

**Via CFTC Portal**

03<sup>rd</sup> July 2019

**Ms. Abigail S. Knauff**

Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street NW  
Three Lafayette Centre  
Washington DC 20581

Dear Ms. Abigail S. Knauff,

Pursuant to CFTC regulation §40.6(a), LCH SA, a derivatives clearing organization (“**DCO**”) registered with the Commodity Futures Trading Commission (the “**CFTC**”), is submitting for self-certification the proposed amendments to the CDS Clearing Rule Book, CDS Clearing Supplement, and CDS Clearing Procedures (the “**Rules**”) in order to incorporate additional changes made to the Rules certified with the CFTC<sup>1</sup> in order to implement the “settled-to-market” (“**STM**”) treatment of variation margin.

The intended date of implementation is July 18<sup>th</sup>, 2019, subject to any relevant regulatory review or approval process duly completed and in no event, the changes will be implemented earlier than ten (10) business days after the formal filing with the CFTC.

The submission changes made to the Rules are attached hereto as Appendix.

**Part I: Explanation and Analysis**

LCH SA is proposing to add a few minor changes to the Rules recently certified in order to duly implement the STM treatment of variation margin.

**Part II: Description of Rule changes**

**1) CDS Clearing Rule Book:**

The definition of “Converting Clearing Member” in Section 1.1.1 has been amended for clarification purposes.

In Article 4.2.3.2, the reference to “in” will be replaced with “into” and the relevant reference to “Irrevocable Backloading STM Transactions” will be added under article 4.2.5.1.

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<sup>1</sup> [https://www.lch.com/sites/default/files/media/files/LCHSA\\_CDS\\_Clear\\_STM\\_CFTC%20Self%20Cert%2BApp\\_26%20Feb%202019.p df](https://www.lch.com/sites/default/files/media/files/LCHSA_CDS_Clear_STM_CFTC%20Self%20Cert%2BApp_26%20Feb%202019.p df)

**2) CDS Clearing Supplement:**

It is proposed to replace “in” with “into” in indent (iv) of paragraph (a) of: Section 2.6 (*Terms of STM Cleared Transaction*) in Part A, Section 2.6 (*Terms of STM Cleared Transaction*) in Part B and Section 2.4 (*Terms of STM Cleared Transaction*) in Part C of the CDS Clearing Supplement.

**3) Section 1 of the Procedures:**

In paragraph 1.1 (b), it is proposed to clarify:

- the indicative timeline for the application process by replacing any reference to a “Day” with a reference to a “Business Day”;
- that the CDSClear Application Form is available “on demand”; and
- that the due diligence “visit” shall mean a reference to an “on-site” visit

**4) Section 2 of the Procedures:**

The change to the name of the Section 2 of the Procedures to add a reference to “NPV Payment” needs to be reflected in the summary and in the first paragraph of page 1.

The definition of "Price Alignment Amount Rate" under paragraph 2.17 is also modified and aligned.

Other minor corrections have been made to paragraphs 2.14 and 2.17.

**5) Section 5 of the Procedures:**

The typing error referring to “STM Trade Account” was changed into “CTM Trade Account” in paragraph 5.11 (d) (iv).

**Part III: Core Principle Compliance**

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

**Part IV: Public Information**

LCH SA has posted a notice of pending certifications with the CFTC and a copy of the submission on LCH’s website at: <https://www.lch.com/resources/rules-and-regulations/proposed-rule-changes>

**Part V: Opposing Views**

There were no opposing views expressed to LCH SA by governing board or committee members, members of LCH SA that were not incorporated into the rules.

**Certification**

LCH SA hereby certifies to the CFTC, pursuant to the procedures set forth in the Commission regulation §40.6, that this change submission complies with the Commodity Exchange Act, as amended, and the regulations promulgated there under.

Should you have any questions please contact me at: [françois.faure@lch.com](mailto:françois.faure@lch.com)

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

**Francois Faure**  
Chief Compliance Officer  
+33 1 70 37 65 96

## **APPENDIX**

**Draft CDS Clearing Rule Book, CDS Clearing Procedures and CDS Clearing Supplement including the proposed rule changes**

## Extracts from the draft CDS Clearing Rule Book

[...]

**Converting Clearing Member:** [A Clearing Member which has submitted LCH SA a request to convert its CTM Trade Account\(s\) into STM Trade Account\(s\) according to Article 3.1.10.8.](#)

[...]

**Payment Failure:** Any failure by a Clearing Member to, by the due time, transfer, deliver, deposit with or pay to LCH SA:

- (i) any or all Price Alignment Interest, Price Alignment Amount, Initial Payment Amount, Fixed Amounts, Premiums, cash amounts due upon the occurrence of a Credit Event, securities, deliverable obligations or assets owed to LCH SA or to another Clearing Member in respect of Cleared Transactions registered in the name of the Defaulting Clearing Member with LCH SA;
- (ii) subject to Article 4.2.3.3(iii) Collateral to satisfy its Margin Requirements (including but limited to Spread Margin, Additional Margin, Short Charge Margin, Self-Referencing Protection Margin, Recovery Risk Margin, Interest Rate Risk Margin, Wrong Way Risk Margin, Accrued Fixed Amount Liquidation Risk Margin, Credit Event Margin, Concentration Risk Margin, Credit Quality Margin, Extraordinary Margin, Contingency Variation Margin or any additional Margin imposed by LCH SA pursuant to Article 4.2.1.2);
- (iii) Collateral to satisfy its Contribution Requirement;
- (iv) Variation Margin to satisfy its Variation Margin Requirement; and
- (v) NPV Amount to satisfy its NPV Payment Requirement.

[...]

### Article 4.2.3.2

As set out in Section 3 of the Procedures, LCH SA will make a Collateral Call of an amount equal to the Required Collateral Amount in accordance with Section 3 of the Procedures.

At the same time as each Collateral Call (other than an Additional Collateral Call), except as otherwise provided for in the Procedures, each Clearing Member or LCH SA, as the case may be, shall also be required to (i) make an NPV Payment to satisfy the NPV Payment Requirement and/or (ii) make a Variation Margin Collateral Transfer to LCH SA to satisfy the Variation Margin Requirement applicable

to each of the Clearing Member's Margin Accounts. Such NPV Payments and/or Variation Margin Collateral Transfers shall be made in the currency as provided for in Section 3 of the Procedures.

By exception to the above, in any circumstance preventing the NPV Payments or Variation Margin Collateral Transfers from being performed in US Dollar, LCH SA shall be entitled, and inform the Clearing Members of its intention, to convert any amount denominated in US Dollar ~~in~~ into Euro, such conversion to be effected at the prevailing rate of exchange at the time of conversion and therefore, the NPV Payments and/or Variation Margin Collateral Transfers obligations shall be performed in Euro, in accordance with Section 3 of the Procedures.

All payments and/or transfers required to be made, in accordance with this Article 4.2.3.2, will be netted in the manner set out in Section 3 of the Procedures.

[...]

#### **Article 4.2.5.1**

In order to manage the risk of price fluctuations occurring in respect of a Clearing Member's CTM Cleared Transactions and/or STM Cleared Transactions, as applicable (and, as the case may be, Irrevocable Backloading CTM Transactions [and/or Irrevocable Backloading STM Transactions](#), which are not Rejected Transactions), LCH SA and/or the Clearing Member (as applicable) shall be required to make Variation Margin Collateral Transfers or NPV Payments (as applicable) to meet (i) with respect to CTM Cleared Transactions (or Irrevocable Backloading CTM Transactions), the House Variation Margin Requirement and the Client Variation Margin Requirement(s) and (ii) with respect to STM Cleared Transactions (or Irrevocable Backloading STM Transactions), the House NPV Payment Requirement and the Client NPV Payment Requirement(s), when such amounts are due and payable.

## Extracts from the draft CDS Clearing Supplement

### PART A

#### CDS CLEARING SUPPLEMENT

##### FOR INDEX CLEARED TRANSACTIONS AND SINGLE NAME TRANSACTIONS INCORPORATING THE 2003 ISDA CREDIT DERIVATIVES DEFINITIONS

[...]

#### 2.6 Terms of STM Cleared Transaction

The following terms of a registered STM Cleared Transaction are designated as the “**STM Cleared Terms**”.

If a Cleared Transaction is designated as an STM Cleared Transaction in accordance with Article 3.1.10.7 of the CDS Clearing Rule Book the terms of such Cleared Transaction will automatically, and without any further action by either party, include the STM Cleared Terms.

(a) **Net present value**

- (i) LCH SA shall, at least once per Cash Payment Day, determine the net present value of this STM Cleared Transaction in such manner and at such times as may be provided in Section 2 of the Procedures.
- (ii) Immediately upon LCH SA making such a determination of the net present value of this STM Cleared Transaction:
  - (A) An amount (determined in accordance with Section 2.14 (*NPV Amount*) of the Procedures) of cash may become due and payable by the Clearing Member or LCH SA (as applicable, and as determined in accordance with Section 2.14 (*NPV Amount*) of the Procedures) under these STM Cleared Terms; and
  - (B) the net present value of this STM Cleared Transaction shall for all purposes be reset to zero.
- (iii) The amount (if any) referred to in (ii)(A) above shall immediately become due and payable by the relevant party under the STM Cleared Terms applicable to this STM Cleared Transaction and shall be made in such manner and at such times as may be provided in Section 2 of the Procedures.
- (iv) In any circumstance preventing the NPV Payments or Variation Margin Collateral Transfers from being performed in US Dollar, LCH SA shall be entitled to convert any amount denominated in US Dollar ~~to~~ into Euro in accordance with Article 4.2.3.2 of the CDS Clearing Rule Book.

[...]

**PART B**

**CDS CLEARING SUPPLEMENT**

**FOR INDEX CLEARED TRANSACTIONS AND SINGLE NAME TRANSACTIONS INCORPORATING THE  
2014 ISDA CREDIT DERIVATIVES DEFINITIONS**

[...]

**2.6 Terms of STM Cleared Transaction**

The following terms of a registered STM Cleared Transaction are designated as the “**STM Cleared Terms**”.

If a Cleared Transaction is designated as an STM Cleared Transaction in accordance with Article 3.1.10.7 of the CDS Clearing Rule Book the terms of such Cleared Transaction will automatically, and without any further action by either party, include the STM Cleared Terms.

**(a) Net present value**

- (i) LCH SA shall, at least once per Cash Payment Day, determine the net present value of this STM Cleared Transaction in such manner and at such times as may be provided in Section 2 of the Procedures.
- (ii) Immediately upon LCH SA making such a determination of the net present value of this STM Cleared Transaction:
  - (A) An amount (determined in accordance with Section 2.14 (*NPV Amount*) of the Procedures) of cash may become due and payable by the Clearing Member or LCH SA (as applicable, and as determined in accordance with Section 2.14 (*NPV Amount*) of the Procedures) under these STM Cleared Terms; and
  - (B) the net present value of this STM Cleared Transaction shall for all purposes be reset to zero.
- (iii) The amount (if any) referred to in (ii)(A) above shall immediately become due and payable by the relevant party under the STM Cleared Terms applicable to this STM Cleared Transaction and shall be made in such manner and at such times as may be provided in Section 2 of the Procedures.
- (iv) In any circumstance preventing the NPV Payments or Variation Margin Collateral Transfers from being performed in US Dollar, LCH SA shall be entitled to convert any amount denominated in US Dollar ~~to~~ [into](#) Euro in accordance with Article 4.2.3.2 of the CDS Clearing Rule Book.

[...]



**PART C**  
**CDS CLEARING SUPPLEMENT**  
**FOR CREDIT INDEX SWAPTIONS**

[...]

**2.4 Terms of STM Cleared Transaction**

The following terms of a registered STM Cleared Transaction are designated as the “**STM Cleared Terms**”.

If a Cleared Transaction is designated as an STM Cleared Transaction in accordance with Article 3.1.10.7 of the CDS Clearing Rule Book the terms of such Cleared Transaction will automatically, and without any further action by either party, include the STM Cleared Terms.

**(a) Net present value**

- (i) LCH SA shall, at least once per Cash Payment Day, determine the net present value of this STM Cleared Transaction in such manner and at such times as may be provided in Section 2 of the Procedures.
- (ii) Immediately upon LCH SA making such a determination of the net present value of this STM Cleared Transaction:
  - (A) An amount (determined in accordance with Section 2.14 (*NPV Amount*) of the Procedures) of cash may become due and payable by the Clearing Member or LCH SA (as applicable, and as determined in accordance with Section 2.14 (*NPV Amount*) of the Procedures) under these STM Cleared Terms; and
  - (B) the net present value of this STM Cleared Transaction shall for all purposes be reset to zero.
- (iii) The amount (if any) referred to in (ii)(A) above shall immediately become due and payable by the relevant party under the STM Cleared Terms applicable to this STM Cleared Transaction and shall be made in such manner and at such times as may be provided in Section 2 of the Procedures.
- (iv) In any circumstance preventing the NPV Payments or Variation Margin Collateral Transfers from being performed in US Dollar, LCH SA shall be entitled to convert any amount denominated in US Dollar ~~to~~ [into](#) Euro in accordance with Article 4.2.3.2 of the CDS Clearing Rule Book.

[...]

## Extracts from the draft Section 1 of the Procedures

[...]

### 1.1 APPLICATION PROCEDURE

(a) Indicative timeline for an application

The following is an indicative, non-binding timeline for the processing of an application. The exact period to process an application will depend on the circumstances; for example, the period may be longer where LCH SA requests that the Applicant provides further information or a legal opinion is required to be issued.

(b) Application Process

**Business Day 1**

An Applicant shall submit a query to LCH SA's CDSClear Business Development & Relationship Management team, which, in turn, will request such Applicant to provide the LCH SA's application form relating to the CDS Clearing Service which is available on ~~the Website~~ [demand](#) (the "**CDSClear Application Form**") and other supporting documents such as, in particular and as a matter of priority:

- (i) the most recent annual financial statements along with any interim statements of such Applicant; and
- (ii) details of any implicit or explicit support available from group or external entities.

Following receipt of the information and documents listed in sub-paragraphs (i) and (ii) above, LCH SA will carry out an initial review to assess the credit risk of the Applicant. LCH SA shall endeavour to review the information and documents within 5 Business Days from receipt by LCH SA but owes no duty or obligation to the Applicant to do so.

Following completion of the initial review, LCH SA will:

- (x) either confirm that the application process may continue. In such a case, the next steps of the application process as set out in sub-paragraphs (c) to (f) below will apply; or
- (y) refuse admission of the Applicant.

The decision of LCH SA shall be communicated to the Applicant. Where an Applicant was refused admission, the decision of LCH SA will indicate the reasons why membership was refused.

The application process, other than the initial review mentioned above in this paragraph (b), shall start upon receipt of all the supporting documents requested by LCH SA.

### **Business Day 1 to 30**

Following receipt of the duly completed CDSClear Application Form and all required supporting documents by LCH SA (including any additional information or documents requested by LCH SA) the application is reviewed by LCH SA and due diligence is carried out on the Applicant which may include [an on-site visit](#).

Further to such review and due diligence, and subject to internal approval by LCH SA of the Applicant's application, the Applicant and LCH SA shall execute the Admission Agreement and the Access Agreement.

Where the country of incorporation of the Applicant is not covered by an existing legal opinion, which will require LCH SA to provide the relevant legal opinion, the indicative timeline as set out in this sub-paragraph (b) will be extended from 30 Business Days to 40 Business Days from receipt of the CDSClear Application Form and required supporting documents by LCH SA (including any additional information or documents requested by LCH SA).

### **Business Day 30**

Application is either: rejected or accepted.

[...]

- (d) Due diligence and review process

[...]

As part of the review process one or more LCH SA representatives (which may include any of LCH SA's third party advisers) may carry out one or more on-site visit(s) to the Applicant's operations office. LCH SA will give an Applicant reasonable advance notice of any proposed visit. An Applicant may refuse access to any or all LCH SA representatives or third party advisers but any such refusal of access may result in the application process being delayed and/or LCH SA being unable to process the Applicant's application. During this visit the Applicant should be able to show the LCH SA representatives the following:

- (i) operational personnel – who may be questioned to identify their individual knowledge of CDS and, as the case may be, Index Swaptions;
- (ii) computer systems; and
- (iii) on-site procedures.

## Extracts from the draft Section 2 of the Procedures

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Capitalised terms used in this Margin, [NPV Payment](#) and Price Alignment Procedure and not otherwise defined herein shall have the meaning given pursuant to the remainder of the CDS Clearing Documentation, as such term is defined in the document entitled "CDS Clearing Rule Book" published by LCH SA, as amended from time to time.

[...]

## 2.14 NPV Amount

[...]

In respect of all STM Cleared Transactions, LCH SA shall, on each Cash Payment Day, and to the extent that the following amounts are payable in the same currency and are related to the same Margin Account:

- (A) aggregate the NPV Amounts (if any) payable by the Clearing Member to LCH SA on such Cash Payment Day in accordance with this paragraph 2.14; and
- (B) aggregate the NPV Amounts (if any) payable by LCH SA to the Clearing Member on such Cash Payment Day in accordance with this paragraph 2.14;

and the NPV Amount payable on a Cash Payment Day to one party (the Payee) by the other party (the Payer) under paragraphs 2.14 (A) or (B) above (as applicable) shall be reduced by setting-off such NPV Amount against the NPV Amount payable by the Payee to the Payer under paragraphs 2.14 (A) or (B) above (as applicable).

On the basis of these calculations, LCH SA will determine:

- (x) the Client NPV Payment Requirement for each Client Margin Account of the Clearing Member; and/or
- (y) the House NPV Payment Requirement for the House Margin Account,

which will trigger an NPV Payment to be made by the Clearing Member and/or LCH SA in accordance with Article 4.2.3.2 of the CDS Clearing Rule Book and Section 3 of the Procedures.

The NPV Amount paid or received by LCH SA to or from a Clearing Member may be adjusted in accordance with Clause 7 of the CDS Default Management Process.

[...]

## 2.17 Price Alignment Amount

Upon LCH SA's determination of the Price Alignment Amount in relation to an STM Cleared Transaction:

- (i) if LCH SA has determined that the Cumulative Net Present Value is greater than zero, then, subject to (3) below, an amount of cash denominated in the currency of the STM Cleared Transaction equal to the Price Alignment Amount shall immediately become due and payable by the Clearing Member to LCH SA;
- (ii) if LCH SA has determined that the Cumulative Net Present Value is less than zero, then, subject to (3) below, an amount of cash denominated in the currency of the STM Cleared Transaction equal to the Price Alignment Amount shall immediately become due and payable by LCH SA to the Clearing Member; and
- (iii) if the Price Alignment Amount payable by a party on a Cash Payment Day is a negative amount, then the Price Alignment Amount payable by that party will be deemed to be zero, and the other party will pay to that party the absolute value of the negative Price Alignment Amount on such Cash Payment Day.

A Report published in accordance with and subject to Section 5 of the Procedures and received by each Clearing Member on each Cash Payment Day shall indicate the amount of Price Alignment Amount to be paid or received by a Clearing Member.

These payments are made in order to minimise distortion of pricing for Original Transactions cleared through LCH SA as a result of daily NPV Payments and changes in the net present value of STM Cleared Transactions.

For the purpose of determining the Cumulative Net Present Value of an STM Cleared Transaction that has been either (i) transferred to a Backup Clearing Member pursuant to the CDS Default Management Process, or (ii) transferred to a Receiving Clearing Member pursuant to Title V, Chapter 3 and Title ~~VI~~ VI, Chapter 3 of the CDS Clearing Rule Book the Trade Date of the STM Cleared Transaction that comes into existence immediately following such transfer shall be the Trade Date of the STM Cleared Transaction that was so transferred.

[...]

**"Price Alignment Amount Rate"** means the applicable interest rate prevailing on that Cash Payment Day, as ~~published by LCH SA on the Website~~ mentioned in the files and reports available to the Clearing Member.

[...]

## Extracts from the draft Section 5 of the Procedures

[...]

### 2.11 REGISTRATION OF CLEARED TRANSACTIONS

#### (d) Conversion of STM Cleared Transactions

Following its receipt of a request (an “**STM Conversion Request**”) made by a Converting Clearing Member pursuant to Article 3.1.10.8 of the CDS Clearing Rule Book, LCH SA may, in its sole and absolute discretion, nominate a Business Day (the “**STM Conversion Date**”) from, and including, which the relevant CTM Trade Account shall, subject to the satisfaction of the conditions specified below in this paragraph (d), become an STM Trade Account and all the Cleared Transactions registered in such Trade Account shall cease to be registered as CTM Transactions and shall immediately and automatically become STM Cleared Transaction.

For the avoidance of doubt, if LCH SA determines that it shall convert a CTM Trade Account into an STM Trade Account, such conversion shall be effected through LCH SA making such conversion in its systems and not through LCH SA and the Converting Clearing Member terminating the relevant CTM Transactions and entering into new Cleared Transactions registered into an STM Trade Account.

The occurrence of an STM Conversion Date in respect of an STM Trade Account shall be subject to the condition precedent that:

- (i) the Converting Clearing Member is not a Defaulting Clearing Member;
- (ii) no early termination date, howsoever described in the relevant CDS Client Clearing Agreement, has occurred in respect of the relevant Deemed Client Transactions(s);
- (iii) the conversion of that CTM Trade Account to an STM Trade Account would not violate or result in the violation of any applicable law or regulation;
- (iv) the Converting Clearing Member has satisfied all of its Cash Payment and Variation Margin and Collateral transfer obligations including any Margin Requirements, Variation Margin Requirements and Cash Payments in respect of the Cleared Transactions registered in that ~~STM~~CTM Trade Account up to, but excluding, the STM Conversion Date. The Converting Clearing Member shall satisfy such Margin Requirements and Variation Margin Requirements in accordance with the CDS Clearing Rules, as would ordinarily be the case;
- (v) the Converting Clearing Member has paid to LCH SA, or LCH SA has paid to the Converting Clearing Member (as applicable), any cash settlement amount that LCH SA determines (in its sole and absolute discretion) must be paid to ensure that the net present value of each Cleared Transaction registered in the relevant Trade Account shall be equal to zero on the STM Conversion Date. The Converting Clearing Member and LCH SA agree that LCH SA may, in its sole and absolute discretion, apply any Variation Margin transferred to and held by LCH SA in respect of the Cleared Transaction

registered in the relevant Trade Account to satisfy (in whole or in part) the Converting Clearing Member's obligation to pay the amount (if any) required under this paragraph in relation to each such Cleared Transaction. The Converting Member and LCH SA agree that any Variation Margin transferred to and held by the Converting Clearing Member in respect of the Cleared Transaction registered in the relevant Trade Account shall be applied to satisfy (in whole or in part) LCH SA's obligation to pay the amount (if any) required under this paragraph in relation to each such Cleared Transaction; and

- (vi) all other conditions stipulated by LCH SA have been complied with in a manner satisfactory to it.

Each time a Clearing Member delivers an STM Conversion Request that Clearing Member:

- a. agrees and acknowledges for the benefit of LCH SA that if an STM Conversion Date occurs in respect of any CTM Trade Account, such Trade Account and the Cleared Transaction registered therein cannot, in any circumstance, be re-converted into, respectively, a CTM Trade Account and CTM Cleared Transactions; and
- b. is deemed to represent to LCH SA that the person, agent, officer, employee, or representative that delivers that STM Conversion Request is fully authorised by it to do so, and has the requisite power to bind the Converting Clearing Member in this regard.

[...]