clearing, or impose disciplinary sanctions, such as fines or public censure.<sup>21</sup> LCH SA also may suspend or terminate the membership in certain circumstances, such as upon a member's material breach of its obligations, upon suspension or termination of a member's membership in another clearing house, or upon the occurrence of an event that materially impacts the member's ability to meet its obligations under relevant membership agreements.<sup>22</sup>

LCH SA also has established pre-defined procedures for member discipline and for affording a member the opportunity to dispute a decision by LCH SA to impose disciplinary measures. These disciplinary procedures require investigations of an alleged breach and written notifications to a member regarding the details of the investigation and an opportunity for the member to object. Such procedures also provide members with the right to bring to the attention of LCH SA potential conflicts of interest involving investigative personnel appointed by LCH SA to perform an investigation of a member's alleged breach. Following an investigation, LCH SA is required to provide a written report of its findings to the member and, where LCH SA has determined to impose disciplinary proceedings, form a disciplinary committee and provide the member the opportunity to respond to the report.

<sup>19</sup> See LCH SA Form CA-1, Schedule A at 9; see also CDS Clear Rulebook, Sections 2.3.1 and 2.3.2.

<sup>20</sup> See *id.* at Section 2.3.3.

<sup>21</sup> See *id.* at Section 2.4.1; and LCH SA Form CA-1, Exhibit E-6.8 (CDS Clear CDS Clearing Procedures, Section 8: Disciplinary Proceedings) Section 8.4.

<sup>22</sup> See CDS Clear Rulebook, Article 2.4.1.1.

The disciplinary committee is required to provide the member with notice of its decision and any sanctions imposed. Members are permitted to dispute the decision and imposition of sanctions, and to submit such dispute to arbitration or litigation, as applicable.<sup>23</sup>

In addition, LCH SA has established procedures to notify a membership applicant if the applicant is denied membership. These procedures require LCH SA to communicate the reason(s) for such denial by registered mail to the applicant.<sup>24</sup>

### *C. Governance—Fair Representation and Operational and Risk Transparency*

LCH SA is governed by its Board of Directors ("Board"), which determines LCH SA's business strategies and oversees implementation of those strategies. The Terms of Reference of LCH SA's Board of Directors require the Board to be composed of between three and eighteen directors and must include a non-executive chair, executive directors, independent<sup>25</sup> non-executive directors, at least one director representing the London Stock Exchange Group plc ("LSEG"),<sup>26</sup> and

<sup>23</sup> See LCH SA Form CA-1, Exhibit E-6.8 (CDS Clear CDS Clearing Procedures, Section 8: Disciplinary Proceedings).

<sup>24</sup> See LCH SA Form CA-1, Exhibit E-6.1 (CDS Clear CDS Clearing Procedures, Section 1: Membership).

<sup>25</sup> Independent director means a director, who satisfies applicable regulatory requirements regarding independent directors and who is appointed in accordance with the Nomination Committee terms of reference. See LCH SA Form CA-1, Exhibit A-2 (LCH SA Terms of Reference of the Board of Directors), Article 2. Under EMIR, LCH SA is required to maintain minimum number of members of the board that are independent and EMIR defines an independent member of the board as "a member of the board who has no business, family or other relationship that raises a conflict of interest regarding the CCP concerned or its controlling shareholders, its management or its clearing members, and who has had no such relationship during the five years preceding his membership of the board." See Article 27 and Article 2(28), Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R0648>. In addition, in determining whether a person is fit for appointment as an independent director, the Nomination Committee will consider whether such person is independent in character and judgment, and whether there are relationships or circumstances (including any with LSEG or any of its subsidiary undertakings and/or with any significant user or venue shareholder) which are likely to affect, or could appear to affect, such person's judgment." See LCH Clearnet Group Limited Terms of Reference of the Nomination Committee of the Board of Directors, Article 5.3, available at <http://www.lch.com/documents/731485/762675/qccp-status-lch-9+feb-2015.pdf/fa48a090-d90c-4193-91d8-52f8068a4c56>.

<sup>26</sup> As described in the Notice, LSEG is a majority owner of LCH Group.

user directors, among other categories of directors.<sup>27</sup>

LCH SA has also established various Board-level committees to facilitate the Board's work. Specifically, LCH SA's Board has an Audit Committee tasked with determining whether LCH SA's management has put in place adequate internal control systems and assisting the Board in reviewing LCH SA's audited financial statements, regulatory compliance, risk governance framework, internal control environment and information security and business continuity plans.<sup>28</sup> The Audit Committee is made up of at least four non-executive directors of the Board, at least three of whom must be independent.<sup>29</sup> Additionally, one member of the Audit Committee must be a member of the Risk Committee (described below), one must be a user director and one must be recommended or approved by LSEG so long as LSEG controls at least 20% of the votes of LCH Group.<sup>30</sup>

As noted above, LCH SA's Board also has a Risk Committee to consider LCH SA's risk appetite, tolerance and strategy. The Risk Committee reviews on an annual basis LCH SA's operational risk policy and regularly reviews reports prepared by LCH SA's risk management department.<sup>31</sup> Representatives of members and customers are directly represented on the Risk Committee<sup>32</sup> and are chosen based on several factors, including asset classes cleared, volume cleared, contribution to relevant default funds and whether they have previously been a voting member of the Risk Committee.<sup>33</sup> The remainder of the committee is made up of independent, non-executive directors. The chairman of the Risk Committee must be an

<sup>27</sup> See LCH SA Form CA-1, Exhibit A and Exhibit A-2 (LCH SA Terms of Reference of the Board of Directors), Article 3. A user director is "a director who is nominated by a shareholder of [LCH Group] which is a user or who is otherwise connected to such user shareholder by virtue of his employment or directorship." *Id.* at Article 2. For purposes of the definition of a "user director," "users" include inter-dealer brokers, clearing members, financial institutions or investors which are buy-side, indirect 'users', including asset managers. See LCH SA Form CA-1, Exhibit E-2 (Special Resolution of LCH Group), Article 1.1. However, the category of user directors does not include customer directors, as "customer" is used under the CFTC rules.

<sup>28</sup> See LCH SA Form CA-1, Exhibit A-5 (LCH SA Terms of Reference of the Audit Committee of the Board of Directors), Section 1.

<sup>29</sup> *Id.* at Section 2.1.

<sup>30</sup> *Id.*

<sup>31</sup> See LCH SA Form CA-1, Exhibit A-4 (LCH SA Terms of Reference of the Risk Committee of the Board of Directors).

<sup>32</sup> *Id.* at Section 1.1.3.

<sup>33</sup> *Id.* at Section 1.7.

independent, non-executive director.<sup>34</sup> Management and additional member representatives may be invited to attend Risk Committee meetings in a non-voting capacity.<sup>35</sup>

In addition to these internal governance structures, LCH SA also has established a consultative process for considering external views regarding changes to its rules, as set forth in its CDSClear Rulebook, among other material documentation.<sup>36</sup> When LCH SA is considering changes to rules that apply to its clearing members, it must first consult with legal, risk, operational and/or other committees that it establishes, in which clearing members may request to participate.<sup>37</sup> If LCH SA determines to pursue the changes after this initial consultation, it must issue a proposal to all clearing members, providing at least 14 days for clearing members to comment.<sup>38</sup> Following the completion of the comment period, LCH SA may publish the new rule, for effectiveness no sooner than two days after its publication, presuming LCH SA has complied with all other regulatory requirements for changing its rules.<sup>39</sup>

Furthermore, LCH SA must publish and keep updated on its Web site its CDSClear Rulebook, as well as other material rules and other documents concerning CDSClear services.<sup>40</sup> Similarly, LCH SA must publish proposals and notices concerning any changes to the provisions of these documents,<sup>41</sup> as well as a current schedule of fees.<sup>42</sup>

#### D. Safeguarding of Securities and Funds and Financial Resources

##### i. Financial Resources

LCH SA employs a risk-based margin methodology specific to its CDSClear service to calculate its exposures to CDSClear members and to set initial

margin requirements.<sup>43</sup> Specifically, LCH SA uses a Value at Risk (“VaR”) model to calculate member initial margin requirements sufficient to cover losses under normal market conditions with a 99.7% confidence interval.<sup>44</sup> This model takes into account a variety of risks, including changes to credit spreads, recovery rates, and interest rates,<sup>45</sup> and is reviewed on a monthly basis via back testing and stress testing (including reporting of the results of such review to risk management personnel). LCH SA performs an independent model validation annually, which includes a review of the parameters and assumptions that underlie the model by qualified and independent personnel. LCH SA imposes additional margin requirements on members to address position concentrations, wrong way risk, and illiquid positions over and above that calculated pursuant to its VaR model.<sup>46</sup> LCH SA also requires additional margin from members with lower internal credit scores, as well as for those members whose scores deteriorate or fall below a certain threshold.<sup>47</sup> LCH SA requires each member to post collateral to satisfy its margin requirement, which allows LCH SA to manage its risk exposure. LCH SA limits eligible collateral to cash and securities with low credit, liquidity, and market risk; as a further precaution, LCH SA applies haircuts to collateral posted in the form of securities.<sup>48</sup> In addition to its initial margin requirements, to manage the risk of price fluctuations occurring in a member’s open position, LCH SA and members are required to make cash payments to meet a variation margin requirement.<sup>49</sup>

To further augment its ability to address a default, LCH SA has established a mutualized default fund dedicated to the CDSClear service. This fund is maintained separately from the default funds for LCH SA’s other

services.<sup>50</sup> The default fund is only available for use to cover losses as a result of, and following, an event of default with respect to a CDSClear member. LCH SA sizes the default fund to cover the theoretical losses associated with the default of the two CDSClear participant families to which LCH SA has the largest exposures in extreme but plausible market conditions, plus an additional buffer.<sup>51</sup> Each CDSClear member is required to contribute to the default fund in an amount that is the greater of the CDSClear member’s proportionate share of the total CDSClear default fund based on the margin requirements related to positions held in the CDSClear service, or the minimum contribution of €10 million.<sup>52</sup> LCH SA calibrates its CDSClear default fund, and CDSClear member default fund requirements, on a monthly basis.<sup>53</sup> LCH SA’s Risk Committee reviews results of stress testing related to the CDSClear default fund on at least a quarterly basis.<sup>54</sup>

##### ii. Collateral Policy and Investment of Collateral

LCH SA restricts the types of collateral that may be provided by members to satisfy their margin and default fund requirements to cash (in Euros), foreign exchange (restricted to U.S. Dollars and Pound Sterling), liquid sovereign debt instruments issued by governments in Western Europe (specifically, France, Belgium, Portugal, the United Kingdom, Italy, Spain, Germany, and the Netherlands) and the United States, as well as equities that are part of the Euro Stoxx 50 Index, and applies haircuts to all collateral received from members except cash.<sup>55</sup> LCH SA has established an investment risk policy to govern the management of cash collateral posted by members to satisfy their margin and default fund requirements. The investment risk policy provides that its objective is to ensure that cash collateral is invested securely by, among other things, requiring that investments be made with counterparties that meet certain minimum credit standards (based on LCH SA’s internal credit assessment of the counterparty’s financial condition

<sup>34</sup> *Id.* at Section 1.1.1.

<sup>35</sup> *Id.* at Sections 1.2 and 1.3.

<sup>36</sup> See CDSClear Rulebook, Article 1.2.2. The consultative process applies to changes in CDS Clearing Documentation, which includes CDSClear’s CDS Admission Agreement, CDS Clearing Rules, CDS Clearing Supplement Documents, Index Cleared Transaction Confirmation and Single Name Cleared Transaction Confirmation, among other documents, as each is individually defined in Section 1.1.1 of the CDSClear Rulebook.

<sup>37</sup> See *id.* at Article 1.2.2.2.

<sup>38</sup> *Id.* The consultation process is not required, however, for certain limited, technical, or administrative changes; changes required to comply with applicable laws; or changes necessary to manage risks under certain extreme market developments. See CDSClear Rulebook, Article 1.2.2.4.

<sup>39</sup> See CDSClear Rulebook, Article 1.2.2.3.

<sup>40</sup> See CDSClear Rulebook, Section 1.2.3.

<sup>41</sup> See *id.* at Section 1.2.3.

<sup>42</sup> See *id.* at Article 1.2.6.1.

<sup>43</sup> See LCH SA Form CA–1, Exhibit H–1 (LCH SA Audited Financial Statements for the Year Ended 31 December 2015) at 22.

<sup>44</sup> *Id.*

<sup>45</sup> See LCH SA Form CA–1, Exhibit E–6.2 (CDSClear CDS Clearing Procedures, Section 2: Margin and Price Alignment Interest).

<sup>46</sup> *Id.*

<sup>47</sup> See *id.* at 20 and LCH SA Form CA–1, Exhibit J–3 (CDSClear Service Description), Section 9.1.

<sup>48</sup> See CDSClear Rulebook, Articles 4.2.6.3 and 4.2.6.4; see also LCH SA Form CA–1, Exhibit E–6.3 (CDSClear CDS Clearing Procedures Section 3: Collateral and Cash Payment), Section 3.9.

<sup>49</sup> See LCH SA Form CA–1, Exhibit H–1 (LCH SA Audited Financial Statements for the Year Ended 31 December 2015), 20; see also CDSClear Rulebook, Section 4.2.5 and LCH SA Form CA–1, Exhibit E–6.2 (CDSClear CDS Clearing Procedures, Section 2: Margin and Price Alignment Interest).

<sup>50</sup> See CDSClear Rulebook, Article 4.4.1.1.

<sup>51</sup> See *id.* at Articles 4.4.1.1 and 4.4.1.2.

<sup>52</sup> See *id.* at Article 4.4.1.3.

<sup>53</sup> See LCH SA Form CA–1, Exhibit J–3 (CDSClear Service Description), Section 11.1.

<sup>54</sup> See LCH SA Form CA–1, Exhibit A–4 (LCH SA Terms of Reference of the Risk Committee of the Board of Directors), Section 9.1.

<sup>55</sup> See LCH SA Form CA–1, Exhibit E–6.3 (CDSClear CDS Clearing Procedures Section 3: Collateral and Cash Payment).

and operational capacity).<sup>56</sup> Furthermore, LCH SA restricts the types of investments of collateral it is permitted to make by allowing cash deposits and purchases of securities, where such securities are not backed by certain governments, to be restricted to an overnight term only.<sup>57</sup>

### iii. Default Management, Loss Allocation, and Recovery

To manage losses incurred in the event of a member default, LCH SA's default management process sets forth the steps LCH SA would take in the event of such an occurrence.<sup>58</sup> Upon the declaration of an event of default, LCH SA's default management process begins to minimize losses and disruption by attempting (i) to hedge against market risk, (ii) to transfer customer positions to non-defaulting members, and (iii) to dispose of the defaulting member's portfolio through a competitive auction process—all within a five-business-day period.<sup>59</sup> The only financial resources or recovery tools available to cover losses resulting from a CDSClear member's default are those specified in the CDSClear default waterfall.<sup>60</sup>

Under the CDSClear default waterfall, the defaulting CDSClear member's initial margin, variation margin, and additional margins are first used to cover losses. If these resources are insufficient to cover the losses, the defaulting CDSClear member's default fund contribution is applied. To the extent that losses are still not covered, LCH SA would utilize its own capital (in the amount established in the CDSClear default waterfall pursuant to the CDSClear Rulebook) to cover remaining losses. If losses exceed the financial resources used up to this point, LCH SA may then access the CDSClear default fund contributions of non-defaulting CDSClear members and also may impose additional default fund contribution assessments against non-defaulting CDSClear members. If these pre-funded resources and assessments are insufficient to cover losses within a five business-day period, LCH SA may impose, on a pro rata basis, reductions in daily settlement payments owed to non-defaulting members ("Variation Margin Haircutting"), subject to certain

limits. The entire default management process, including the use of Variation Margin Haircutting, is intended to be completed within five business days following the declaration of a default.<sup>61</sup> At any time during the default management process, if LCH SA determines that it would not have sufficient resources to meet obligations arising from the default auction or auctions in accordance with the default waterfall, LCH SA must early terminate all open contracts and proceed to wind down the CDSClear service pursuant to the terms set forth in the CDSClear Rulebook.<sup>62</sup>

To manage its liquidity needs resulting from a member's default, LCH SA monitors and measures its liquidity resources and requirements daily, at the entity level. In addition to cash collateral, LCH SA may use its own capital as an immediately available liquidity resource, and during liquidity stress events, LCH SA also can access central bank liquidity through the Banque de France, as well as other secured financing facilities that LCH SA maintains.<sup>63</sup>

LCH SA makes its default policies and procedures available to members by posting them to its public Web site, in addition to other key information such as default resources, margin methodology, daily settlement prices, and open interest and volume, among other things.<sup>64</sup>

### E. Operational Risk Management

LCH SA manages its operational risk pursuant to, among other policies and procedures, an operational risk policy applicable to each entity within LCH Group. The operational risk policy lists regulatory operational risk standards applicable to LCH SA; assigns roles and responsibilities to the business departments, Operational Risk Department, and Audit Department for the identification, assessment, and mitigation of operational risks; and establishes regularly scheduled reviews of the framework by management and applicable committees of the Board of Directors. The operational risk management policy requires ongoing self-assessment, monitoring, and reporting of risks (including to relevant Board of Directors and business control

committees), as well as the development and implementation of risk mitigation plans when necessary. LCH SA's rules and procedures also provide for regular testing of its various systems as part of its operation risk management process.<sup>65</sup>

LCH SA's policies and procedures establish governance processes to reinforce controls and procedures for operational risk management. For example, the operational risk management framework establishes monitoring and reporting obligations by the risk owners and Operational Risk Department to applicable Board committees. The Terms of Reference of the Audit Committee and Risk Committee, respectively, dictate the Committees' responsibilities to oversee various aspects of LCH SA's operational risk management. The Risk Committee, among other things, considers the risk controls related to new markets and contracts; reviews LCH SA's money settlement arrangements; and reviews LCH SA's Operational Risk Policy.<sup>66</sup> The Audit Committee has responsibility for determining whether management has put in place adequate internal control systems that provide reasonable assurance that corporate objectives will be achieved and that LCH SA complies with applicable regulatory requirements.<sup>67</sup>

LCH SA has established multiple policies, standards, procedures, and operational guidelines pertaining to system reliability, resiliency, and security. For example, LCH SA's business continuity and disaster recovery plans address threat assessments and monitoring, systems testing, and possible responses to potential threats, including the migration of main operational and data systems to back-up systems and sites.<sup>68</sup> LCH SA maintains multiple systems and data centers in support of maintaining operational capacity and resilience. In addition, LCH SA's rules require its clearing members to participate in technical and operational tests organized by LCH SA to ensure the continuity and orderly functioning of the CDS Clearing Service.<sup>69</sup> Moreover, LCH SA also maintains an ongoing self-assessment policy to continually

<sup>56</sup> See LCA SA Form CA-1, Exhibit H-1 (LCH SA Audited Financial Statements for the Year Ended 31 December 2015), 20.

<sup>57</sup> See LCH Group Risk Management Policy: Investment Risk.

<sup>58</sup> See CDSClear Rulebook, Appendix 1 "CDS Default Management Process".

<sup>59</sup> See LCH SA Form CA-1, Schedule A, 10-11; see also CDSClear Rulebook, Appendix 1, Section 2.1.

<sup>60</sup> See CDSClear Rulebook, Section 4.4.1.

<sup>61</sup> See LCH SA Form CA-1, Exhibit J-3 (CDSClear Service Description), Section 11.2; see also CDSClear Rulebook, Appendix 1.

<sup>62</sup> See CDSClear Rulebook, Appendix 1, Clauses 2.1.4 and 8.1.

<sup>63</sup> See LCH SA Form CA-1, Exhibit H-1 (LCH SA Audited Financial Statements for the Year Ended 31 December 2015), 27-28.

<sup>64</sup> See CDSClear Rulebook, Title IV, Chapters 3 and 4, and Appendix 1.

<sup>65</sup> See LCH SA Form CA-1, Exhibit K (LCH SA Security Measures and Operational Safeguards).

<sup>66</sup> See LCH SA Form CA-1, Exhibit A-4 (LCH SA Terms of Reference of the Risk Committee of the Board of Directors).

<sup>67</sup> See LCH SA Form CA-1, Exhibit A-5 (LCH SA Terms of Reference of the Audit Committee of the Board of Directors).

<sup>68</sup> See LCH SA Form CA-1, Exhibit K-2 (LCH Group Business Continuity Management Policy).

<sup>69</sup> See generally, CDSClear Rulebook, Section 2.2.8

monitor and assess operational risk, such as security risk, and provide for the mitigation of such risks when they exceed applicable tolerances.<sup>70</sup> Furthermore, LCH SA has established policies and procedures regarding information security that provide for requirements with respect to employee access and use of business and customer information, as well as the maintenance of confidentiality of sensitive information.<sup>71</sup> Additionally, LCH SA is subject to group-wide policies and procedures that govern personal trading of employees for their own account.<sup>72</sup>

#### F. Fees, Dues, and Charges

LCH SA charges transaction fees linked to products and annual membership fees, which are generally usage-based and apply equally to all members using LCH SA's CDSClear service. LCH SA also imposes annual account structure fees for individually segregated accounts and omnibus segregated accounts that are equally applicable to all members.<sup>73</sup>

### III. Discussion

Section 17A(b)(1) of the Act requires a clearing agency to register with the Commission prior to performing the functions of a clearing agency.<sup>74</sup> The Commission shall grant a clearing agency's registration if it finds that the requirements of the Act and the rules and regulations thereunder with respect to the clearing agency are met.<sup>75</sup> Section

<sup>70</sup> See, e.g., LCH SA Form CA-1, Ex. K-3 (LCH. Clearnet Group Information Security Strategy/Maturity Self-assessment tool); LCH Clearnet Group Operational Risk Policy—Operational Risk Management.

<sup>71</sup> See LCH SA Form CA-1, Exhibits K-1.1 (LSEG Employee Information Security Policy) and K-1.2 (Technical Information Security Policy).

<sup>72</sup> See LCH Clearnet Group Confidentiality Policy; Group Personal Account Dealing Policy; and Group Market Abuse Policy.

<sup>73</sup> See LCH SA Form CA-1, Exhibit Q (LCH SA Schedule of Prices, Rates or Fees Fixed by Registrant for Services Rendered by its Participants).

<sup>74</sup> 15 U.S.C. 78q-1(b)(1).

<sup>75</sup> 15 U.S.C. 78s(a)(1); 15 U.S.C. 78q-1(b)(3). Among other requirements, registered clearing agencies are subject to Exchange Act Rule 17Ad-22. In 2012, the Commission adopted standards establishing minimum requirements regarding registered clearing agencies' risk management procedures and controls. See Securities Exchange Act Release No. 68080 (Oct. 22, 2012), 77 FR 66220 (Nov. 2, 2012). On September 28, 2016, the Commission adopted amendments to Rule 17Ad-22 establishing enhanced standards for the operation and governance of those clearing agencies registered with the Commission that meet the definition of covered clearing agency. See Securities Exchange Act Release No. 78961 (Sep. 28, 2016), 81 FR 70786 (Oct. 13, 2016) (compliance date April 11, 2017). See also Definition of Covered Clearing Agency, Proposed Rule Amendments, Securities Exchange Act Release No. 78963 (Sept. 28, 2016), 81 FR 70744 (Oct. 13, 2016).

17A(b)(3) of the Act requires that the Commission make a number of determinations with respect to the clearing agency's organization, capacity, and rules,<sup>76</sup> including, among other things, determining whether a clearing agency is "so organized and [has] the capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts, and transactions for which it is responsible, to safeguard securities and funds in its custody or control or for which it is responsible, [and] to comply with the provisions of [the Act] and the rules and regulations thereunder."<sup>77</sup> The Commission discusses below the applicable requirements under the Exchange Act and rules and regulations thereunder, and its findings regarding whether these requirements are met.

#### A. Membership Standards

##### 1. Exchange Act Requirements

Section 17A(b)(3)(B) of the Act provides that the rules of a clearing agency must permit certain enumerated categories of persons to be eligible for membership: Registered brokers or dealers, registered clearing agencies, registered investment companies, banks, and insurance companies.<sup>78</sup>

Section 17A(b)(4)(B) of the Act allows a registered clearing agency to deny, or condition participation of, any member or any category of members listed in Section 17A(b)(3)(B) of the Act if such persons do not meet the financial responsibility, operational capability, experience, and competence standards set forth by the clearing agency.<sup>79</sup> In addition, Section 17A(b)(3)(F) of the Act requires that the rules of the clearing agency must not be designed to permit unfair discrimination in the admission of members or among members in the use of the clearing agency.<sup>80</sup> Similarly, Section 17A(b)(3)(I) provides that the rules of a clearing agency may not impose any burden on competition not necessary or appropriate in furtherance of the purposes of section 17A.<sup>81</sup>

Rules 17Ad-22(b)(5) and (6) further require that a registered clearing agency establish, implement, maintain, and enforce written policies and procedures that do not limit membership to dealers and do not impose any specific portfolio size or transaction volume minimums.<sup>82</sup>

<sup>76</sup> 15 U.S.C. 78q-1(b)(3).

<sup>77</sup> 15 U.S.C. 78q-1(b)(3)(A).

<sup>78</sup> 15 U.S.C. 78q-1(b)(3)(B).

<sup>79</sup> 15 U.S.C. 78q-1(b)(4)(B).

<sup>80</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>81</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>82</sup> 17 CFR 240.17Ad-22(b)(5) and (6).

Rule 17Ad-22(b)(7)<sup>83</sup> requires that a registered clearing agency establish, implement, maintain, and enforce written policies and procedures that provide a person who maintains net capital equal to or greater than \$50 million with the ability to obtain membership at the clearing agency, so long as the net capital requirement is scalable to the risk posed by the participant's activities. In addition, Rule 17Ad-22(d)(2) requires that a registered clearing agency establish, implement, maintain, and enforce written policies and procedures to require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency; have procedures in place to monitor that participation requirements are met on an ongoing basis; and have participation requirements that are objective and publicly disclosed, and permit fair and open access.<sup>84</sup>

##### 2. Commission Findings

The Commission finds that LCH SA's membership standards, as described in the application, are consistent with Exchange Act Section 17A and the relevant provisions of Rule 17Ad-22.

##### i. Access to the Clearing Services

With respect to providing access to CDSClear services, LCH SA has established a general membership category for non-EU persons<sup>85</sup> that includes the categories of persons enumerated in Section 17A(b)(3)(B).<sup>86</sup> Therefore, as described in the application, LCH SA's rules are

<sup>83</sup> 17 CFR 240.17Ad-22(b)(7).

<sup>84</sup> 17 CFR 240.17Ad-22(d)(2).

<sup>85</sup> See CDSClear Rulebook, Section 2.1.1.2(v).

<sup>86</sup> 15 U.S.C. 78q-1(b)(3)(B). Article 2.1.1.2(v) of the CDSClear Rulebook refers to "Credit Institutions" and "Investment Firms" not having their head office in a "Member State" of the European Economic Area, as well as legal persons whose principal or sole object is the clearing of financial instruments.

The terms "Investment Firm" and "Credit Institution," as defined in relevant European directives, substantially overlap with the categories of persons enumerated in Section 17A(b)(3)(B), as defined in the Exchange Act and, where incorporated by reference in the Exchange Act, the Investment Company Act of 1940. Compare definitions of "Investment Firm" (Directive 2004/39/EC Article 4(1)(1) and Annex I, Section A) and "Credit Institution" (Directive 2006/48/EC, Article 4(1)(a)) with definitions of "broker" (15 U.S.C. 78c(a)(4)), "dealer" (15 U.S.C. 78c(a)(5)), "clearing agency" (15 U.S.C. 78c(a)(23)), "investment company" (15 U.S.C. 80a-3(a)(1)), "insurance company" (15 U.S.C. 80a-2(a)(17)) and "bank" (15 U.S.C. 78c(a)(6)). Thus, CDSClear's general admission category for non-European persons would include persons who are seeking clearing membership and are brokers, dealers, clearing agencies, investment companies, banks, and insurance companies.

consistent with Section 17A(b)(3)(B).<sup>87</sup> In addition, LCH SA's rules do not tie CDSClear membership to providing any specific dealer service, maintaining a portfolio of any minimum size or maintaining any particular transaction volume. Therefore, LCH SA's rules, as described in the application, are consistent with Rules 17Ad-22(b)(5) and (6).<sup>88</sup> Finally, LCH SA's rules contemplate a minimum net capital requirement of \$50 million for U.S. FCM clearing members or €37 million for other clearing members of CDSClear.<sup>89</sup> The rules specifically give LCH SA discretion to scale (a) a CDSClear member's net capital requirement in accordance with the level of risk it introduces to LCH SA, and (b) a CDSClear member's level of risk it introduces to LCH SA in accordance with its net capital requirement.<sup>90</sup> Therefore, LCH SA's rules, as described in the application, provide that any net capital requirements are scalable so that they are proportional to the risk posed by the participant's activities to the clearing agency, consistent with Rule 17Ad-22(b)(7).<sup>91</sup>

#### ii. Capacity To Perform Obligations to Clearing Agency

With respect to clearing membership standards, the Commission finds that LCH SA's rules establish standards for CDSClear membership that are consistent with Sections 17A(b)(4)(B), 17A(b)(3)(F), and 17A(b)(3)(I).<sup>92</sup> Specifically, LCH SA's rules provide that an applicant for CDSClear membership must be able to pay amounts required by LCH SA, including margin and default fund contributions. An applicant must also satisfy a minimum internal credit score that is based on quantitative and qualitative data,<sup>93</sup> have sufficient expertise in relation to clearing activities, and have systems and personnel required to support performance as a participant.<sup>94</sup> Further, LCH SA has the authority under its rules to deny participation if a CDSClear applicant does not meet these standards.<sup>95</sup> Although LCH SA's rules permit LCH SA to impose, amend or withdraw additional requirements in relation to its CDSClear membership standards, LCH SA may do so only if such additional requirements are non-discriminatory and their objective is to

control the risk members pose to LCH SA.<sup>96</sup> These rules, along with the others addressing a member's continuing obligations,<sup>97</sup> provide standards for members' financial responsibility, operational capability, experience, and competence, consistent with Exchange Act Section 17A(b)(4)(B).<sup>98</sup> In addition, the Commission finds that these rules are not designed to permit unfair discrimination in the admission of members or among members' use of the clearing agency, and any burden they impose on competition is necessary or appropriate in furtherance of the purposes of Section 17A; they therefore satisfy the requirements of Exchange Act Sections 17A(b)(3)(F) and 17A(b)(3)(I).<sup>99</sup>

The Commission believes that LCH SA's rules with respect to the CDSClear service also satisfy the requirement in Rule 17Ad-22(d)(2) that a registered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, are objective and publicly disclosed, and permit fair and open access.<sup>100</sup> As described above, LCH SA's rules prescribe standards with respect to members' financial responsibility, operational capability, experience, and competence designed to manage risks to the clearing agency. These standards require participants to have sufficient financial resources and robust operational capacity to meet their obligations because LCH SA can set and monitor financial requirements and operational capacity commensurate with LCH SA's business and risk management needs. Specifically, LCH SA can apply scalable capital requirements<sup>101</sup> and assesses its members' credit risk;<sup>102</sup> clearing members must pay amounts required by LCH SA, specifically margin and default fund requirements and cash payment obligations;<sup>103</sup> clearing members must not be subject to insolvency proceedings;<sup>104</sup> and clearing members must satisfy LCH SA that they have

sufficient expertise in relation to clearing activities and that their systems and operations are operationally reliable and capable of supporting proper performance of its business as a clearing member.<sup>105</sup> These standards apply equally to all applicants for CDSClear membership and existing CDSClear members and are publicly disclosed in the CDSClear Rulebook. Therefore, the Commission finds that LCH SA's CDSClear membership standards meet Rule 17Ad-22(d)(2)'s requirement that standards be reasonably designed to be objective, are publicly disclosed, and permit fair and open access.

LCH SA requires its CDSClear members to maintain on-going compliance with the standards described above, subject to on-going monitoring by LCH SA.<sup>106</sup> For example, LCH SA's rules require clearing participants to report significant events<sup>107</sup> and file regularly certain financial information with LCH SA.<sup>108</sup> In addition to monitoring various forward-looking indicators,<sup>109</sup> LCH SA's rules require that participants agree to submit clearing activity to inspections reasonably requested by LCH SA,<sup>110</sup> and participate in technical and operational tests.<sup>111</sup> The Commission therefore finds that LCH SA meets the requirement in Rule 17Ad-22(d)(2) to establish, implement, maintain, and enforce written policies and procedures reasonably designed to have procedures in place to monitor that participation requirements are met on an ongoing basis.<sup>112</sup>

#### B. Capacity To Enforce Rules and Discipline Members in Accordance With Fair Procedures

##### 1. Exchange Act Requirements

Section 17A(b)(3)(A) of the Act provides that a clearing agency must be organized and have the capacity to enforce compliance by its members with the rules of the clearing agency.<sup>113</sup> Section 17A(b)(3)(G) of the Act requires that the rules of a clearing agency provide that its members shall be appropriately disciplined for violations of any provision of those rules by expulsion, suspension, a limitation of activities, functions, and operations, fine, censure, or any other fitting

<sup>87</sup> 15 U.S.C. 78q-1(b)(3)(B).

<sup>88</sup> 17 CFR 240.17Ad-22(b)(5) and (6).

<sup>89</sup> See CDSClear Rulebook, Section 2.2.3.

<sup>90</sup> See *id.* at Section 2.2.3.

<sup>91</sup> 17 CFR 240.17Ad-22(b)(7).

<sup>92</sup> 15 U.S.C. 78q-1(b)(3)(B), (F) and (I).

<sup>93</sup> See CDSClear Rulebook, Section 2.2.4.

<sup>94</sup> See *id.* at Section 2.2.1.

<sup>95</sup> See *id.* at Article 2.2.0.1.

<sup>96</sup> *Id.* at Article 2.2.0.1.

<sup>97</sup> See *id.* at Article 2.2.2.1.

<sup>98</sup> 15 U.S.C. 78q-1(b)(4)(B).

<sup>99</sup> 15 U.S.C. 78q-1(b)(3)(F) and (I).

<sup>100</sup> See 17 CFR 240.17Ad-22(d)(2).

<sup>101</sup> CDSClear Rulebook, Article 2.2.3.1.

<sup>102</sup> See *id.* at Article 2.2.4.1. CDS Clear assigns clearing members an internal credit score. This score is based on data including financial analysis, external market data and implicit or external support available to the clearing member. *Id.*

<sup>103</sup> See *id.* at Article 2.2.1.1(xiii).

<sup>104</sup> *Id.* at Article 2.2.1.1(vii).

<sup>105</sup> *Id.* at Article 2.2.1.1(x).

<sup>106</sup> *Id.* at Article 2.2.2.1.

<sup>107</sup> *Id.* at Article 2.3.1.1.

<sup>108</sup> *Id.* at Article 2.3.1.2.

<sup>109</sup> *Id.* at Section 2.3.2.

<sup>110</sup> *Id.* at Section 2.3.3.

<sup>111</sup> *Id.* at Article 2.2.8.1.

<sup>112</sup> 17 CFR 240.17Ad-22(d)(2).

<sup>113</sup> 15 U.S.C. 78q-1(b)(3)(A).

sanction.<sup>114</sup> Section 17A(b)(3)(H) of the Act requires that the rules of the clearing agency be in accordance with the provisions of Section 17A(b)(5), and, in general, provide a fair procedure with respect to the disciplining of members, the denial of membership, and the prohibition or limitation by the clearing agency of any person with respect access to the services offered by the clearing agency.<sup>115</sup> Section 17A(b)(5) generally requires a clearing agency to bring specific charges, notify a disciplined participant of them, give a disciplined participant an opportunity to defend against such charges, and keep a record in determining whether a participant should be disciplined.<sup>116</sup>

## 2. Commission Findings

The Commission finds that LCH SA meets the above-described requirements with respect to its CDS Clear service. As part of the CDS Admission Agreement, CDS Clear members must abide by relevant LCH SA rules and procedures.<sup>117</sup> Pursuant to these rules and procedures, LCH SA has the ability to (i) notify members that it believes they may have violated LCH SA's rules, (ii) conduct an investigation of alleged breaches, (iii) communicate its investigation results with the members, (iv) form a disciplinary committee, (v) grant an opportunity for members to contest the allegations, and (vi) impose disciplinary measures accompanied by details of the grounds supporting the decision and sanctions imposed, if any.<sup>118</sup> Moreover, LCH SA's rules and procedures confer on it the discretion to tailor its disciplinary measures to the nature and severity of the infraction at issue: In accordance with its rules and procedures, LCH SA may choose to suspend or terminate any member of CDS Clear, convey a public or private reprimand, impose sanctions, or impose fines.<sup>119</sup> The breadth of disciplinary measures available to LCH SA and the flexibility to tailor these measures to the nature and severity of any infractions of its rules, coupled with the procedural safeguards—described more fully below—conferred on members accused of violations, taken together, enable LCH SA to “appropriately” discipline members for violations of its rules. Therefore, the Commission finds that LCH SA's rules provide for appropriate

disciplinary measures and sanctions of its members for violations of LCH SA's rules.

With their significant procedural protections described in Section II.B, LCH SA's rules also satisfy applicable fairness requirements. Among other things, members have the right to notice of any alleged violation, the right to respond, the right to a hearing, and the right to an explanation of the grounds supporting the discipline imposed.<sup>120</sup> In addition, LCH SA's rules are designed to avoid conflicts of interest by permitting members to object to personnel selected by LCH SA to lead an investigation of the member on the basis of the existence of a conflict of interest and by allowing members to refuse access to their offices by LCH SA's personnel when a substantiated conflict of interest exists.<sup>121</sup> If disciplinary measures are imposed, a member has the right to contest them by arbitration or litigation pursuant to LCH SA's procedures.<sup>122</sup> Similarly, if LCH SA denies membership to an applicant, LCH SA will provide the reasons for the denial of access.<sup>123</sup> Members are permitted to dispute the decision and imposition of sanctions, and to submit such dispute to arbitration or litigation, as applicable.<sup>124</sup> Taken together, the procedural protections in LCH SA's rules ensure, at a minimum, that targets of discipline are informed of the charges pending against them, have the ability to contest those charges, will receive an explanation of the discipline imposed, if any, and will have the opportunity to appeal any adverse decision.

Therefore, the Commission finds that LCH SA's rules, policies, and procedures, as described in the application, meet the requirements under Exchange Act Section 17A(b)(3)(A) (regarding the capacity to enforce compliance by its members with the rules of the clearing agency), Section 17A(b)(3)(H) (regarding providing a fair procedure with respect to the disciplining of members, the denial of membership, and the prohibition or limitation with respect to access to the services offered by the clearing agency), and Section 17A(b)(5) (regarding bringing charges against members,

disciplinary notification, affording members with an opportunity to defend against charges, and recordkeeping relating to disciplinary determinations).

## C. Governance—Fair Representation and Operational and Risk Transparency

### 1. Exchange Act Requirements

Section 17A(b)(3)(C) of the Act requires that the rules of a clearing agency assure fair representation of the clearing agency's shareholders (or members) and participants in the selection of the clearing agency's directors and in the administration of the clearing agency's affairs.<sup>125</sup> In addition, Rule 17Ad-22(d)(8) requires that a clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to, as applicable, have governance arrangements that are clear and transparent to fulfil the public interest requirements in Section 17A of the Act applicable to clearing agencies, to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency's risk management procedures.<sup>126</sup> Rule 17Ad-22(d)(9) provides that a clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide market participants with sufficient information for them to identify and evaluate the risks and costs associated with using the clearing agency's services.<sup>127</sup>

### 2. Commission Findings

The Commission finds that LCH SA's rules meet the above-described requirements under the Exchange Act. With respect to the selection of directors, the Terms of Reference of the LCH SA Board provide that the Board is composed of three through eighteen directors in the categories of a non-executive Chairman, independent non-executive directors, executive directors, venue directors, user directors, and one director representing LSEG.<sup>128</sup> Currently, LCH SA's Board consists of fourteen directors, three of whom are affiliated with clearing participants. Although LCH SA's rules do not specify the number of directors in each category, the Board's Terms of Reference specify that these categories and numbers of directors within each category are subject to change to comply with any applicable legal or regulatory

<sup>120</sup> See LCH SA Form CA-1, Exhibit E-6.8 (CDS Clear CDS Clearing Procedures, Section 8: Disciplinary Proceedings).

<sup>121</sup> See *id.* at Section 8.2(a)(iii) and (v).

<sup>122</sup> See LCH SA Form CA-1, Exhibit E-6.8 (CDS Clear CDS Clearing Procedures, Section 8: Disciplinary Proceedings).

<sup>123</sup> See LCH SA Form CA-1, Exhibit E-6.1 (CDS Clear CDS Clearing Procedures, Section 1: Membership).

<sup>124</sup> See LCH SA Form CA-1, Exhibit E-6.8 (CDS Clear CDS Clearing Procedures, Section 8: Disciplinary Proceedings).

<sup>125</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>126</sup> 17 CFR 240.17Ad-22(d)(8).

<sup>127</sup> 17 CFR 240.17Ad-22(d)(9).

<sup>128</sup> See LCH SA Form CA-1, Exhibit A-2 (LCH SA Terms of Reference of the Board of Directors), Article 3.

<sup>114</sup> 15 U.S.C. 78q-1(b)(3)(G).

<sup>115</sup> 15 U.S.C. 78q-1(b)(3)(H).

<sup>116</sup> 15 U.S.C. 78q-1(b)(5).

<sup>117</sup> See LCH SA Form CA-1, Exhibit P-2 (LCH SA CDS Admission Agreement).

<sup>118</sup> See CDS Clear Rulebook, Sections 2.3 and 2.4 and Exhibit E-6.8 (CDS Clear CDS Clearing Procedures, Section 8: Disciplinary Proceedings).

<sup>119</sup> See *id.*

requirements from time to time (including the appointment of additional directors as may be required from time to time).<sup>129</sup> Therefore, LCH SA's rules are designed to ensure that the numbers of the directors in each category, including user directors, satisfy the fair representation requirements in the Exchange Act and enable LCH SA to adapt the composition of its Board to any evolving regulatory requirements. The Commission finds that users have the opportunity to provide meaningful input in the nomination for appointment of user directors.<sup>130</sup> Taken together, LCH SA's rules meet the requirement to assure fair representation of its shareholders and participants in the selection of its directors under Section 17A(b)(3)(C) of the Act.<sup>131</sup>

With respect to the administration of its affairs, LCH SA's rules establish a consultative process for considering clearing member views regarding material changes to LCH SA's rules that apply to clearing members, as described in Section II.C above. Additionally, as described in Section II.C and discussed further below, the Audit and Risk Committees have substantial roles in risk management oversight and informing the full Board on risk management activities. Because there are roles for clearing members and customers on the Risk Committee and for the user director on the Audit Committee, the Commission believes LCH SA assures that participants have fair representation in the administration

of LCH SA's affairs, as required by Section 17A(b)(3)(C) of the Act.<sup>132</sup>

In particular, LCH SA's Board has established an Audit Committee and a Risk Committee, which are tasked with engagement in and oversight of various aspects of LCH SA's financial and operational risk management. For example, as described in Section II.C, the Audit Committee oversees internal control systems and assists the Board in reviewing LCH SA's audited financial statements, regulatory compliance, risk governance framework, internal control environment, and information security and business continuity plans.<sup>133</sup> Among other things, the Audit Committee also monitors the quality and effectiveness of the internal Audit Department,<sup>134</sup> reviews the process for annual validations of LCH SA's risk management models,<sup>135</sup> commissions and reviews audit reports relating to the risk management of LCH SA,<sup>136</sup> and establishes and annually reviews LCH SA's operational risk policy.<sup>137</sup> The Audit Committee must also ensure that the Board is regularly informed of the adequacy of key control systems in the financial, operational and compliance-related areas.<sup>138</sup>

Additionally, LCH SA's Board has established a Risk Committee,<sup>139</sup> which includes members and customer representatives.<sup>140</sup> The Risk Committee considers LCH SA's risk appetite, tolerance, and strategy. Among other things, the Risk Committee also reviews initial and ongoing membership requirements and decisions on membership applications,<sup>141</sup> the decision to clear a new product or contract,<sup>142</sup> margin methodology adequacy and changes,<sup>143</sup> and default fund adequacy and changes to stress testing scenarios.<sup>144</sup>

To ensure that LCH SA's governance structure and important decisions are clear and transparent to the public, the Risk Committee is also tasked with ensuring publication on LCH SA's Web site summaries of significant decisions arising from its operations that

implicate the public interest, including decisions relating to open access, membership and the determination to accept a new product for clearing.<sup>145</sup> Therefore, the Commission believes that LCH SA has governance arrangements that are clear and transparent to fulfil the public interest requirements in Section 17A of the Act applicable to clearing agencies, to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency's risk management procedures, as required by Rule 17Ad-22(d)(8).<sup>146</sup>

Similarly, the Commission further believes that LCH SA provides sufficient transparency to market participants with respect to the costs and risks associated with using CDSClear. LCH SA achieves this transparency by making available to members and the public information regarding the fees and costs associated with using CDSClear (including disclosure of product specific fees for self and customer clearing, and account structures fees), as well as the CDSClear Rulebook (which includes key default management provisions).<sup>147</sup> LCH SA also publishes information regarding daily settlement prices, volume and open interest.<sup>148</sup> This information provides current and potential members with the opportunity to assess costs and risks associated with membership, allowing for informed decision making with respect to continuing or commencing membership in the CDSClear service. Furthermore, based on the public disclosure of significant decisions described above, as well as publication of the clearing procedures, and governance arrangements, the Commission finds that, as described in the application, LCH SA meets the requirement to provide market participants with sufficient information for them to identify and evaluate the risks and costs associated with using the clearing agency's services, as required by Rule 17Ad-22(d)(9).<sup>149</sup>

#### D. Safeguarding of Securities and Funds and Financial Resources

##### 1. Exchange Act Requirements

Sections 17A(b)(3)(A) and (F) of the Act, in part, require that a clearing agency be duly organized and not only have the capacity to safeguard securities

<sup>129</sup> *Id.* The Board's proposal for appointment of each director at a shareholders' meeting must be based on recommendations made by the Nomination Committee, which is required to recommend two user directors out of an aggregate of ten directors that the Nomination Committee is required to recommend to the Board for appointment as directors. See LCH.Clearnet Group Limited Terms of Reference of the Nomination Committee of the Board of Directors, Article 2.4, available at <http://www.lch.com/documents/731485/762675/qccp-status-lch-9+feb-2015.pdf/fa48a090-d90c-4193-91d8-52f8068a4c56>. Therefore, users will be represented by at least two directors on the Board.

<sup>130</sup> In formulating its recommendation for user director nominees, the user member sitting on the Nomination Committee must be present to satisfy a quorum, and the rules further allow the seventeen largest user shareholders of LCH Group who are not connected with an existing director to submit names to the Nomination Committee for consideration as a user director. See LCH.Clearnet Group Limited Terms of Reference of the Nomination Committee of the Board of Directors, Appendix, available at <http://www.lch.com/documents/731485/762675/qccp-status-lch-9+feb-2015.pdf/fa48a090-d90c-4193-91d8-52f8068a4c56>. Therefore, users will have the opportunity to provide meaningful input in the nomination of user directors.

<sup>131</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>132</sup> *Id.*

<sup>133</sup> See LCH SA Form CA-1, Exhibit A-5 (LCH SA Terms of Reference of the Audit Committee of the Board of Directors), Section 1.

<sup>134</sup> *Id.* at Section 3.3.3(c).

<sup>135</sup> *Id.* at Section 3.3.5(a).

<sup>136</sup> *Id.* at Section 3.3.5(c).

<sup>137</sup> *Id.* at Section 3.3.9(a).

<sup>138</sup> *Id.* at Section 5.4.

<sup>139</sup> See LCH SA Form CA-1, Exhibit A-4 (LCH SA Terms of Reference of the Risk Committee of the Board of Directors).

<sup>140</sup> *Id.* at Section 1.1.

<sup>141</sup> *Id.* at Section 6.

<sup>142</sup> *Id.* at Section 7.

<sup>143</sup> *Id.* at Section 8.

<sup>144</sup> *Id.* at Section 9.

<sup>145</sup> *Id.* at Section 14.

<sup>146</sup> 17 CFR 240.17Ad-22(d)(8).

<sup>147</sup> See <http://www.lch.com/asset-classes/otc-credit-default-swaps/fees> and <http://www.lch.com/rules-regulations/rulebooks/sa>.

<sup>148</sup> See <http://www.lch.com/asset-classes/cdsclear>.

<sup>149</sup> 17 CFR 240.17Ad-22(d)(9).



and funds over which it has custody and control, or for which it is responsible, but also implement rules designed to do so.<sup>150</sup> In addition, under Section 17A(b)(3)(F), a clearing agency's rules must be designed to promote the prompt and accurate clearance and settlement of securities transactions and, in general, to protect investors and the public interest.<sup>151</sup> Moreover, rule 17Ad-22 requires a clearing agency to establish, implement, maintain, and enforce reasonably designed policies and procedures pertaining to the maintenance of sufficient financial resources, the investment of cash collateral, liquidity risk management, and default management.

#### i. Financial Resources

Rule 17Ad-22(b)(2) requires a registered cleared agency that performs CCP services to establish, implement, maintain, and enforce written policies and procedures reasonably designed to use margin requirements to limit its credit exposures to participants under normal market conditions, use risk-based models and parameters to set margin requirements, and review such margin requirements and the related risk-based models and parameters at least monthly.<sup>152</sup> Rule 17Ad-22(b)(3) requires a registered clearing agency acting as a CCP for security-based swaps to establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions, in its capacity as a CCP for security-based swaps.<sup>153</sup> Rule 17Ad-22(b)(4) requires registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for an annual model validation consisting of evaluating the performance of the clearing agency's margin models and the related parameters and assumptions associated with such models by a qualified person who is free from influence from the persons responsible for the development or operation of the models being validated.<sup>154</sup>

#### ii. Collateral Policy and Investment of Cash Collateral

Rule 17Ad-22(d)(3) requires registered clearing agencies to have

policies and procedures reasonably designed to ensure that the clearing agency (i) holds assets in a manner that minimizes the risk of loss or of delay in their access, and (ii) invests assets in instruments with minimal credit, market and liquidity risks.<sup>155</sup>

#### iii. Default Management, Loss Allocation, and Recovery

With respect to managing a member default, Section 17A(b)(3)(F) of the Act requires a registered clearing agency to assure the safeguarding of securities and funds, promote the prompt and accurate settlement of securities transactions, and, in general, protect investors and the public interest.<sup>156</sup> In addition, Rule 17Ad-22(d)(11) provides that such clearing agency must have policies and procedures to make key aspects of its default procedures publicly available and establish default procedures that ensure that the clearing agency can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default.<sup>157</sup>

### 2. Commission Findings

#### i. Financial Resources

As described in Section II.D.i above, LCH SA has policies and procedures that provide for the use of a VaR model to calculate margin requirements for members and for the review of the model on a monthly basis. These policies and procedures provide that the CDSClear model take into consideration a variety of risks relevant to clearing security-based swaps, including, but not limited to, changes in credit spreads, recovery rates, and interest rates, in order to appropriately measure LCH SA's exposures to CDSClear members under normal market conditions.<sup>158</sup> In addition to the margin requirements calculated using the model, LCH SA also imposes additional margin charges on members to address concentration risk, wrong way risk, and liquidity risk, which exist under normal market conditions, and imposes additional margin on members with lower credit ratings. LCH SA's policies and procedures require CDSClear members to post collateral to meet these margin requirements, and to also post variation margin. Additionally, the CDSClear rules establish a mutualized default

fund that, together with the margin requirements, is sized to maintain sufficient financial resources sufficient to withstand, at a minimum, the default by the two CDSClear member families to which LCH SA has the largest exposures in extreme but plausible market conditions (the "cover-two standard"). In addition, LCH SA also has policies and procedures that establish monthly back testing to evaluate the performance of the CDSClear margin methodology and stress testing to ensure maintenance of sufficient financial resources to meet the cover-two standard. Finally, as noted above, LCH SA has policies and procedures that require an annual validation of its margin model by independent personnel that are qualified to perform such a validation. This validation must include a review of the parameters and assumptions underlying the model, as well as the reporting of the results of such model validation to risk management personnel.

Based on the above, the Commission finds that, as described in the application, LCH SA has both the capacity to ensure that LCH SA maintains the required financial resources, and policies and procedures reasonably designed to do so, as required by Exchange Act sections 17A(b)(3)(A) and 17A(b)(3)(F), as well as Rules 17Ad-22(b)(2), (b)(3), and (b)(4) thereunder.<sup>159</sup>

#### ii. Collateral Policy and Investment of Cash Collateral

As described in Section II.D.ii above, LCH SA maintains a collateral policy that requires it to accept cash (in Euros), foreign currency, and highly liquid debt and equity securities as collateral, with all collateral except Euros subject to a haircut to minimize LCH SA's exposure to market risk. With respect to cash collateral, LCH SA has in place an investment policy that requires LCH SA to invest or deposit assets received as collateral only with counterparties that meet certain minimum credit standards. LCH SA monitors its counterparties, in furtherance of ensuring that such counterparties will be able to meet their obligations to LCH SA with respect to such assets, and that LCH SA will have access to such assets when needed. In addition, LCH SA has policies and procedures that require it to invest its assets in highly liquid instruments backed by creditworthy issuers. The term of investment permitted may depend on the type of asset and creditworthiness of the issuer. For

<sup>155</sup> 17 CFR 240.17Ad-22(d)(3).

<sup>156</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>157</sup> 17 CFR 240.17Ad-22(d)(11).

<sup>158</sup> See LCH SA Form CA-1, Exhibit H-1 (LCH SA Audited Financial Statements for the Year Ended 31 December 2015), 18; see also CDSClear Rulebook, Section 4.2.5 and Exhibit E-6.2 (CDSClear CDS Clearing Procedures, Section 2: Margin and Price Alignment Interest).

<sup>159</sup> 15 U.S.C. 78q-1(b)(3)(A) and (F); 17 CFR 240.17Ad-22(b)(2), (3), and (4).

<sup>150</sup> 15 U.S.C. 78q-1(b)(3)(A) and (F).

<sup>151</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>152</sup> 17 CFR 240.17Ad-22(b)(2).

<sup>153</sup> 17 CFR 240.17Ad-22(b)(3).

<sup>154</sup> 17 CFR 240.17Ad-22(b)(4).

example, cash deposits and securities of issuers not explicitly guaranteed by the US, UK, or a European government are restricted to an overnight term. For these reasons, the Commission finds that LCH SA's policies and procedures, as described in the application, are reasonably designed to ensure that LCH SA holds assets in a manner that minimizes the risk of loss or of delay in their access, and invests in instruments with minimal credit, market and liquidity risks, as required by Exchange Act Sections 17A(b)(3)(A) and 17A(b)(3)(F), as well as Rule 17Ad-22(d)(3).<sup>160</sup>

### iii. Default Management, Loss Allocation, and Recovery

As described in Section II.D.iii. above, LCH SA has rules, policies, and procedures regarding the management of losses resulting from a CDS Clear member default. Specifically, LCH SA's rules, policies and procedures require LCH SA, upon the declaration of a CDS Clear member's default, (i) to take action to hedge against market risk of the defaulting member's portfolio, (ii) to transfer customer positions to non-defaulting members, if the applicable provisions of LCH SA's rules are met, and (iii) to dispose of the defaulting member's portfolio through a competitive auction process. The Commission finds that LCH SA's rules allowing for the porting of customer positions are designed to safeguard securities and funds and protect investors, consistent with Section 17A(b)(3)(F) of the Act.<sup>161</sup> The hedging and disposition of the defaulting member's positions through default auction procedures further safeguards LCH SA's securities and funds by allowing LCH SA to limit the amount of losses that either LCH SA or its non-defaulting clearing members must bear as a result of the member's default.

This entire default management process must be completed within five business days. These policies and procedures provide for the use of financial resources in accordance with the CDS Clear default waterfall, to cover losses associated with the member's default while LCH SA conducts the competitive auction process in order to dispose of the defaulting member's portfolio. The only financial resources or recovery tools available to cover losses resulting from a CDS Clear member's default are those specified in the CDS Clear default waterfall. Furthermore, to manage liquidity

pressures associated with a member's default, LCH SA monitors and measures its liquidity resources and requirements daily. To continue meeting its obligations, LCH SA may use cash collateral, other collateral it is able to liquidate in a timely manner, or its own capital as an immediately available liquidity resource. LCH SA may also access central bank liquidity through the Banque de France, as well as other secured financing facilities that LCH SA maintains. The Commission finds that, taken together, these tools allow LCH SA to contain losses within the CDS Clear service and manage liquidity pressures associated with a member's default, while continuing to meet its obligations, thereby allowing LCH SA to safeguard securities and funds and to continue to facilitate prompt and accurate clearance and settlement, in accordance with Section 17A(b)(3)(F) of the Act.<sup>162</sup> The Commission finds that these tools are designed to mitigate the risk of financial loss contagion and therefore are consistent with the public interest requirement under Section 17A(b)(3)(F).

Finally, the Commission notes that LCH SA's policies and procedures regarding its CDS Clear default management process are available on its public Web site and can be reviewed by members and the general public alike. Based on the above, the Commission finds that LCH SA has established default procedures reasonably designed to ensure that it can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default, and to make key aspects of its default procedures publicly available, in accordance with the requirements of Rule 17Ad-22(d)(11), as well as the applicable requirements of Section 17A(b)(3)(F) of the Act.<sup>163</sup>

### E. Operational Risk Management

#### 1. Exchange Act Requirements

Section 17A(b)(3)(A) of the Act provides that a clearing agency shall not be registered unless the Commission determines that such clearing agency has the capacity to be able to facilitate prompt and accurate clearance and settlement and the safeguarding of securities and funds. In this regard, Rule 17Ad-22(d)(4) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, identify sources of operational risk and minimize them

through the development of appropriate systems, controls, and procedures; implement systems that are reliable, resilient and secure, and have adequate, scalable capacity; and have business continuity plans that allow for timely recovery of operations and fulfillment of a clearing agency's obligations.<sup>164</sup>

#### 2. Commission Findings

As described in Section II.E above, LCH SA has established written policies and procedures that address the self-assessment, monitoring, measuring, reporting, and mitigation of operational risks to LCH SA. LCH SA's operational risk framework assigns roles and responsibilities to the business departments, Operational Risk Department, and Audit Department for the identification, monitoring, reporting, mitigation, and oversight of operational risks. The Audit Committee and Risk Committee are assigned oversight responsibilities for specific aspects of LCH SA's internal controls and the implementation of LCH SA's operational risk management processes. Thus, LCH SA's policies and procedures provide for multiple lines of defense and layers of oversight over operational risk management.

In addition, LCH SA maintains written policies and procedures reasonably designed to ensure that LCH SA's systems are reliable, resilient and secure; and have business continuity plans that allow for timely recovery of operations and fulfillment of its operations. For example, LCH SA's business continuity policies provide for, among other things, regular threat assessments, operational and business continuity testing involving member participation, multiple systems and data centers at geographically dispersed locations, and the migration of data and functionality in the event of various types of business disruption.<sup>165</sup> The Commission believes that the business continuity management policies, along with the maintenance and use of redundant systems at multiple back-up sites, will provide LCH SA with the capacity to timely recover its operations and fulfill its obligations in the event of a disruption. Moreover, as described above, LCH SA also maintains an ongoing self-assessment policy to continually monitor and assess operational risk, such as security risk, and provide for the mitigation of such risk when it exceeds applicable

<sup>164</sup> 17 CFR 240.17Ad-22(d)(4).

<sup>165</sup> See LCH SA Form CA-1, Exhibit K-2 (LCH Group Business Continuity Management Policy); LCH SA Form CA-1, Exhibit E-6.7 (CDS Clear CDS Clearing Procedures, Section 7: Business Continuity).

<sup>160</sup> 15 U.S.C. 78q-1(b)(3)(A) and (F); 17 CFR 240.17Ad-22(d)(3).

<sup>161</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>162</sup> *Id.*

<sup>163</sup> 15 U.S.C. 78q-1(b)(3)(F); 17 CFR 240.17Ad-22(d)(11).

tolerances.<sup>166</sup> The Commission believes that the operational risk and business continuity testing required under LCH SA's rules, policies, and procedures will further assist LCH SA in identifying and minimizing sources of operational risk, as well as gain facility in responding to business disruption or disaster recovery scenarios. Additionally, as described above, the Commission believes that the information security policies and procedures adopted by LCH SA will assist LCH SA in ensuring that sensitive information is appropriately protected and that confidentiality of such information is maintained, that only authorized employees and other select entities are able to access and use such information, and that no such employees trade on this information for their personal accounts. Given the above, the Commission finds that LCH SA has established, implemented, and maintained operational risk management and business continuity policies that are reasonably designed to identify sources of operational risk and minimize them through appropriate systems, controls, and procedures; implement systems that are reliable, resilient and secure, and have adequate, scalable capacity; and allow for timely recovery of operations and fulfillment of LCH SA's obligations.

For the reasons above, the Commission finds that LCH SA's governance and operational risk policies and procedures are designed to meet the requirements of Section 17A(b)(3)(A) concerning the capacity to facilitate the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds, as well as the operational risk requirements under Rule 17Ad-22(d)(4).

#### F. Fees, Dues, and Charges

##### 1. Exchange Act Requirements

Sections 17A(b)(3)(D) and (E) of the Act require a clearing agency's rules to provide for the equitable allocation of reasonable dues, fees and other charges among its participants and prohibit the rules of a clearing agency from imposing any schedule of prices, or fixing rates or other fees for services rendered by its participants.<sup>167</sup> Section 17A(b)(3)(I) provides that the rules of a clearing agency may not impose any burden on competition not necessary or

<sup>166</sup> See, e.g., LCH SA Form CA-1, Ex. K-3 (LCH. Clearnet Group Information Security Strategy/ Maturity Self-assessment tool); LCH Clearnet Group Operational Risk Policy—Operational Risk Management.

<sup>167</sup> 15 U.S.C. 78q-1(b)(3)(D) and (E).

appropriate in furtherance of the purposes of Section 17A.<sup>168</sup>

##### 2. Commission Findings

In connection with its CDSClear service, LCH SA charges transaction fees linked to products, which are generally usage-based, as well as annual membership fees, which apply equally to all CDSClear members. LCH SA also imposes annual account structure fees for individually segregated accounts and omnibus segregated accounts that are equally applicable to all CDSClear members based on usage.<sup>169</sup> The Commission finds that these fees apply equally to all members, that LCH SA does not impose any schedule of fees for services rendered by its participants and that these fees are not imposed in an attempt to burden competition. Accordingly, the Commission finds that LCH SA's CDSClear rules governing fees, dues, and charges are consistent with the requirements of Sections 17A(D), (E), and (I) of the Act.<sup>170</sup>

#### G. Prompt and Accurate Clearance and Settlement

##### 1. Exchange Act Requirements

Section 17A(b)(3)(A) of the Act<sup>171</sup> provides that a clearing agency shall not be registered unless the Commission finds that the clearing agency is so organized and has the capacity to facilitate the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts, and transactions for which it is responsible. Similarly, Exchange Act Section 17A(b)(3)(F) requires a clearing agency to have rules designed to promote these same goals.<sup>172</sup>

##### 2. Commission Findings

The Commission finds that, based on LCH SA's rules, policies, and procedures described above pertaining to its CDSClear membership standards; capacity to enforce rules and discipline CDSClear members; governance, particularly in connection with financial and operational risk management responsibilities of the Audit and Risk Committees; financial resources; investment of cash collateral and liquidity risk management; and CDSClear default management loss allocation and recovery, taken together, LCH SA is so organized and has the capacity to facilitate the prompt and

<sup>168</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>169</sup> See LCH SA Form CA-1, Exhibit Q (LCH SA Schedule of Prices, Rates or Fees Fixed by Registrant for Services Rendered by its Participants).

<sup>170</sup> 15 U.S.C. 78q-1(b)(3)(D), (E), and (I).

<sup>171</sup> 15 U.S.C. 78q-1(b)(3)(A).

<sup>172</sup> 15 U.S.C. 78q-1(b)(3)(F).

accurate clearance and settlement and has rules designed to promote these same goals, in accordance with Sections 17A(b)(3)(A) and 17A(b)(3)(F) of the Act.<sup>173</sup>

As a first line of defense, LCH SA's CDSClear membership standards seek to ensure that applicants will not be accepted if they lack the ability to meet obligations to LCH SA for operational or financial reasons. Similarly, LCH SA's policies and procedures that establish its authority to enforce its rules and discipline members are designed to minimize risks from existing members to LCH SA's ability to facilitate prompt and accurate clearance and settlement. LCH SA's governance structure, which creates multiple lines of oversight over specific responsibilities of—and interactions among—its business departments, control departments, Board-level committees, and ultimately Board of Directors, is designed to identify, minimize, mitigate, and oversee the management of operational and financial risks both external to and inherent in LCH SA. If a financial risk emerges in the form of a member default, for example, LCH SA's rules, policies, and procedures, as described in the application, contemplate the ability to cover losses consistent with the cover two standard using pre-funded resources. To the extent CDSClear pre-funded resources are insufficient, LCH SA may draw on assessment powers and loss allocation and recovery tools established in accordance with its rules, policies, and procedures, to continue meeting clearance and settlement obligations. In addition, LCH SA's CDSClear rules are designed to ensure that, during the default management process, which may last no longer than five business days, LCH SA may continue to offer CDSClear services only if its financial resources, including assessment powers and Variation Margin Haircutting, are sufficient to support a successful disposition of the defaulting member's portfolio through auction and meet LCH SA's daily settlement obligations.

Based on the foregoing, the Commission believes that LCH SA's rules, policies and procedures meet the requirements of Sections 17A(b)(3)(A) and 17A(b)(3)(F) of the Exchange Act.<sup>174</sup>

#### IV. Request for Exemptive Relief

In connection with its application for registration as a clearing agency, as described above, LCH SA has submitted a Request for Exemptive Relief from certain requirements of the Exchange

<sup>173</sup> 15 U.S.C. 78q-1(b)(3)(A) and (F).

<sup>174</sup> *Id.*

Act and the rules thereunder.<sup>175</sup> Section 36 of the Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from certain provisions of the Exchange Act or certain rules or regulations thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.<sup>176</sup> After careful consideration, as further discussed below, the Commission concludes that the conditional exemptive relief requested by LCH SA is necessary or appropriate in the public interest, and is consistent with the protection of investors.

#### A. Exemptive Relief from Sections 5 and 6 of the Act

##### 1. Background

Section 5 of the Act prohibits any broker, dealer, or exchange from using any facility of an exchange to effect any transaction in a security, or to report any such transaction, unless such exchange is registered as a national securities exchange.<sup>177</sup> Section 6 of the Act sets out the terms and conditions for registration of an exchange.<sup>178</sup> LCH SA has requested exemptive relief (i) from the requirements of Sections 5 and 6 of the Act with respect to its “forced trade” mechanism used in the calculation of settlement prices for open positions in cleared CDS; and (ii) for each of its CDSClear members that are brokers or dealers, from Section 5 of the Act with respect to their participation in the forced trade mechanism.<sup>179</sup> LCH SA represents that, as part of its clearing and risk management processes for cleared CDS transactions in its CDSClear services, including single-name CDS cleared by LCH SA (“Single-Name CDS”), it computes the end-of-day settlement price for each contract in which any of its members has a cleared position, based on off-market prices submitted by its clearing members, and uses those prices to establish a daily mark on which to base margin calculations. To promote the integrity of these price submissions, LCH SA employs a forced trade mechanism pursuant to which its members are required at certain times to execute CDS trades based on their price submissions.<sup>180</sup>

##### 2. LCH SA’s Representations

LCH SA acknowledges that, absent an exemption, LCH SA’s forced trade mechanism would cause LCH SA to meet the criteria of Rule 3b–16 under the Act<sup>181</sup> and, as a result, would require LCH SA to register with the Commission as a national securities exchange under Sections 5 and 6 of the Act or obtain an appropriate exemption therefrom. Additionally, any clearing member that is a broker or dealer would not be permitted to utilize LCH SA to effect any transaction in a security, or to report any such transaction, unless LCH SA were registered as a national securities exchange or had obtained an appropriate exemption.

##### 3. Commission Findings

The Commission notes that it previously has granted the temporary, conditional exemptive relief that LCH SA has requested under Sections 5 and 6 of the Act to CDS clearing agencies ICE Clear Credit, ICE Clear Europe, and CME.<sup>182</sup> The Commission notes that LCH SA’s procedures for calculating end-of-day settlement prices and LCH SA’s forced trade mechanism are substantially similar to the other CDS clearing agencies and does not believe that any differences between LCH SA’s forced trade mechanism and those of the other CDS clearing agencies warrant different treatment in the consideration of LCH SA’s requested relief from the requirements of Sections 5 and 6 of the Act. In light of the risk management benefits of the forced trade mechanism in maintaining the integrity of the pricing process, the Commission finds it necessary or appropriate in the public interest and consistent with the protection of investors to grant a temporary conditional exemption to LCH SA from the requirements of Sections 5 and 6 of the Act, and to its CDSClear clearing members from the requirements of Section 5 of the Act, subject to the conditions described below. These exemptions are solely with respect to the forced trade mechanism used in connection with the calculation of settlement prices for cleared CDS. As with the exemptions granted to other CDS clearing agencies in the Commission’s Temporary Exemptions Release, the exemptions

<sup>181</sup> 17 CFR 240.3b–16.

<sup>182</sup> See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment, Securities Exchange Act Rel. No. 34–64795 (Jul. 1, 2011), 76 FR 39927, 39934 (Jul. 7, 2011) (“Temporary Exemptions Release”).

from Section 5 and 6 applicable to LCH SA and to its clearing members that are brokers or dealers will remain in effect until the earliest compliance date set forth in any of the final rules regarding the registration of security-based swap execution facilities and will be subject to the following conditions:<sup>183</sup>

First, LCH SA shall report to the Commission the following information with respect to its calculation of settlement prices for Single-Name CDS within thirty (30) calendar days of the end of each quarter, and to electronically preserve such reports for a period of ten (10) years: (a) The total dollar volume of transactions executed during the quarter, broken down by reference entity; and (b) the total unit volume and/or notional amount executed during the quarter, broken down by reference entity. Reporting of this information will assist the Commission in carrying out its responsibility to supervise and regulate the securities markets.

Second, LCH SA shall establish and maintain adequate safeguards and procedures to protect clearing members’ confidential trading information, including: (a) Limiting access to the confidential trading information of clearing members to those employees of LCH SA who are operating the systems or are responsible for their compliance with this exemption or any other applicable rules; and (b) establishing and maintaining standards controlling LCH SA employees who trade for their own accounts.<sup>184</sup> LCH SA shall establish and maintain adequate oversight procedures to ensure that the safeguards and procedures established pursuant to this condition are followed. This condition is designed to prevent any misuse of trading information that may be available to LCH SA in connection with the forced trade mechanism. This condition is expected to strengthen confidence in LCH SA’s protections of confidential trading information, thus promoting participation.

Third, LCH SA shall directly or indirectly make available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (a) All end-of-day settlement prices and any other prices with respect to Single-Name CDS that it may establish to calculate mark-to-market margin requirements for its clearing members;

<sup>183</sup> See *id.* at 39934.

<sup>184</sup> See *supra* notes 70 and 71. As discussed above LCH SA currently has policies and procedures in place that control access to confidential information, including confidential information relating to LCH SA clearing members, and that control the personal trading of LCH SA employees.

<sup>175</sup> See *supra* note 8 and accompanying text.

<sup>176</sup> 15 U.S.C. 78mm.

<sup>177</sup> 15 U.S.C. 78e *et seq.*

<sup>178</sup> 15 U.S.C. 78f *et seq.*

<sup>179</sup> See Request for Exemptive Relief at 2.

<sup>180</sup> See *id.* at 3–4.

and (b) any other pricing or valuation information with respect to Single-Name CDS as is published or distributed by LCH SA. This condition is designed to make relevant pricing data available to the public on terms that are fair and reasonable and not unreasonably discriminatory.

Finally, LCH SA shall implement policies and procedures designed to ensure compliance with these terms and conditions relating to the requested exemptive relief from Sections 5 and 6 of the Act, and shall conduct periodic internal reviews related to its compliance program.

### *B. Exemptive Relief from Section 19(b) of the Act and Rule 19b-4 Thereunder*

#### 1. Background

Pursuant to Section 19(b)(1) of the Exchange Act, self-regulatory organizations (“SROs”), including registered clearing agencies, are required to file with the Commission copies of any proposed rule,<sup>185</sup> or any addition to or deletion from their existing rules (a “proposed rule change”).<sup>186</sup> LCH SA has requested exemptive relief from the requirements of Section 19(b) of the Act and Rule 19b-4 thereunder with respect to filing certain proposed rule changes that (i) primarily affect its clearing operations with respect to its Non-U.S. Business, and (ii) do not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using such services (“Non-U.S. Business Rule Changes”).<sup>187</sup> As a condition of the requested relief, LCH SA has proposed to provide notice of its Non-U.S. Business Rule Changes to Commission staff in lieu of filing such changes under Section 19(b) and Rule 19b-4 once such changes are duly approved by its national competent authorities.

As described above, LCH SA represents that its Non-U.S. Business is comprised of clearing services offered completely offshore entirely to non-U.S. persons outside of the United States that would not otherwise implicate the Commission’s registration requirements under the Act, nor those of the CFTC.<sup>188</sup>

<sup>185</sup> See 15 U.S.C. 78c(a)(27) (defining “rules of a clearing agency”) and (28) (defining “rules of a self-regulatory organization”).

<sup>186</sup> See 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4(a)(4) (defining “proposed rule change”).

<sup>187</sup> See Request for Exemptive Relief at 2–3.

<sup>188</sup> See Request for Exemptive Relief at 5–12. As noted above, LCH SA currently provides clearing services for equities, exchange-traded futures and options, as well as fixed income instruments and commodity products traded on European exchanges and multilateral trading facilities in which no U.S. persons participate as clearing members, *i.e.* its Non-U.S. Businesses.

LCH SA also represents that its CDSClear service, from which it intends to offer clearing services for Single-Name CDS to U.S. persons, will be maintained separate and apart from its Non-U.S. Business. Specifically, LCH SA’s Non-U.S. Business has: (1) Separate rules, including policies and procedures; (2) distinct financial safeguards and default arrangements; and (3) significant numbers of exclusively dedicated personnel and information technology services. LCH SA maintains that such separation will ensure that the rights and obligations of a U.S. person participating in the CDSClear services would not be affected by a member default or operational risk occurring in the Non-U.S. Business. In other words, LCH SA represents that “there is no possibility of risk contagion or mutualization . . . [to U.S. persons participating in CDSClear] in the event of a member default in the other services provided by the Non-U.S. Business.”<sup>189</sup>

LCH SA nonetheless acknowledges that CDSClear is not totally separated from the rest of its business. Among other things, LCH SA’s overall governance framework applies equally to CDSClear and the other services provided by the Non-U.S. Business.<sup>190</sup> Similarly, LCH SA’s risk management framework requires certain functions to be shared across all of its various business lines in order for risks to be adequately managed while maintaining an appropriate segregation of duties.

Specifically, LCH SA’s Non-U.S. Business currently includes: (i) “EquityClear”, which refers to clearing services in respect of equities, debt instruments and futures contracts traded on the Euronext, Equiduct, and Bourse de Luxembourg trading platforms; (ii) “CommodityClear”, which refers to clearing services in respect of futures and options for agricultural and energy products on Euronext; and (iii) “RepoClear”, which refers to clearing services in respect of repo transactions on French, Italian and Spanish government debt as well as corporate debt, and also includes the Euro GC+ clearing service. LCH SA may expand its Non-U.S. Business to include other new services. At all times, the Non-U.S. Business does not and will not have any U.S. clearing members or extend membership to any U.S. persons. See LCH SA Form CA-1, Exhibit C; Request for Exemptive Relief at 6–8 & n.22.

<sup>189</sup> Request for Exemptive Relief at 11.

<sup>190</sup> LCH SA’s Board of Directors maintains overall responsibility for risk management of all clearing services; subcommittees of the Board, including the Audit Committee, Risk Committee and Remuneration Committee, exercise their functions across all clearing services. In addition, LCH SA maintains an executive committee, known as the “Local Management Committee”, which has overall responsibility for LCH SA’s risk function. The LCH Group has also established certain risk committees with joint oversight responsibility across LCH SA, LCH Limited and LCH LLC, including the Executive Risk Committee, Market Risk Management Committee, and Credit Risk Management Committee.

LCH SA represents that CDSClear and the Non-U.S. Business jointly rely on certain resources (collectively, “Shared Support Functions”), which include second-line risk management, treasury/liquidity management, legal and compliance, systems safeguards/security/business continuity, internal audit, finance and human resources.

In recognition of CDSClear’s relationship to its Non-U.S. Business, LCH SA does not seek an exemption from filing all rule changes pertaining to its Non-U.S. Business. Specifically, LCH SA does not seek exemption from filing rule changes which significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using such services. Thus, even if LCH SA’s request for exemptive relief were granted, LCH SA would nonetheless be required to file, pursuant to Section 19(b) and Rule 19b-4, rule changes that do not explicitly pertain to the CDSClear services, but have a significant impact on the CDSClear operations, such as proposed rule changes relating to Shared Support Functions.

#### 2. LCH SA’s Representations

LCH SA contends that the exemptive relief it has proposed is consistent with Section 36 of the Act because such relief is necessary or appropriate in the public interest, and is consistent with the protection of investors. In particular, LCH SA argues that relief is necessary or appropriate in the public interest because applying rule filing requirements under Section 19(b) of the Act and Rule 19b-4 thereunder would not advance the Commission’s regulatory interests, as applied to its Non-U.S. Business Rule Changes. Additionally, in light of the separation between CDSClear and its Non-U.S. Business, LCH SA maintains that this exemption is consistent with the protection of investors because it would not compromise the Commission’s oversight responsibility with respect to LCH SA as a whole.

LCH SA believes that the existing rule filing framework, as applied to its Non-U.S. Business Rule Changes, is both burdensome and would not advance the Commission’s regulatory interests. In particular, LCH SA asserts that it is registered with the CFTC for the purposes of clearing index CDS (which are swaps) and with the Commission for the purpose of clearing single-name CDS (which are security-based swaps). LCH SA notes that clearing agencies that are also registered with the CFTC as a DCO (“Dually-Registered Clearing Agencies”) are permitted to rely on Rule 19b-

4(f)(4)(ii) to file certain proposed rule changes under Section 19(b)(3)(A) of the Act.<sup>191</sup> That rule is designed to eliminate unnecessary delays that could arise from the differences between the Commission's rule filing process and the CFTC's self-certification process for rule changes primarily affecting clearing with respect to swaps, futures, options on futures and forwards regulated by the CFTC that also do not significantly affect any securities clearing operations or the rights or obligations of the clearing agency with respect to securities clearing or persons using the securities-clearing service.<sup>192</sup>

Nonetheless, LCH SA maintains that this framework does not adequately consider its status as a foreign clearing agency registered with—and subject to supervision by—its own national competent authority. In light of the significant separation it maintains between CDSClear and its Non-U.S. Business, LCH SA seeks an exemption from filing its Non-U.S. Business Rule Changes. LCH SA asserts that its Non-U.S. Business would not otherwise require it to register with the Commission as a clearing agency but for the fact that LCH SA intends to expand its CDSClear business to offer clearing services for Single-Name CDS to U.S. persons.<sup>193</sup> Thus, LCH SA argues that because CDSClear participants are ring-fenced from risks associated with its Non-U.S. Business and the Commission would not regulate its Non-U.S. Business standing alone, requiring the filing of Non-U.S. Business Rule Changes “would not serve the SEC's regulatory interest.”<sup>194</sup>

In addition, LCH SA maintains that it has tailored its exemption request to ensure that the Commission's regulatory interests in overseeing LCH SA on an entity-wide basis are not compromised. As described above, LCH SA notes that rule changes to its Non-U.S. Business clearing which significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using such services will nonetheless be filed with the Commission pursuant to Section 19(b) of the Exchange Act and Rule 19b-4. In addition, as a condition of the exemptive relief it seeks, LCH SA will provide Commission staff notice of and copies of all Non-U.S. Business Rule Changes once such changes are duly approved by its national competent

authorities in lieu of filing such changes under Section 19(b) and Rule 19b-4. Taken as whole, LCH SA maintains that its exemptive request does not compromise the Commission's historical approach of overseeing clearing agencies on an entity-wide basis. Accordingly, LCH SA maintains that an exemption from filing its Non-U.S. Business Rule Changes with the Commission is necessary or appropriate in the public interest, and is consistent with the protection of investors.

### 3. Commission Findings

The Commission notes that its oversight responsibility over registered clearing agencies extends to the clearing agency as a whole and is entity-based, rather than product-based.<sup>195</sup> Therefore, absent exemptive or other relief, a registered clearing agency is required to comply with all applicable requirements under the Exchange Act, including filing all proposed rule changes with the Commission. The Commission has previously explained that a clearing agency's failure to submit proposed rule changes would prevent the Commission from discharging its statutory responsibilities.<sup>196</sup> After careful consideration of the specific facts and circumstances of LCH's request for exemptive relief, and as further described below, the Commission concludes that granting to LCH SA a conditional exemption from Section 19(b) of the Act and Rule 19b-4 thereunder in connection with LCH SA's Non-U.S. Business Rule Changes is necessary or appropriate in the public interest, and is consistent with the protection of investors, subject to the condition that LCH SA will provide notice of such Non-U.S. Business Rule Changes to the Commission staff within three business days of being duly approved by LCH SA's national competent authorities.

First, the Commission finds that requiring LCH SA to file Non-U.S. Business Rule Changes would not advance the Commission's regulatory interest in overseeing registered clearing agencies. In the Dually Registered Clearing Agency Release, the Commission explained that a proposed rule change “primarily affects” a clearing agency's clearing operation with respect to products that are not securities “when it is targeted to matters related only to the clearing of those

products.”<sup>197</sup> Therefore, for a proposed rule change to primarily affect LCH SA's clearing operations with respect to its Non-U.S. Business, it must be targeted to matters related only to the clearing of the products offered by the services provided in the Non-U.S. Business. As such, the Non-U.S. Business Rule Changes would be targeted to matters concerning LCH SA's offshore business in which U.S. persons do not participate. Further, LCH SA has represented that its Non-U.S. Business will not extend membership to any U.S. persons.<sup>198</sup> In addition, as described above, LCH SA has represented that it has a structure that essentially ring-fences its CDSClear business in which U.S. persons will participate from its Non-U.S. Businesses.<sup>199</sup> Therefore, U.S. persons participating in CDSClear will not be exposed to risks resulting from LCH SA's Non-U.S. Business Rule Changes. Taken together, the Commission concludes that reviewing LCH SA's Non-U.S. Business Rule Changes for purposes of approval or disapproval would not materially advance its regulatory interests.<sup>200</sup>

Second, the Commission finds that allowing LCH not to file these rule changes would not compromise the Commission's oversight responsibilities over registered clearing agencies on an entity basis.<sup>201</sup> As stated in the Dually Registered Clearing Agency Release, the Commission would not consider rules of general applicability that would apply equally to CDSClear operations and Non-U.S. Business to be “primarily affecting” LCH SA's clearing operations with respect to the Non-U.S. Business.<sup>202</sup> Therefore, this exemptive relief would not relieve LCH SA from the obligation of filing rules of general

<sup>197</sup> See *id.*

<sup>198</sup> Request for Exemptive Relief at 6, n.22.

<sup>199</sup> *Id.* at 11 & n.34. LCH SA acknowledges that U.S. persons remain at risk from a default in treasury management, and for that reason rule changes involving that function, along with other Shared Support Functions, are not subject to the exemption. *Id.*

<sup>200</sup> See Securities Exchange Act Release Nos. 34-43775 (Dec. 28, 2000), 66 FR 819 (Jan. 4, 2001) (order exempting Euroclear Bank from clearing agency registration) and 34-39643 (Feb. 18, 1998), 63 FR 8232 (Feb. 18, 1998) (order exempting Euroclear Bank's predecessor, Morgan Guaranty Trust Company, as operator of the Euroclear system, from clearing agency registration); Securities Exchange Act Release No. 34-38328 (Feb. 24, 1997), 62 FR 9225 (Feb. 28, 1997) (order exempting Clearstream Bank, formerly Cedel Bank, from clearing agency registration); and Exemption of Certain Foreign Brokers or Dealers, Proposed Rule, 73 FR 39182, 39198 (July 8, 2008).

<sup>201</sup> See, e.g., Dually Registered Clearing Agency Release at 21050. (“The Commission's oversight responsibility over [registered clearing agencies] extends to the clearing agency as a whole and is entity-based, rather than product based”).

<sup>202</sup> See *id.*

<sup>191</sup> 17 CFR 240.19b-4(f)(4)(ii).

<sup>192</sup> Amendment to Rule Filing Requirements for Dually-Registered Clearing Agencies, 78 FR 21046, 21048 (April 9, 2013), hereinafter referred to as “Dually Registered Clearing Agency Release”.

<sup>193</sup> Request for Exemptive Relief at 6 & n.21.

<sup>194</sup> Request for Exemptive Relief at 11-12.

<sup>195</sup> The Commission has explained that its oversight responsibility over registered clearing agencies “extends to the clearing agency as a whole and is entity based, rather than product-based.” Dually Registered Clearing Agency Release, 78 FR at 21050 & n.52.

<sup>196</sup> See *id.*

applicability in accordance with Section 19(b). For example, to the extent a proposed rule change regarding the Shared Support Functions constitutes a rule of general applicability that would apply equally to CDSClear operations and the Non-U.S. Business, it would not be considered to primarily affect LCH SA's Non-U.S. Business, and LCH SA would be required to file such proposed rule change for the Commission's review in accordance with Section 19(b).<sup>203</sup>

Similarly, consistent with the Dually Registered Clearing Agency Release, changes to general provisions in the constitution, articles, or bylaws of LCH SA that address the operations of the entire clearing agency would also affect CDSClear.<sup>204</sup> Therefore, LCH SA would be required to file any proposed rule changes to its constitution, articles, bylaws, or other rule changes that address its operations on an entity-wide basis, with the Commission in accordance with Section 19(b) and Rule 19b-4.

Furthermore, Non-U.S. Business Rule Changes would not include proposed rule changes that would "significantly affect" LCH SA's CDSClear Services. As the Commission stated in the Dually Registered Clearing Agency Release, a proposed rule change may significantly affect securities clearing operations, "even in circumstances when such effects may be indirect."<sup>205</sup> Therefore, LCH SA would be required to file a proposed rule change that significantly affects its CDSClear operations with the Commission, even in circumstances where the effects of such proposed rule change on the CDSClear operations are indirect.

Based on the above, the Commission believes that granting LCH SA exemptive relief from the rule filing requirement with respect to the Non-U.S. Business Rule Changes is necessary or appropriate in the public interest, and consistent with the protection of investors, because doing so would preserve the Commission's regulatory interest in protecting the rights and obligations of U.S. persons participating in the CDSClear services and facilitate LCH SA's operational, risk management, and other changes pertaining to the Non-U.S. Business as effected by Non-

U.S. Business Rule Changes, without compromising the Commission's oversight of LCH SA on an entity basis.

To monitor LCH SA's implementation of the exemptive relief, a condition of the exemptive relief is that LCH SA provide notice to Commission staff of its Non-U.S. Business Rule Changes within three business days once duly approved by LCH SA's national competent authorities. This requirement will provide the Commission with the ability to review LCH SA's determination of what constitutes Non-U.S. Business Rule Changes and to ensure that such determination is consistent with the scope of this exemptive relief such that the exemptive relief does not undermine the Commission's oversight over LCH SA under the Exchange Act.

#### *C. Exemptive Relief From Rules 17Ad-22(c)(2) and 17Ad-22(c)(2)(iii)*

LCH SA requests exemptive relief from the requirements of the introductory paragraph of Rule 17Ad-22(c)(2) and from Rule 17Ad-22(c)(2)(iii) with respect to its financial statements for fiscal years 2014 and 2015.<sup>206</sup> The introductory paragraph of Rule 17Ad-22(c)(2) requires that, within 60 days after the end of a clearing agency's fiscal year, the clearing agency must post its annual audited financial statements to its Web site.<sup>207</sup> Rule 17Ad-22(c)(2)(iii) also requires that financial statements for the past two years be audited in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB") by a registered public accounting firm that is qualified and independent in accordance with 17 CFR 210.2-01 (the "PCAOB Standards").<sup>208</sup>

#### 1. Background

As a factual matter, LCH SA represents that pursuant to the listing rules to which its indirect parent company LSEG is subject, LCH SA is not permitted to publish its own financial statements prior to the publication of LSEG's financial statements.<sup>209</sup> Given the scope of LSEG's business activities, LCH SA represents that it is "not possible" for LSEG to publish its financial statements within 60 days of the end of its fiscal year, nor would LCH SA have control over when such financial statements ultimately would be published.<sup>210</sup> LCH SA has requested instead that it post such annual audited financial

statements no later than the first quarter following its fiscal year-end.

In addition, LCH SA represents that it currently prepares its financial statements in accordance with International Financial Reporting Standards ("IFRS"), and its financial statements are audited in accordance with International Standards on Auditing ("ISA"). Additionally, LCH SA states that, under French law, it is required to maintain two statutory auditing firms that jointly sign the annual audited accounts.<sup>211</sup> LCH SA represents that it has made arrangements to ensure that, beginning in 2016, its annual financial statements will be audited in accordance with Public Company Accounting Oversight Board ("PCAOB") standards and will be signed by auditors who meet the relevant PCAOB qualifications.<sup>212</sup>

However, absent exemptive relief, upon registration with the Commission in 2016, LCH SA would be required to have its 2014 and 2015 annual financial statements audited in accordance with PCAOB standards. LCH SA represents that its 2014 and 2015 financial records would need to be re-analyzed (including reviewing past judgments regarding accounting figures), and that re-opening its audit files in such a manner would present practical and potentially legal challenges. In addition, compliance with Rule 17Ad-22(c)(2)(iii) prior to the end of the calendar year would impose material burdens on LCH SA, its staff and auditors.<sup>213</sup> LCH SA states that such challenges would be further exacerbated if the relief requested were to be granted only with respect to LCH SA's 2014 financial statements, as auditing its 2015 financial statements in isolation would cause auditors to use unaudited 2014 figures in their auditing report for the 2015 financial statements.<sup>214</sup>

#### 2. LCH SA's Representations

LCH SA argues that its requests for relief from Rules 17Ad-22(c)(2) and 17Ad-22(c)(2)(iii) are necessary or appropriate in the public interest, and consistent with the protection of investors in accordance with Section 36 of the Act.<sup>215</sup> LCH SA maintains that it cannot comply with the requirement of Rule 17Ad-22(c)(2)<sup>216</sup> that audited financial statements be published within 60 days of its fiscal year-end because UK Listing Rules forbid publication of LCH SA's annual

<sup>203</sup> This is consistent with the Commission's approach taken in the Dually Registered Clearing Agency Release, where the Commission stated that "rules of general applicability that would apply equally to securities clearing operations, including security-based swaps, would not be considered to primarily affect a Registered Clearing Agency's non-securities clearing operations." See *id.*

<sup>204</sup> *Id.*

<sup>205</sup> *Id.*; see also *id.* at n.50.

<sup>206</sup> See Request for Exemptive Relief at 4.

<sup>207</sup> 17 CFR 240.17Ad-22(c)(2).

<sup>208</sup> 17 CFR 240.17Ad-22(c)(2)(iii).

<sup>209</sup> See Request for Exemptive Relief at 15.

<sup>210</sup> *Id.*

<sup>211</sup> See Request for Exemptive Relief at 14.

<sup>212</sup> *Id.* at 13.

<sup>213</sup> *Id.* at 14.

<sup>214</sup> *Id.*

<sup>215</sup> 17 CFR 240.17Ad-22(c)(2) and 17 CFR 240.17Ad-22(c)(2)(iii); 15 U.S.C. 78mm.

<sup>216</sup> 17 CFR 240.17Ad-22(c)(2).

financial statements before those of its indirect parent, LSEG, over which LCH SA has limited control. Moreover, LCH SA contends that not only does it have limited control over when LSEG publishes its audited annual financial statements, LSEG is not able to publish its annual audited financial statements within the timeframe required under Rule 17Ad-22(c).<sup>217</sup> Thus, absent exemptive relief, LCH SA could not comply with this requirement.

With respect to Rule 17Ad-22(c)(2)(iii),<sup>218</sup> LCH SA argues that temporary exemptive relief is warranted as LCH SA has already committed to comply with Rule 17Ad-22(c)(2)(iii) on a prospective basis and it asserts that retroactive compliance with this provision raises significant practical—and potentially legal—challenges stemming from reanalyzing prior financial records and reopening the work of prior auditors. Moreover, LCH SA maintains that a PCAOB-compliant audit for 2016 necessitates *de facto* compliance for 2015 to ensure that the 2016 audit begins with an accurate 2015 closing balance.

### 3. Commission Findings

The Commission concludes that LCH SA's requests for exemptions from Rule 17Ad-22(c) and Rule 17Ad-22(c)(2)(iii)<sup>219</sup> are necessary or appropriate in the public interest and consistent with the protection of investors.

With respect to LCH SA's request for an exemption from Rule 17Ad-22(c)(2),<sup>220</sup> the Commission recognizes the legal and practical necessity that LSEG, as the ultimate parent company, publish its financial statements prior to LCH SA, and the inability of LCH SA as a subsidiary to change when LSEG can publish its financial statements. Thus, LCH SA would not be able to comply with the requirements of Rule 17Ad-22(c)(2),<sup>221</sup> and would not be able to register as a clearing agency with the Commission, absent the requested exemptive relief. The Commission believes that a delay of 31 days in the publication of the LCH SA's annual audited financial statements, were LCH SA to post its annual audited financial statements no later than the end of the first quarter following its year-end, would not have a material or meaningful impact on investor protection. Accordingly, the

Commission finds it necessary or appropriate, and consistent with the protection of investors, to grant LCH SA exemptive relief from the requirement in Rule 17Ad-22(c)(2)<sup>222</sup> that a clearing agency post its annual audited financial statements within sixty days following the end of its fiscal year, so long as LCH SA publishes such audited financial statements within one quarter of the end of its fiscal year.

Similarly, with respect to LCH SA's request for relief from Rule 17Ad-22(c)(2)(iii),<sup>223</sup> the Commission notes that the financial statements for which LCH SA requests relief from the PCAOB audit standards cover 2014 and 2015, years that do not overlap with any time during which LCH SA would be registered with the Commission. During 2014, and 2015, LCH SA performed no clearing services for U.S. clearing members. The Commission also notes that these financial statements were audited, albeit under an alternative, internationally recognized auditing standard. Moreover, from 2016 onwards, the timeframe that would overlap with LCH SA's registration as a clearing agency, LCH SA's financial statements would be audited in accordance with PCAOB standards as required under Rule 17Ad-22(c)(2)(iii).<sup>224</sup> Since LCH SA does not anticipate onboarding U.S. Clearing Members to CDSClear until 2017, those members would have a reasonably clear view of LCH SA's finances at the time they become members of LCH SA. Based on the above and on LCH SA's representation that its annual audited financial statements from fiscal year 2016 onward will be audited in accordance with the requirements of 17Ad-22(c)(2)(iii),<sup>225</sup> the Commission finds that it is necessary or appropriate in the public interest, and is consistent with the protection of investors, to grant LCH SA's requested relief from the requirements of Rule 17Ad-22(c)(2)(iii)<sup>226</sup> to have annual financial statements for the past two years posted on its Web site that are audited in accordance with PCAOB standards, with respect to LCH SA's 2014 and 2015 annual audited financial statements.

#### D. Exemptive Relief From Rule 17a-22

LCH SA also has requested exemptive relief from Exchange Act Rule 17a-22,<sup>227</sup> which provides, in relevant part, that within ten days after making

available certain materials such as manuals, notices, circulars, and bulletins to its participants or other entities with whom it has a significant relationship, such as transfer agents ("Rule 17a-22 Materials"), a registered clearing agency shall file three copies of such materials with the Commission. LCH SA requests exemptive relief from the requirement to file Rule 17a-22 materials where such materials (i) primarily affect LCH SA's clearing operations with respect to the Non-U.S. Business lines, and (ii) do not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to its CDSClear services or persons using the CDSClear services.<sup>228</sup> Additionally, LCH SA requests relief from the requirement of Rule 17a-22 to file physical copies of Rule 17a-22 Materials primarily concerning its CDSClear services.<sup>229</sup> LCH SA requests instead that it be permitted to provide the Commission with electronic submissions for Rule 17a-22 Materials with respect to CDSClear services.<sup>230</sup>

#### 1. LCH SA's Representations

LCH SA states that its rationale for requesting exemptive relief from Rule 17a-22 is essentially the same as the rationale used to support its request for exemptive relief from Section 19(b) of the Exchange Act and Rule 19b-4 thereunder, as described above.<sup>231</sup> Specifically, LCH SA believes that filing physical copies of Rule 17a-22 materials with the Commission would not advance the Commission's regulatory interests as applied to any 17a-22 Materials related to its Non-U.S. Business, and that in light of the separation between CDSClear and its Non-U.S. Business such an exemption is consistent with the protection of investors because it would not compromise the Commission's oversight responsibility with respect to LCH SA as a whole.<sup>232</sup>

#### 2. Commission Findings

Consistent with the Commission's rationale above granting LCH SA's request for relief from Section 19(b) of the Act and Rule 19b-4 thereunder with respect to LCH SA's Non-U.S. Business Rule Changes,<sup>233</sup> the Commission finds it is necessary or appropriate in the public interest, and consistent with protection of investors, to grant LCH

<sup>217</sup> *Id.*

<sup>218</sup> 17 CFR 240.17Ad-22(c)(2)(iii).

<sup>219</sup> 17 CFR 240.17Ad-22(c)(2) and 17 CFR 240.17Ad-22(c)(2)(iii).

<sup>220</sup> 17 CFR 240.17Ad-22(c)(2).

<sup>221</sup> 17 CFR 240.17Ad-22(c)(2).

<sup>222</sup> *Id.*

<sup>223</sup> 17 CFR 240.17Ad-22(c)(2)(iii).

<sup>224</sup> *Id.*

<sup>225</sup> *Id.*

<sup>226</sup> *Id.*

<sup>227</sup> 17 CFR 240.17a-22.

<sup>228</sup> See Request for Exemptive Relief at 15-16.

<sup>229</sup> 17 CFR 240.17a-22.

<sup>230</sup> *Id.*

<sup>231</sup> See Request for Exemptive Relief at 15.

<sup>232</sup> See Request for Exemptive Relief at 8-13; see also *supra* Section IV.B.2.

<sup>233</sup> See *supra* Section IV.B.3.



SA's request for relief from Rule 17a-22<sup>234</sup> with respect to filing with the Commission Rule 17a-22 Materials pertaining to LCH SA's Non-U.S. Business. The Commission also believes that granting LCH SA's request for exemptive relief from filing physical copies of Rule 17a-22 Materials pertaining to the CDS Clear business is necessary or appropriate in the public interest and consistent with the protection of investors. As a condition to such relief, LCH SA would file Rule 17a-22 Materials pertaining to the CDS Clear business via email rather than in hard copy.

Allowing LCH SA to satisfy its applicable filing obligations under Rule 17a-22 in this manner will expedite the filing process and allow LCH SA to minimize costs arising from international mail delivery service. The Commission also believes the exemptive relief should have no impact on the Commission's ability to examine or otherwise supervise CDS Clear operations because LCH SA's obligation to file materials relating to CDS Clear operations or activities not falling within the definition of Non-U.S. Business would still apply.

## V. Conclusion

For the reasons discussed above, the Commission finds that LCH SA meets the requirements for registration as a clearing agency, including those standards set forth under Section 17A of the Act and the rules and regulations thereunder.

Further, for the reasons discussed above, the Commission finds that the exemptions provided in this Order are necessary or appropriate in the public interest, and are consistent with the protection of investors.

*It is hereby ordered* that the application for registration as a clearing agency filed by LCH SA (File No. 600-36) pursuant to Sections 17A(b) and 19(a)(1) of the Act be, and hereby is, APPROVED.

*It is further ordered*, pursuant to Section 36 of the Act, based on the representations and facts presented in LCH SA's Request for Exemptive Relief, that LCH SA is exempt from the requirements of Sections 5 and 6 of the Act, and LCH SA's CDS Clear clearing members that are brokers or dealers are exempt from the requirements of Section 5, solely with respect to the "forced trade" mechanism used in connection with the calculation of settlement prices for Single-Name CDS, and until the earliest compliance date set forth in any final rules regarding the

registration of security-based swap execution facilities, subject to the following conditions:

(a) LCH SA shall report to the Commission the following information with respect to its calculation of settlement prices for Single-Name CDS within thirty (30) calendar days of the end of each calendar quarter and electronically preserve such reports during a period of ten (10) years:

(1) The total volume of transactions executed during the quarter, broken down by reference entity, presented in Euros, and converted into US Dollars;

(2) The total unit volume and/or notional amount executed during the quarter, broken down by reference entity;

(b) LCH SA shall establish and maintain adequate safeguards and procedures to protect its BD-FCM Clearing Members' confidential trading information, including:

(1) limiting access to the confidential trading information of members to LCH SA employees who operate the system or who are responsible for its compliance with this exemptive relief and any other applicable rules;

(2) establishing and maintaining standards controlling LCH SA employees that trade for their own account;

(c) LCH SA shall establish and maintain adequate oversight procedures to ensure that the safeguards and procedures established pursuant to (b) are followed;

(d) LCH SA shall directly or indirectly make available to the public on terms that are fair and reasonable and not unreasonably discriminatory:

(1) All end-of-day settlement prices and any other prices with respect to Single-Name CDS that it may establish to calculate mark-to-market margin requirements for its clearing members; and

(2) any other pricing or valuation information with respect to Single-Name CDS as is published or distributed by LCH SA.

(e) LCH SA shall implement policies and procedures designed to ensure compliance with these terms and conditions, and to conduct periodic internal reviews related to its compliance program.

*It is further ordered*, pursuant to Section 36 of the Act, that LCH SA, based on the representations and facts presented in its Request for Exemptive Relief, is exempt from the requirements of Section 19(b) of the Act and Rule 19b-4 thereunder to file proposed rule changes with respect to its Non-U.S. Business, *i.e.* proposed rule changes that (i) primarily affect LCH SA's clearing

operations with respect to the Non-U.S. Business and (ii) do not significantly affect any CDS Clear operations or any rights or obligations of LCH SA with respect to the CDS Clear services or persons using the CDS Clear services, subject to the following conditions:

(a) LCH SA shall provide notice to Commission staff of its Non-U.S. Business Rule Changes within three business days of their being duly approved by the national competent authorities.

*It is further ordered*, pursuant to Section 36 of the Act, that LCH SA, based on the representations and facts presented in its Request for Exemptive Relief, is exempt from the requirement of Rule 17Ad-22(c)(2) that a clearing agency, within 60 days after the end of its fiscal year, must post its annual audited financial statements for the past two years to its Web site, subject to the following condition:

(a) LCH SA shall post its annual audited financial statements for the past two years to its Web site no later than the end of the first quarter following LCH SA's fiscal year-end.

*It is further ordered*, pursuant to Section 36 of the Act, that LCH SA, based on the representations and facts presented in its Request for Exemptive Relief, is exempt from the requirement of Rules 17Ad-22(c)(2)(iii) that a clearing agency's annual audited financial statements must be audited in accordance with the standards of the PCAOB by a registered public accounting firm that is qualified and independent in accordance with 17 CFR 201.1-01 with respect to its annual audited financial statements for its fiscal years 2014 and 2015, subject to the following conditions:

(a) For the calendar years 2014 and 2015, LCH SA's annual audited financial statements shall be prepared in accordance with IFRS and audited in compliance with ISA rather than the PCAOB requirement set out in Rule 17Ad-22(c), with the exception that the closing balance of LCH SA's 2015 financial statements shall be audited in accordance with PCAOB standards; and

(b) For calendar year 2016 and onwards, LCH SA's annual financial statements shall be prepared in accordance with IFRS and audited in accordance with PCAOB standards and shall be signed by auditors that meet the relevant PCAOB qualifications.

*It is further ordered*, pursuant to Section 36 of the Act, that LCH SA, based on the representations and facts presented in its Request for Exemptive Relief, is exempt from the requirements of Rule 17a-22 under the Act, to file certain materials such as manuals,

<sup>234</sup> 17 CFR 240.17a-22.

notices, circulars, and bulletins, as more fully described in Rule 17a–22, in connection with its Non-U.S. Business, that (i) primarily affect LCH SA’s clearing operations with respect to the Non-U.S. Business and (ii) do not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using the CDSClear services.

*It is further ordered*, pursuant to Section 36 of the Act, that LCH SA, based on the representations and facts presented in its Request for Exemptive Relief, is exempt from the requirements of Rule 17a–22 under the Act, to file with the Commission three copies of materials such as manuals, notices, circulars, and bulletins, as more fully described in Rule 17a–22, within ten days of making such materials available to its participants or other persons as more fully described in Rule 17a–22, subject to the following conditions:

(a) LCH SA shall file such materials in electronic format with the Commission within ten (10) calendar days after issuing or making such materials available to its participants or to other entities with whom it has a significant relationship as applicable, except for materials that (i) primarily affect LCH SA’s clearing operations with respect to the Non-U.S. Business and (ii) do not significantly affect any CDSClear operations or any rights or obligations of LCH SA with respect to the CDSClear services or persons using the CDSClear services, which materials as ordered above shall be exempt from the filing requirements of Rule 17a–22.

This exemptive relief is subject to modification or revocation at any time the Commission determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act. This exemption is based on the facts presented and the representations made in the Request for Exemptive Relief. Any different facts or representations may require a different response.

By the Commission.

**Eduardo A. Aleman,**

*Assistant Secretary.*

[FR Doc. 2016–31940 Filed 1–4–17; 8:45 am]

**BILLING CODE 8011–01–P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–79711; File No. SR–C2–2016–025]

### Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Fees for C2 Real-Time Data Feeds

December 29, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b–4 thereunder,<sup>2</sup> notice is hereby given that on December 19, 2016, C2 Options Exchange, Incorporated (the “Exchange” or “C2”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization’s Statement of the Terms of the Substance of the Proposed Rule Change

C2 Options Exchange, Incorporated (the “Exchange” or “C2”) proposes to amend fees for certain C2 real-time data feeds. The text of the proposed rule change is available on the Exchange’s Web site (<http://www.c2exchange.com/Legal/>), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

#### II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange 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. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The purpose of the proposed rule change is to amend the Data Fee for the

BBO and Book Depth Data Feeds and user fees for the Complex Order Book (“COB”) Data Feed. These data feeds are made available by C2’s affiliate Market Data Express, LLC (“MDX”). The Exchange proposes to make the following fee changes effective January 1, 2017.

###### Data Feeds

*BBO Data Feed:* The BBO Data Feed is a real-time, low latency data feed that includes the following content: (i) Outstanding quotes and standing orders at the best available price level on each side of the market, with aggregate size (“BBO data”), and last sale data;<sup>3</sup> (ii) totals of customer versus non-customer contracts at the BBO, (iii) All-or-None contingency orders priced better than or equal to the BBO, (iv) BBO and last sale data for complex strategies (multi-leg strategies such as spreads, straddles and buy-writes); (v) expected opening price (“EOP”) and expected opening size (“EOS”) information that is disseminated prior to the opening of the market and during trading rotations, (vi) end-of-day (“EOD”) summary messages that are disseminated after the close of a trading session that include summary information about trading in C2 listed options (*i.e.*, product name, opening price, high and low price during the trading session and last sale price), (vii) “recap messages” that are disseminated during a trading session any time there is a change in the open, high, low or last sale price of a C2 listed option, as well as product name and total volume traded in the product during the trading session; and (viii) product IDs and codes for all C2 listed options contracts. The BBO Data Feed includes market data for simple options as well as complex strategies. The data in the BBO Data Feed is refreshed periodically during the trading session. The BBO and last sale data contained in the BBO Data Feed is identical to the data sent to the Options Price Reporting Authority (“OPRA”) for redistribution to the public.<sup>4</sup>

*Book Depth Data Feed:* The Book Depth Data Feed is a real-time, low latency data feed that includes all data contained in the BBO Data Feed (as described above) plus outstanding quotes and standing orders for an additional four price levels on each side of the market, with aggregate size (“Book Depth”). The data in the Book

<sup>3</sup> “Best bid and offer” or “BBO” data is sometimes referred to as “top-of-book” data. Data with respect to executed trades is referred to as “last sale” data.

<sup>4</sup> MDX makes available to Customers the BBO data and last sale data that is included in the BBO Data Feed no earlier than the time at which the Exchange sends that data to OPRA.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b–4.