

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 116 SECURITIES AND EXCHANGE COMMISSION File No.* SR - 2019 - * 009
 WASHINGTON, D.C. 20549
 Form 19b-4 Amendment No. (req. for Amendments *)

Filing by Banque Centrale de Compensation
 Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal	Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
			Rule		
Pilot	Extension of Time Period for Commission Action *	Date Expires *	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>	<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) *	Section 806(e)(2) *
<input type="checkbox"/>	<input type="checkbox"/>
	Section 3C(b)(2) *
	<input type="checkbox"/>

Exhibit 2 Sent As Paper Document **Exhibit 3 Sent As Paper Document**

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

LCH SA is proposing to amend its Reference Guide: CDS Clear Margin Framework in order to allow Index Basis Packages margining as single instrument

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Mohamed Last Name * Meziane
 Title * Senior Regulatory Advisor
 E-mail * mohamed.meziane@lch.com
 Telephone * (000) 000-0000 Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title *)

Date 10/29/2019 Chief Compliance Officer
 By Francois Faure

(Name *)

Francois Faure, francois.faure@lch.com

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

Form 19b-4 Information

Item 1. Text of Proposed Rule Change

(a) Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), is proposing to amend its Reference Guide: CDSClear Margin Framework (the “CDSClear Risk Methodology”) in order to allow Index Basis Packages margining as single instrument.

The text of the proposed rule change has been annexed as Exhibit 5.1.¹

The change in the CDSClear Risk Methodology will be contingent on LCH SA’s receipt of all necessary regulatory approvals.

(b) Not applicable.

(c) Not applicable.

Item 2. Procedure of the Self-Regulatory Organization

LCH SA has completed all of the required actions to be taken to approve and authorize the proposed rule change. The proposed rule change was approved by the LCH SA Executive Risk Committee (“ERCo”) on 03 October 2019. No further approvals to authorize this proposed rule change are necessary.

Questions should be addressed to François Faure, Chief Compliance Officer, at francois.faure@lch.com or +33 1 70 37 65 96; or Mohamed Meziane, Senior Regulatory Advisor, Compliance Department, at mohamed.meziane@lch.com or +33 1 70 37 65 52.

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

Item 3. Self-Regulatory Organization's Statement of Purpose, and Statutory Basis for, the Proposed Rule Change

(a) **Purpose**

LCH SA CDSClear is proposing to amend its CDSClear Risk Methodology in order to consider any relevant and identified Index Basis Packages identified as a single instrument.

1) **Index Basis Package principles**

LCH SA CDSClear currently clears CDS on a number of indices such as iTraxx Main, iTraxx Cross-over, iTraxx Senior Financials as well as all the Single Name constituents of these indices. The iTraxx Subordinated Financials indices will soon be made eligible for clearing as well. Indices and their constituents are currently managed and margined as independent instruments. However, market participants may execute Index Basis Packages consisting of an Index CDS trade and individual Single Name CDS trades on each of the reference entities constituents of such Index perfectly offsetting the index.

The following criteria would need to be required to constitute an Index Basis Package:

- The package is constituted of an Index CDS and Single Names CDS on all the entities constituting the index
- The position (Long /Short) on the Index offsets the positions on the Single Names (Short / Long).
- The notional of the Index and across all the Singles Names match exactly
- All the Single Names CDS trades to have the same currency, coupon and maturity as the Index CDS

- All the Single Name CDS trades to have the same Seniority, ISDA Definition and Restructuring Clause than as constituents of the Index

Clearing Members and/or Clients will be required to identify all trades being part of an Index Basis Package and to notify LCH SA CDSClear. CDSClear would then perform controls to ensure all principles and requirements stated above for qualifying the trades as an Index Basis Package are satisfied and would flag them with a common ID number. These trades will continue to be margined as different trades until these tasks and controls have been fully completed and the qualification as an Index Basis Package confirmed.

Once an Index Basis Package is validated as complete, the margin enhancement proposed in the current rule change would then be applied as part of the overnight margin calculation.

In order to ensure that the trades continue to meet the criteria of an Index Basis Package, controls will be performed every day at the start of the overnight batch process.

Index Basis Packages identified and flagged as such will be excluded from compression runs with the rest of the portfolio in order to avoid breaking any packages.

Index Basis Packages can be un-flagged as such at the Clearing Member and/or Client's request. The Index CDS and the Single Name CDS would then be treated and margined separately as per the current framework.

In case of a Clearing Member's default, CDSClear will have the ability to liquidate Index Basis Packages in a dedicated auction should it be advised to do so by the Default Management Group in order to minimize the liquidation costs.

2) Proposed changes to CDSClear Risk Methodology

In order to take into account the specific risk created by Index Basis Packages positions, LCH SA proposes to amend the calculation of the Spread Margin and the calculation of the Liquidity Charge Margin as described in its Reference Guide, *CDSClear Margin Framework*.

LCH SA CDSClear currently considers an Index Basis Package as multiple instruments in the calculation of its Spread Margin. In accordance with the portfolio margining requirements under Article 27 of Commission Delegated Regulation (EU) No 153/2013² (the “RTS”), LCH SA CDSClear applies a cap of 80% to the possible margin offsets reduction. Therefore the Spread Margin of an Index Basis Package is calculated as the maximum between the expected shortfall of the package and 20% of the sum of the expected shortfalls calculated for each components of the package.

Considering that this does not appropriately reflect the actual risk of an Index Basis Package meeting the criteria stated above, CDSClear is proposing to amend its CDSClear Risk Methodology in order to consider Index Basis Packages identified as such as a single instrument when calculating the amount of margins required. In particular, the 80% cap on offsets between the components of the Index Basis Package would not be applied in the calculation of the Spread Margin, but would be maintained between an Index Basis Package and all the other positions in the portfolio.

In the opinion published in April 2017³ and clarifying the application of Article 27 of the RTS, the European Securities and Market Authority (“ESMA”), acknowledges the low level of risk presented by a package consisting in a future on an

² <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0041:0074:EN:PDF>

³ https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-18_opinion_on_portfolio_margining.pdf

index and futures on each of the constituents of the index and allows a CCP to acknowledge margin reduction in excess of 80% in this specific case.

Considering that an Index Basis Package would likely be sold off in a dedicated auction in case of default of a Clearing Member, LCH SA also proposes to amend the calculation of the Liquidity Charge Margin described in the CDSClear Risk Methodology in order to better reflect the actual cost it would incur when liquidating an Index Basis Package. CDSClear proposes to charge a specific bid/ask spread for each Index family underlying an Index Basis Package identified as such rather than use the current Liquidity Charge Margin algorithm based on charging bid/ask spreads for each individual component in the package taken independently. The current Liquidity Charge Margin methodology will nevertheless remain in the calculation specific to Index Basis Packages identified as such by acting as a cap to the new calculation method.

Finally, Index Basis Packages flagged as such would be excluded from the Recovery Risk, Interest Risk, or Wrong Way Risk Margin calculations as by construction Index Basis Packages are immune to the risks these margins aim at capturing.

No other changes are made to the CDSClear Risk Methodology.

3) Proposed changes to CDSClear Risk Methodology

The CDS Clearing Rulebook, Supplement and Procedures will not need to be amended for the IBP initiative purposes. Only one new Clearing Notice is expected to be published, this notice defines what an IBP is and the procedure to be followed to request a set of Cleared Trades to be identified as an IBP.

(b) Statutory Basis

LCH SA believes that the proposed rule change in connection with the specific margin calculations for Index Basis Packages identified as such is consistent with the

requirements of Section 17A of the Securities Exchange Act of 1934⁴ (the “Act”) and the regulations thereunder, including the standards under Rule 17Ad-22⁵. In particular, Section 17(A)(b)(3)(F)⁶ of the Act requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and derivatives agreements, contracts, and transactions and to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.

As noted above, the proposed rule change is designed to apply specific margin calculations for Index Basis Packages flagged as such in order:

- To appropriately collect and maintain financial resources intended to cover the risks to which LCH SA is exposed in connection with offering clearing services for Index Basis Packages. As such, LCH SA will be able to minimize the risk that losses associated with the default of a participant (or participants) in the clearing service will extend to other participants in the service.
- To reflect the specific features of Index Basis Packages, notably the way that these are executed by market participants, which in turn promotes the prompt and accurate clearance and settlement of securities transactions, derivatives agreements, contracts and transactions and contributes to the safeguarding of securities and funds associated with security-based swap transactions in LCH SA’s custody or control, or for which LCH SA is responsible.

For these reasons, LCH SA believes that the proposed rule change should help promote the prompt and accurate clearance and settlement of securities transactions, derivatives

⁴ 15 U.S.C. 78q-1.

⁵ 17 CFR 240.17Ad-22.

⁶ 15 U.S.C. 78q-1(b)(3)(F).

agreements, contracts and transactions. Similarly, it should enhance LCH SA's ability to help assure the safeguarding of securities and funds which are in the custody or control of LCH SA or for which it is responsible.

LCH SA believes that the proposed changes to the CDSClear Margin Framework and the Default Fund Methodology satisfy the requirements of Rule 17Ad-22(e)⁷.

Rule 17Ad-22(e)(4) requires a covered clearing agency to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing and settlement processes by maintaining sufficient financial resources⁸, and Rule 17Ad-22(e)(6) requires a covered clearing agency that provides central counterparty services to cover its credit exposures to its participants by establishing a risk-based margin system that meets certain minimum requirements⁹.

As described above, LCH SA proposes to amend its CDSClear Methodology Framework to manage the risks associated with the clearing of Index Basis Packages identified as such. Specifically, the proposed rule change amends the Spread Margin calculation for Index Basis Packages by not applying the 80% cap on offsets between the various instruments constituting the package. It also amends the Liquidity Charge Margin by applying a specific bid-ask spread per Index family underlying of an Index Basis Package identified as such in order to reflect the way that those packages trade in the market and would likely be auctioned off in the case of a default of a Clearing Member, as well as by capping the new Liquidity Charge Margin calculation by the amount calculated using the current Liquidity Charge framework based on an

⁷ 17 CFR 240.17Ad-22(e).

⁸ 17 CFR 240.17Ad-22(e)(4)(i)

⁹ 17 CFR 240.17Ad-22(e)(6)(i)

individual bid-ask spread per component of the Index Basis Package. Finally, all the other margins part of the CDSClear Risk Methodology will not be calculated on Index Basis Packages flagged as such as immune to those risks due to the complete offsets between the components of the package.

These changes are designed to use an appropriate risk-based model to set margin requirements and use such margin requirements to limit LCH SA's credit exposures to participants in clearing Index Basis Packages and/or other CDS and CDS Options under normal market conditions, consistent with Rule 17Ad-22(e)(3)¹⁰. LCH SA also believes that its risk-based margin methodology takes into account, and generates margin levels commensurate with the risks and particular attributes of each of Index Basis Packages, other CDS as well as CDS Options at the product and portfolio levels, appropriate to the relevant market it serves, consistent with Rule 17Ad-22(e)(6)(i) and (v)¹¹. In addition, LCH SA believes that the margin calculation under the revised CDSClear Margin Framework would sufficiently account for the 5-day liquidation period for house account portfolios and 7-day liquidation period for client portfolios and therefore, is reasonably designed to cover LCH SA's potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default, consistent with Rule 17Ad-22(e)(6)(iii).¹²

Further, Rule 17Ad-22(e)(4)(ii)¹³ requires a covered clearing agency that provides central counterparty services for security-based swaps to maintain financial

¹⁰ 17 CFR 240.17Ad-22(e)(3)

¹¹ 17 CFR 240.17Ad-22(e)(6)(i) and (v)

¹² 17 CFR 240.17Ad-22(e)(6)

¹³ 17 CFR 240.17Ad-22(e)(4)(ii)

resources additional to margin to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, meeting the cover two standard¹⁴. LCH SA believes that its Default Fund Methodology, not being impacted by the proposed rule change, will therefore still appropriately incorporate the risk of clearing Index Basis Packages, CDS, and CDS Options which, together with the proposed changes to the CDSClear Margin Framework, will be reasonably designed to ensure that LCH SA maintains sufficient financial resources to meet the cover two standard, in accordance with Rule 17Ad-22(e)(4)(ii)¹⁵.

LCH SA also believes that the proposed rule changes are consistent with the provisions of Rule 17Ad-22(e)(17)¹⁶ requiring that a covered clearing agency to manage operational risks by (i) identifying the plausible sources of operational risk, both internal and external, and mitigating their impact through the use of appropriate systems, policies, procedures, and controls; (ii) ensuring that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity; and (iii) establishing and maintaining a business continuity plan that addresses events posing a significant risk of disrupting operations.

As stated above LCH SA will flag each component of an Index Basis Package using a common ID number to ensure complete identification of the package and perform checks to ensure all principles and requirements for qualifying as an Index Basis Package are satisfied. No margin enhancement will be given until the full Index Basis Package is complete. Once an Index Basis Package is validated as complete, the

¹⁴ 17 CFR 240.17Ad-22(e)(4)(ii)

¹⁵ 17 CFR 240.17Ad-22(b)(3) and (e)(4)(ii)

¹⁶ 17 CFR 240.17Ad-22(e)(17)

specific margin calculations will then be applied as part of the overnight margin calculation.

LCH SA will also implement additional automated controls in its systems performed daily to ensure all the requirements are met on a continuous basis.

Index Basis Packages will be excluded from compressions with the rest of the portfolio in order to avoid being broken up.

LCH SA will update its operational procedures and IT systems to ensure all the above is adequately implemented and operational risk reduced to a very minimum.

Rule 17Ad-22(e)(2)¹⁷ requires LCH SA to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Act¹⁸.

LCH SA's governance arrangements clearly assign and document responsibility for risk decisions and require consultation with or approval from the LCH SA Board, Risk committees, or management. LCH SA's proposed rule change was decided in accordance with the LCH SA governance process, which included review of the changes to the CDSClear Margin Framework and related risk management considerations by the LCH SA Executive Risk Committee. These governance arrangements continue to be clear and transparent, such that information relating to the assignment of responsibilities for risk decisions and the requisite involvement of the LCH SA Board, committees, and management is clearly documented, consistent with the requirements of Rule 17Ad-22(e)(2)¹⁹.

¹⁷ 17 CFR 240.17Ad-22(e)(2)

¹⁸ 15 U.S.C. 78q-1.

¹⁹ 17 CFR 240.17Ad-22(e)(2)

For the reasons stated above, LCH SA believes that the proposed rule change is consistent with the requirements of prompt and accurate clearance and settlement of securities transactions, and assuring the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible, in accordance with Section 17A(b)(3)(F)²⁰ of the Act, with the requirements of operational risk management in Rule 17Ad-22(e)(17)²¹, and with clear and transparent governance arrangements in Rule 17Ad-22(e)(2)²².

Item 4. Self-Regulatory Organization's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act²³, LCH SA does not believe that the proposed rule change would impose burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Act. Specifically, the proposed changes to the CDSClear Margin Framework, would apply equally to all Clearing Members and Clients whose portfolios include Index Basis Packages as long as a request to identify them as such was received by LCH SA and the controls performed confirmed the completeness of the package. Because the margin methodology is risk-based, consistent with the requirements in Rule 17Ad-22(b)(2) and (e)(6), depending on a Clearing Member's portfolio, each Clearing Member would be subject to a margin requirement commensurate with the risk particular to its portfolio. Such margin requirement impose burdens on a Clearing Member but such burdens would be necessary and appropriate to manage LCH SA's

²⁰ 15 U.S.C. 78q-1(b)(3)(F).

²¹ 17 CFR 240.17Ad-22(e)(17).

²² 17 CFR 240.17Ad-22(e)(2).

²³ 15 U.S.C. 78q-1(b)(3)(I).

credit exposures to its CDSClear participants consistent with the requirements under the Act as described above.

Therefore, LCH SA does not believe that the proposed rule change would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

Item 5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments relating to the proposed rule change have not been solicited or received. LCH SA will notify the Commission of any written comments received by LCH SA.

Item 6. Extension of Time Period for Commission Action

LCH SA does not consent to the extension of the time period listed in Section 19(b)(2) of the Securities Exchange Act of 1934 for Commission action.

Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

- (a) Not applicable.
- (b) Not applicable.
- (c) Not applicable.
- (d) Not applicable.

Item 8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or the Commission

The proposed rule change is not based on the rules of another self-regulatory organization or the Commission.

Item 9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

Item 10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

Item 11. Exhibits

Exhibit 1 – Not Applicable

Exhibit 1A – Notice of proposed rule change for publication in the Federal Register.

Exhibit 2 – Not Applicable

Exhibit 3 – Not Applicable

Exhibit 4 – Not Applicable

Exhibit 5 – Text of the proposed rule change.

➤ Amended CDSClear Reference Guide: **Omitted and filed separately with the Commission. Confidential treatment pursuant to 17 CFR 240.24b-2 being requested.**

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Banque Centrale de Compensation has caused this filing to be signed on its behalf by the undersigned hereunto duly authorized.

BANQUE CENTRALE DE COMPENSATION

A handwritten signature in black ink, appearing to read 'Faure', is written over a horizontal line.

By: _____

Francois Faure

Chief Compliance Officer

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION

(Release No. - ; File No. SR-LCH SA-2019-009)

[DATE]

Self-Regulatory Organizations; LCH SA; Proposed Rule Change Relating to amendments to CDSClear Reference Guide to allow Index Basis Packages margining.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder² notice is hereby given that on _____, 2019, Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I, II and III below, which Items have been prepared primarily by LCH SA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), is proposing to amend its (i) Reference Guide: CDSClear Margin Framework (the “CDSClear Risk Methodology”) in order to allow Index Basis Packages margining as single instrument.

The text of the proposed rule change has been annexed as Exhibit 5.³

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ All capitalized terms not defined herein have the same definition as the Rule Book, Supplement or Procedures, as applicable.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

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

A. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.

1. Purpose

LCH SA CDSClear is proposing to amend its CDSClear Risk Methodology in order to consider any relevant and identified Index Basis Packages identified as a single instrument.

a) Index Basis Package principles

LCH SA CDSClear currently clears CDS on a number of indices such as iTraxx Main, iTraxx Cross-over, iTraxx Senior Financials as well as all the Single Name constituents of these indices. The iTraxx Subordinated Financials indices will soon be made eligible for clearing as well. Indices and their constituents are currently managed and margined as independent instruments. However, market participants may execute Index Basis Packages consisting of an Index CDS trade and individual Single Name CDS trades on each of the reference entities constituents of such Index perfectly offsetting the index.

The following criteria would need to be required to constitute an Index Basis Package:

- The package is constituted of an Index CDS and Single Names CDS on all the entities constituting the index
- The position (Long /Short) on the Index offsets the positions on the Single Names (Short / Long).
- The notional of the Index and across all the Singles Names match exactly
- All the Single Names CDS trades to have the same currency, coupon and maturity as the Index CDS
- All the Single Name CDS trades to have the same Seniority, ISDA Definition and Restructuring Clause than as constituents of the Index

Clearing Members and/or Clients will be required to identify all trades being part of an Index Basis Package and to notify LCH SA CDSClear. CDSClear would then perform controls to ensure all principles and requirements stated above for qualifying the trades as an Index Basis Package are satisfied and would flag them with a common ID number. These trades will continue to be margined as different trades until these tasks and controls have been fully completed and the qualification as an Index Basis Package confirmed.

Once an Index Basis Package is validated as complete, the margin enhancement proposed in the current rule change would then be applied as part of the overnight margin calculation.

In order to ensure that the trades continue to meet the criteria of an Index Basis Package, controls will be performed every day at the start of the overnight batch process.

Index Basis Packages identified and flagged as such will be excluded from compression runs with the rest of the portfolio in order to avoid breaking any packages.

Index Basis Packages can be un-flagged as such at the Clearing Member and/or Client's request. The Index CDS and the Single Name CDS would then be treated and margined separately as per the current framework.

In case of a Clearing Member's default, CDSClear will have the ability to liquidate Index Basis Packages in a dedicated auction should it be advised to do so by the Default Management Group in order to minimize the liquidation costs.

b) Proposed changes to CDSClear Risk Methodology

In order to take into account the specific risk created by Index Basis Packages positions, LCH SA proposes to amend the calculation of the Spread Margin and the calculation of the Liquidity Charge Margin as described in its Reference Guide, *CDSClear Margin Framework*.

LCH SA CDSClear currently considers an Index Basis Package as multiple instruments in the calculation of its Spread Margin. In accordance with the portfolio margining requirements under Article 27 of Commission Delegated Regulation (EU) No 153/2013⁴ (the "RTS"), LCH SA CDSClear applies a cap of 80% to the possible margin offsets reduction. Therefore the Spread Margin of an Index Basis Package is calculated as the maximum between the expected shortfall of the package and 20% of the sum of the expected shortfalls calculated for each components of the package.

Considering that this does not appropriately reflect the actual risk of an Index Basis Package meeting the criteria stated above, CDSClear is proposing to amend its

⁴ <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0041:0074:EN:PDF>

CDSClear Risk Methodology in order to consider Index Basis Packages identified as such as a single instrument when calculating the amount of margins required. In particular, the 80% cap on offsets between the components of the Index Basis Package would not be applied in the calculation of the Spread Margin, but would be maintained between an Index Basis Package and all the other positions in the portfolio.

In the opinion published in April 2017⁵ and clarifying the application of Article 27 of the RTS, the European Securities and Market Authority (“ESMA”), acknowledges the low level of risk presented by a package consisting in a future on an index and futures on each of the constituents of the index and allows a CCP to acknowledge margin reduction in excess of 80% in this specific case.

Considering that an Index Basis Package would likely be sold off in a dedicated auction in case of default of a Clearing Member, LCH SA also proposes to amend the calculation of the Liquidity Charge Margin described in the CDSClear Risk Methodology in order to better reflect the actual cost it would incur when liquidating an Index Basis Package. CDSClear proposes to charge a specific bid/ask spread for each Index family underlying an Index Basis Package identified as such rather than use the current Liquidity Charge Margin algorithm based on charging bid/ask spreads for each individual component in the package taken independently. The current Liquidity Charge Margin methodology will nevertheless remain in the calculation specific to Index Basis Packages identified as such by acting as a cap to the new calculation method.

Finally, Index Basis Packages flagged as such would be excluded from the Recovery Risk, Interest Risk, or Wrong Way Risk Margin calculations as by

⁵ https://www.esma.europa.eu/sites/default/files/library/esma70-708036281-18_opinion_on_portfolio_margining.pdf

construction Index Basis Packages are immune to the risks these margins aim at capturing.

No other changes are made to the CDSClear Risk Methodology.

c) Proposed changes to CDSClear Risk Methodology

The CDS Clearing Rulebook, Supplement and Procedures will not need to be amended for the IBP initiative purposes. Only one new Clearing Notice is expected to be published, this notice defines what an IBP is and the procedure to be followed to request a set of Cleared Trades to be identified as an IBP.

2. Statutory Basis.

LCH SA believes that the proposed rule change in connection with the specific margin calculations for Index Basis Packages identified as such is consistent with the requirements of Section 17A of the Securities Exchange Act of 1934⁶ (the “Act”) and the regulations thereunder, including the standards under Rule 17Ad-22⁷. In particular, Section 17(A)(b)(3)(F)⁸ of the Act requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and derivatives agreements, contracts, and transactions and to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.

As noted above, the proposed rule change is designed to apply specific margin calculations for Index Basis Packages flagged as such in order:

⁶ 15 U.S.C. 78q-1.

⁷ 17 CFR 240.17Ad-22.

⁸ 15 U.S.C. 78q-1(b)(3)(F).

- To appropriately collect and maintain financial resources intended to cover the risks to which LCH SA is exposed in connection with offering clearing services for Index Basis Packages. As such, LCH SA will be able to minimize the risk that losses associated with the default of a participant (or participants) in the clearing service will extend to other participants in the service.
- To reflect the specific features of Index Basis Packages, notably the way that these are executed by market participants, which in turn promotes the prompt and accurate clearance and settlement of securities transactions, derivatives agreements, contracts and transactions and contributes to the safeguarding of securities and funds associated with security-based swap transactions in LCH SA's custody or control, or for which LCH SA is responsible.

For these reasons, LCH SA believes that the proposed rule change should help promote the prompt and accurate clearance and settlement of securities transactions, derivatives agreements, contracts and transactions. Similarly, it should enhance LCH SA's ability to help assure the safeguarding of securities and funds which are in the custody or control of LCH SA or for which it is responsible.

LCH SA believes that the proposed changes to the CDSClear Margin Framework and the Default Fund Methodology satisfy the requirements of Rule 17Ad-22(e)⁹.

Rule 17Ad-22(e)(4) requires a covered clearing agency to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing and settlement processes by maintaining sufficient financial

⁹ 17 CFR 240.17Ad-22(e).

resources¹⁰, and Rule 17Ad-22(e)(6) requires a covered clearing agency that provides central counterparty services to cover its credit exposures to its participants by establishing a risk-based margin system that meets certain minimum requirements¹¹.

As described above, LCH SA proposes to amend its CDSClear Methodology Framework to manage the risks associated with the clearing of Index Basis Packages identified as such. Specifically, the proposed rule change amends the Spread Margin calculation for Index Basis Packages by not applying the 80% cap on offsets between the various instruments constituting the package. It also amends the Liquidity Charge Margin by applying a specific bid-ask spread per Index family underlying of an Index Basis Package identified as such in order to reflect the way that those packages trade in the market and would likely be auctioned off in the case of a default of a Clearing Member, as well as by capping the new Liquidity Charge Margin calculation by the amount calculated using the current Liquidity Charge framework based on an individual bid-ask spread per component of the Index Basis Package. Finally, all the other margins part of the CDSClear Risk Methodology will not be calculated on Index Basis Packages flagged as such as immune to those risks due to the complete offsets between the components of the package.

These changes are designed to use an appropriate risk-based model to set margin requirements and use such margin requirements to limit LCH SA's credit exposures to participants in clearing Index Basis Packages and/or other CDS and CDS Options under

¹⁰ 17 CFR 240.17Ad-22(e)(4)(i)

¹¹ 17 CFR 240.17Ad-22(e)(6)(i)

normal market conditions, consistent with Rule 17Ad-22(e)(3)¹². LCH SA also believes that its risk-based margin methodology takes into account, and generates margin levels commensurate with the risks and particular attributes of each of Index Basis Packages, other CDS as well as CDS Options at the product and portfolio levels, appropriate to the relevant market it serves, consistent with Rule 17Ad-22(e)(6)(i) and (v)¹³. In addition, LCH SA believes that the margin calculation under the revised CDSClear Margin Framework would sufficiently account for the 5-day liquidation period for house account portfolios and 7-day liquidation period for client portfolios and therefore, is reasonably designed to cover LCH SA's potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default, consistent with Rule 17Ad-22(e)(6)(iii)¹⁴.

Further, Rule 17Ad-22(e)(4)(ii)¹⁵ requires a covered clearing agency that provides central counterparty services for security-based swaps to maintain financial resources additional to margin to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, meeting the cover two standard. LCH SA believes that its Default Fund Methodology, not being impacted by the proposed rule change, will therefore still appropriately incorporate the risk of clearing Index Basis Packages, CDS, and CDS Options which, together with the proposed changes to the CDSClear Margin Framework, will be reasonably designed to ensure that LCH SA

¹² 17 CFR 240.17Ad-22(e)(3)

¹³ 17 CFR 240.17Ad-22(e)(6)(i) and (v)

¹⁴ 17 CFR 240.17Ad-22(e)(6)(iii)

¹⁵ 17 CFR 240.17Ad-22(e)(4)(ii)

maintains sufficient financial resources to meet the cover two standard, in accordance with Rule 17Ad-22(e)(4)(ii)¹⁶.

LCH SA also believes that the proposed rule changes are consistent with the provisions of Rule 17Ad-22(e)(17)¹⁷ requiring a covered clearing agency to manage operational risks by (i) identifying the plausible sources of operational risk, both internal and external, and mitigating their impact through the use of appropriate systems, policies, procedures, and controls; (ii) ensuring that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity; and (iii) establishing and maintaining a business continuity plan that addresses events posing a significant risk of disrupting operations¹⁸.

As stated above LCH SA will flag each component of an Index Basis Package using a common ID number to ensure complete identification of the package and perform checks to ensure all principles and requirements for qualifying as an Index Basis Package are satisfied. No margin enhancement will be given until the full Index Basis Package is complete. Once an Index Basis Package is validated as complete, the specific margin calculations will then be applied as part of the overnight margin calculation.

LCH SA will also implement additional automated controls in its systems performed daily to ensure all the requirements are met on a continuous basis.

Index Basis Packages will be excluded from compressions with the rest of the portfolio in order to avoid being broken up.

¹⁶ 17 CFR 240.17Ad-22(e)(4)(ii)

¹⁷ 17 CFR 240.17Ad-22(e)(17)

¹⁸ 17 CFR 240.17Ad-22(e)(17)

LCH SA will update its operational procedures and IT systems to ensure all the above is adequately implemented and operational risk reduced to a very minimum.

Rule 17Ad-22(e)(2)¹⁹ requires LCH SA to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Act²⁰.

LCH SA's governance arrangements clearly assign and document responsibility for risk decisions and require consultation with or approval from the LCH SA Board, Risk committees, or management. LCH SA's proposed rule change was decided in accordance with the LCH SA governance process, which included review of the changes to the CDSClear Margin Framework and related risk management considerations by the LCH SA Executive Risk Committee. These governance arrangements continue to be clear and transparent, such that information relating to the assignment of responsibilities for risk decisions and the requisite involvement of the LCH SA Board, committees, and management is clearly documented, consistent with the requirements of Rule 17Ad-22(e)(2)²¹.

For the reasons stated above, LCH SA believes that the proposed rule change is consistent with the requirements of prompt and accurate clearance and settlement of securities transactions, and assuring the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible, in accordance with Section 17A(b)(3)(F)²² of the Act, with the requirements of operational risk

¹⁹ 17 CFR 240.17Ad-22(e)(2)

²⁰ 15 U.S.C. 78q-1.

²¹ 17 CFR 240.17Ad-22(e)(2)

²² 15 U.S.C. 78q-1(b)(3)(F).

management in Rule 17Ad-22(e)(17)²³, and with clear and transparent governance arrangements in Rule 17Ad-22(e)(2)²⁴.

B. Clearing Agency's Statement on Burden on Competition.

Section 17A(b)(3)(I) of the Act requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act²⁵, LCH SA does not believe that the proposed rule change would impose burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Act. Specifically, the proposed changes to the CDSClear Margin Framework, would apply equally to all Clearing Members and Clients whose portfolios include Index Basis Packages as long as a request to identify them as such was received by LCH SA and the controls performed confirmed the completeness of the package. Because the margin methodology is risk-based, consistent with the requirements in Rule 17Ad-22(b)(2) and (e)(6), depending on a Clearing Member's portfolio, each Clearing Member would be subject to a margin requirement commensurate with the risk particular to its portfolio. Such margin requirement impose burdens on a Clearing Member but such burdens would be necessary and appropriate to manage LCH SA's credit exposures to its CDSClear participants consistent with the requirements under the Act as described above.

Therefore, LCH SA does not believe that the proposed rule change would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

²³ 17 CFR 240.17Ad-22(e)(17).

²⁴ 17 CFR 240.17Ad-22(e)(2).

²⁵ 15 U.S.C. 78q-1(b)(3)(I).

C. Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments relating to the proposed rule change have not been solicited or received. LCH SA will notify the Commission of any written comments received by LCH SA.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-LCH SA-2019-009 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-LCH SA-2019-005. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of LCH SA and on LCH SA's website at: <https://www.lch.com/resources/rules-and-regulations/proposed-rule-changes-0>. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-LCH SA-2019-009 and should be submitted on or before [Commission to insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to
delegated authority.²⁶

Secretary

²⁶ 17 CFR 200.30-3(a)(12).

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