

LCH LIMITED

ARTICLE 38(6) CSDR DISCLOSURE: ENGLISH LAW

1. Introduction

This disclosure is required under Article 38(6) of CSDR and sets out (i) the levels of protection associated with the two types of CSD account segregation LCH makes available to its Clearing Members, in respect of securities collateral LCH holds with CSDs for its Clearing Members (including a description of the main legal implications associated with the two types of CSD account segregation and information on the insolvency law applicable), and (ii) the costs associated with these two types of CSD account segregation.

2. Background

LCH is a CCP incorporated in England providing clearing services to its Clearing Members. Clearing Members may in turn provide clearing services to their Clients.

LCH considers that its Clearing Members are each a “client” of LCH under, and for the purposes of, CSDR. Accordingly, LCH offers its Clearing Members the choice between Individual CSD-Level Segregation and Omnibus CSD-Level Segregation, in respect of securities collateral LCH holds with CSDs for such Clearing Members as “clients” of LCH, as required under Article 38(5) of CSDR (and as such segregation is further described below under the heading “*CSD Accounts*”).

LCH Accounts

LCH makes the following types of LCH accounts available to its Clearing Members (and for a full description of such accounts please contact LCH Onboarding at onboarding@lch.com):

- Proprietary Account
- Client Accounts: Individual Segregated Account, Custodial Segregated Account and Omnibus Segregated Account
- Indirect Accounts: Indirect Gross Account and Indirect Net Account
- Sponsored Clearing Accounts: SM/AM Account and Agent Buffer Account

LCH records the legal entitlement of a Clearing Member to securities collateral it provides to LCH in LCH’s books and records, in accordance with instructions and information provided by such Clearing Member and applicable law and regulation.

CSD Accounts

LCH opens accounts in its name with CSDs and holds securities collateral posted to it by Clearing Members in such accounts. LCH makes two types of CSD account segregation available to Clearing Members, in respect of such securities collateral:

- Individual CSD-Level Segregation, where each account that LCH opens with a CSD in order to provide such segregation is a “**CSD ISA**”; and
- Omnibus CSD-Level Segregation, where each account that LCH opens with a CSD in order to provide such segregation is a “**CSD OSA**”.

Securities collateral, which LCH holds at a CSD for a Clearing Member, will always be held in a CSD OSA or CSD ISA, regardless of the LCH account(s) a Clearing Member has with LCH. By default,

LCH will hold a Clearing Member's securities collateral in a CSD OSA, unless the Clearing Member has requested a CSD ISA.

A CSD ISA is used to hold securities collateral for a single Clearing Member. Accordingly, such securities collateral is held separately from the securities collateral of any other Clearing Member¹. By contrast, a CSD OSA is used to hold securities collateral for a number of Clearing Members on a collective basis¹.

3. Main Legal Implications of Levels of Segregation

English Insolvency Law

If LCH were to become insolvent, the insolvency proceedings would take place in England and be governed by English insolvency law. Under English insolvency law, securities collateral that LCH held on behalf of Clearing Members would not form part of LCH's estate on insolvency and would be deliverable to Clearing Members in accordance with each Clearing Member's proprietary interests in the securities collateral. As a result, it would not be necessary for Clearing Members to make a claim in LCH's insolvency as a general unsecured creditor in respect of such securities collateral.

Nature of Clearing Member's Interests

Although securities collateral is registered in LCH's name at the relevant CSD, LCH holds such securities collateral on behalf of Clearing Members, who are considered as a matter of law to have a beneficial proprietary interest in such securities. This is in addition to any contractual right a Clearing Member might have against LCH to have the securities collateral delivered to it.

This applies to both CSD ISAs and CSD OSAs. However, the nature of Clearing Members' interests in securities collateral differs according to whether the securities are held in a CSD ISA or and CSD OSA.

In relation to a CSD ISA, each relevant Clearing Member is beneficially entitled to all of the securities collateral held in that CSD ISA. In a CSD OSA, securities collateral is held collectively in a single account for multiple Clearing Members and, as such, each relevant Clearing Member is normally considered to have a beneficial interest in all of the securities collateral of a particular type in the CSD OSA (e.g. UK gilts) proportionate to its holding of such securities as recorded in LCH's books and records.

LCH's books and records constitute evidence of the Clearing Member's beneficial interest in such securities collateral. In the event of LCH's insolvency, an insolvency practitioner may require full reconciliation of LCH's books and records in respect of all accounts prior to release of any securities collateral.

Shortfalls on LCH's Insolvency

If there were a shortfall between the number of securities that LCH is obliged to deliver to Clearing Members (as recorded in LCH's books and records) and the number of securities that LCH holds on behalf of Clearing Members in accounts at the CSD, then this could result in fewer securities than a Clearing Member is entitled to being returned to it on LCH's insolvency. Such a shortfall in the number of securities that LCH holds for Clearing Members, while highly unlikely, could arise for a number of reasons, for example an administrative error.

¹ LCH's own proprietary securities are never held in a CSD ISA or CSD OSA.

Treatment of a Shortfall

Where the shortfall arises in relation to securities collateral held in a CSD ISA, the whole of such shortfall will be attributable to the Clearing Member for whom the account is held and will not be shared with other Clearing Members for whom LCH holds securities collateral. Similarly, the CSD ISA Clearing Member will not be exposed to a shortfall on an account held for another Clearing Member or Clearing Members.

Where the shortfall arises in relation to securities collateral held in a CSD OSA, the shortfall is shared among the Clearing Members with an interest in the securities collateral held in that CSD OSA. In order to calculate Clearing Members' shares of any shortfall in respect of a CSD OSA, each relevant Clearing Member's entitlement to securities collateral held would need to be established as a matter of law and fact, based on LCH's books and records. Any shortfall in a particular security held in a CSD OSA would then be allocated among all Clearing Members with an interest in that security in that account. It is likely that this allocation would be made rateably between Clearing Members with an interest in that security in the CSD OSA, although arguments could be made that in certain circumstances a shortfall in a particular security in a CSD OSA should be attributed to a particular Clearing Member or Clearing Members. This could give rise to delays in returning securities and initial uncertainty for a Clearing Member as to its actual entitlement on an insolvency.

Claim for Losses in respect of a Shortfall

In addition, if a shortfall arose, Clearing Members may have a claim against LCH for any loss suffered as a result of such shortfall and, in LCH's insolvency, would rank as general unsecured creditors for any amounts owing to them in connection with such a claim. Clearing Members would therefore be exposed to the risk that they may not be able to recover all or part of any such amounts claimed.

Security Interests

Security Interest Granted to CSDs

Where the CSD benefits from a security interest over securities collateral held for a Clearing Member, there could be a delay in the return of securities to a Clearing Member (and a possible shortfall) in the event that LCH failed to satisfy its obligations to the CSD and the security interest was enforced. This applies whether the securities are held in a CSD ISA or a CSD OSA. However, in practice, we would expect that a CSD would first seek recourse to any securities held in LCH's own proprietary accounts to satisfy LCH's obligations and only then make use of securities in client accounts.

Security Interest Granted to Third Parties

LCH requires that the securities collateral held for Clearing Members is free of any security interests other than those granted to LCH or a CSD. However, to the extent that other security interests have been granted over such securities collateral, the impact would differ in the case of CSD ISAs and CSD OSAs. Where a Clearing Member purported to grant a security interest over its interest in securities collateral held in a CSD OSA and the security interest was asserted, there could be a delay in the return of securities to all Clearing Members for whom LCH holds securities collateral in the relevant account, including those Clearing Members who had not granted a security interest. However, LCH expects CSDs to refuse to recognise a claim asserted by anyone other than LCH as account holder.

4. Costs

LCH will charge a Clearing Member for each Bilateral CSD ISA it requests, where such charge includes (i) the set up and on-going account maintenance costs and expenses which the relevant CSD charges LCH for the account and which LCH will pass on to the Clearing Member, and (ii) LCH's own set up

and on-going account maintenance costs and expenses for such account. Please refer to the LCH website for details of applicable charges.

The charge for a Bilateral CSD ISA is due to the cost of setting up and maintaining a Bilateral CSD ISA, which is higher than for a CSD OSA and a Triparty CSD ISA as a result of the enhanced level of operational time and resources required in order to effectively operate and monitor such Bilateral CSD ISA and the fact associated costs and expenses cannot be spread amongst multiple Clearing Members as with a CSD OSA. All charges are subject to periodic and on-going review and change by LCH.

5. CSD Disclosures

Each CSD must publish its own disclosure document under, and in accordance with, Article 38(6) of CSDR. Please contact the relevant CSD directly for this.

6. General

This disclosure document does not contain all the information a Clearing Member may need in order to determine which account type (i.e. CSD ISA or CSD OSA) is most suitable for it. It is the responsibility of each Clearing Member to review and conduct its own due diligence on the relevant rules, legal documentation and any other information provided by LCH or a third party. This disclosure document is not intended to constitute advice and should not be relied upon as such. A Clearing Member should seek its own independent advice as to the matters discussed in this document.

7. FCM Clearing Members

Please note, LCH does not currently offer FCM Clearing Members the choice between Individual CSD-Level Segregation or Omnibus CSD-Level Segregation under article 38(5) of CSDR. This is because LCH is a “derivatives clearing organization” registered with the U.S. Commodity Futures Trading Commission and is required to hold, segregate and distribute collateral that an FCM Clearing Member provides to LCH in accordance with applicable U.S. law and regulation.

8. Glossary

Bilateral CSD ISA means a CSD ISA, which is not a Triparty CSD ISA.

CCP means an entity that reduces risk in financial markets by interposing itself between trading counterparties.

Clearing Member means a clearing member of LCH, other than an FCM Clearing Member.

Client means a client of a Clearing Member.

CSD is an entity, which (i) records legal entitlements to securities and operates a system for the settlement of transactions in those securities, and (ii) is authorised or recognised under and in accordance with CSDR.

CSDR means Regulation (EU) No. 909/2014.

FCM Clearing Member means an entity, which is (i) registered as a futures commission merchant with the U.S. Commodity Futures Trading Commission, and (ii) designated and approved as an FCM Clearing Member by LCH.

LCH means LCH Limited.

LCH Rulebook means the LCH regulations and procedures, which are located at www.lch.com/resources/rules-and-regulations/ltd-rulebooks, as amended from time to time.

Triparty CSD ISA means a CSD ISA, which operates by the use of a triparty transaction between LCH, the CSD which operates the CSD ISA and the relevant Clearing Member (or its custodian).

Words which begin with a capital letter in this document, but are not defined above, shall have the meaning set out in the LCH Rulebook.