

### 13.3 Clearing Agencies

#### 13.3.1 Banque Centrale De Compensation Carrying on Business as LCH SA – Application for Exemption from Recognition as a Clearing Agency – OSC Notice and Request for Comment

##### OSC NOTICE AND REQUEST FOR COMMENT

##### BANQUE CENTRALE DE COMPENSATION CARRYING ON BUSINESS AS LCH SA

##### APPLICATION FOR EXEMPTION FROM RECOGNITION AS A CLEARING AGENCY

#### A. Background

Banque Centrale de Compensation carrying on business as LCH SA (**LCH SA**) has applied to the Ontario Securities Commission (**Commission**) for an order pursuant to section 147 of the *Securities Act* (Ontario) (**OSA**) to exempt it from the requirement to be recognized as a clearing agency in subsection 21.2(0.1) of the OSA.

LCH SA is a registered central counterparty (**CCP**) authorized to offer clearing services in the European Union pursuant to Regulation (EU) No. 648/2012 of the European Parliament and the Council of 4 July 2012 on OTC derivatives, central counterparties (**CCP**) and trade repositories, the European Market Infrastructure Regulation (**EMIR**). As a CCP, LCH SA is regulated by the Autorité de Contrôle Prudentiel et de Résolution, the Banque de France and the Autorité des Marchés Financiers, collectively, the French National Competent Authorities (**NCA**s).

LCH proposes to offer its Fixed Income Clearing Service (**RepoClear**) and its Credit Default Swap Clearing Services (**CDS Clear**) to Ontario residents.

#### B. Proposed Regulatory Approach

Staff of the OSC (**Staff**) have reviewed the Application and other material required by National Instrument 24-102 *Clearing Agency Requirements* (**NI 24-102**). Subject to comments received, Staff propose to recommend to the Commission that it issue an exemption order to LCH SA in the form of the proposed draft order attached at Appendix A (**Draft Order**). This recommendation is based on the determination that LCH SA is not expected to pose significant risk to Ontario's capital markets and is subject to a comparable regulatory and oversight regime in its home jurisdiction by its home regulators, the NCA's.

In determining whether a clearing agency poses significant risk to Ontario, we consider the level of activity of the clearing agency in Ontario (using indicators such as notional value and volume of transactions cleared for Ontario-based market participants) and other qualitative and quantitative factors, such as interconnectedness, size of obligations of the clearing members and the role and central importance of a clearing agency to a particular market.

#### C. Draft Order

Among other things, the Application describes LCH SA's requirements under EMIR that are generally comparable or that achieve similar outcomes to the requirements of NI 24-102. A copy of LCH SA's Application can be found on the Commission website at: [https://www.osc.gov.on.ca/en/Marketplaces\\_clearing-agencies\\_index.htm](https://www.osc.gov.on.ca/en/Marketplaces_clearing-agencies_index.htm).

The Draft Order if issued would require LCH SA to comply with the various terms and conditions in Schedule "A" to the Draft Order, including relating to:

1. Permitted scope of clearing activities in Ontario
2. Regulation of LCH SA
3. Governance
4. Reporting requirements
5. Information sharing

LCH SA has acknowledged in the Draft Order that the scope of and the terms and conditions imposed by the Commission, or the Commission's determination of whether it is appropriate that LCH SA continue to be exempted from the requirement to be recognized as a clearing agency, may change as a result of the Commission's monitoring of developments in international and domestic capital markets or LCH SA's activities, or as a result of any changes to the laws in Ontario affecting the clearing and settlement of derivatives or securities.

**D. Comment Process**

The Commission is publishing for public comment the Application and Draft Order. We are seeking comment on all aspects of the Application and Draft Order.

Please provide your comments in writing, via e-mail and delivered on or before September 9, 2019 addressed to the attention of the Secretary of the Commission at e-mail: [comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca).

The confidentiality of submissions cannot be maintained as comments received during the comment period will be published.

Questions may be referred to:

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**APPENDIX "A"**  
**DRAFT ORDER**

**IN THE MATTER OF  
THE SECURITIES ACT,  
R.S.O. 1990, CHAPTER S. 5, AS AMENDED  
(THE OSA)**

**AND**

**IN THE MATTER OF  
BANQUE CENTRALE DE COMPENSATION**

**ORDER  
(Section 147 of the OSA)**

**WHEREAS** Banque Centrale de Compensation which carries on business under the name LCH SA (hereinafter **LCH SA**) has submitted an application (**Application**) with the Ontario Securities Commission (**Commission**) pursuant to section 147 of the OSA requesting an order exempting LCH SA from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA (**Order**);

**AND WHEREAS LCH SA** has represented to the Commission that:

- 1.1. LCH SA is incorporated in France as a *société anonyme* (limited company) with a registered office based at 18 rue du Quatre Septembre 75002 Paris.
- 1.2. LCH SA is majority-owned (88.9%) by LCH Group Holdings Limited and indirectly owned (82.6%) by the London Stock Exchange (C) Limited a wholly owned subsidiary of London Stock Exchange Group plc.
- 1.3. LCH SA qualifies as a central counterparty (**CCP**) pursuant to 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 (**EMIR**), which sets out clearing and bilateral risk-management requirements for over-the-counter (**OTC**) derivative contracts, reporting requirements for derivative contracts, and uniform requirements for the performance of activities of CCPs and trade repositories. It was granted authorization as a CCP under EMIR effective from May 22, 2014.
- 1.4. LCH SA is of the opinion that it fully observes the international standards applicable to financial market infrastructures described in the April 2012 report Principles for financial market infrastructures (**PFMI**), having prepared a detailed assessment of its compliance against the PFMI and the associated disclosure framework as of 13 August 2018.
- 1.5. As an authorized CCP, LCH SA is regulated by three national competent authorities (**NCAs**): the *Autorité de Contrôle Prudentiel et de Résolution* (**ACPR**), the *Banque de France* (**BDF**) and the *Autorité des Marchés Financiers* (**AMF**). LCH SA is primarily regulated by the ACPR as a credit institution under the French Monetary and Financial Code (**Comofi**) and is a designated system under the *Settlement Finality Directive* 1998. LCH SA is indirectly supervised by the European Central Bank (**ECB**).
- 1.6. LCH SA is registered in the United States (i) as a Derivatives Clearing Organization with the U.S. Commodity Futures Trading Commission for its CDSClear service and (ii) as a clearing agency with the U.S. Securities and Exchange Commission.
- 1.7. LCH SA has to ensure the adequacy of its capital and risk management procedures and is required to provide its regulators with regular reports and information showing LCH SA clearing activities (including initial margin; default fund size; cash and non-cash collateral data; stress testing results; liquidity and capital adequacy; any significant changes in the organization, governance structure or ownership of LCH SA etc.).
- 1.8. LCH SA also provides its regulators with its annual financial statements and auditors' reports. The LCH SA's regulators may carry out on-site audits.
- 1.9. LCH SA anticipates that banks, investment dealers and any other legal entity resident in Ontario that fulfils the membership requirements duly defined in any applicable regulation and LCH SA Clearing Rules as defined below may be interested in participating in its offerings and becoming clearing members of LCH SA.

1.10 LCH SA provides clearing services for major exchanges and platforms as well as OTC markets. LCH SA clears a broad range of asset classes such as securities, exchange-traded derivatives, Credit Default Swaps (**CDS**) and Euro denominated bonds and repos.

1.10.1 RepoClear (the **Fixed Income Clearing Service**):

- LCH SA provides clearing services for cash and repos trades on Euro-denominated sovereign debts issued by French, Belgian, Italian, Spanish, German, Austrian, Dutch, Portuguese, Slovenian, Slovakian, Irish, Finnish governments as well as supranational bonds. LCH SA has implemented an interoperable link with Cassa di Compensazione e Garanzia SpA (CC&G), a subsidiary of the LSEG group on the Italian government bonds in compliance with the ESMA interoperability guidelines.
- LCH SA has launched €GCPlus, a central clearing service for the triparty repo market based on ECB eligible securities baskets in collaboration with the Central Securities Depository Euroclear and Banque de France. It uses pools of collateral managed by Euroclear, with Euroclear acting as triparty agent. €GCPlus has a dedicated default fund.

1.10.2 CDSClear (the **CDS Clearing Service**)

- LCH SA provides clearing services on European and North –American Indices and Single Names constituents, through MarkitSERV, Bloomberg and Tradeweb trade sources which includes:
  - ITraxx Europe – Main, HiVol and CrossOver indices (3, 5, 7, 10-year tenors) – Senior Financials indices (5 and 10-year tenors) – from Series 6 onwards, Euro-denominated,
  - Single Names on the reference entities composing the eligible indices, 25/100/300/500 bp coupons (quarterly maturities up to 10-year tenors), ‘Standard European Corporate’ or ‘Standard European Financial Corporate’ transaction types, Euro-denominated,
  - CDX Investment-grade indices (3, 5, 7 and 10-year tenors) from Series 7 onwards, US dollar- denominated,
  - Single Names on the reference entities composing the eligible indices, excluding monocline insurers, 100/500 bp coupons (quarterly maturities up to 10-year tenors), ‘Standard North American Corporate’ transaction types, Senior debt, US dollar-denominated.
  - Options on CDS Index

1.11 An applicant to become a clearing member (**Clearing Member**) is required to have sufficient financial resources and operational capacity to meet the obligations arising from participation in LCH SA. The admission requirements are set forth in the documents entitled “CDS Clearing Rule Book” and “Procedures” regarding the CDSClear service and the “Clearing Rule Book” and “Instructions” regarding the RepoClear service. The CDS Clearing Rule Book, Procedures, the Clearing Rule Book and Instructions together being referred to as the “**Clearing Rules**”, are available on LCH SA’s website. LCH SA’s participation requirements are non-discriminatory and objective to ensure fair and open access. The admission requirements do not limit access on grounds other than risk (e.g., sufficient liable equity capital, compliance with technical requirements, and verification of the legal validity and enforceability of the Clearing Rules).

1.12 A Clearing Member is a legal entity that fulfils the membership requirements such as, among others, having sufficient financial resources and operational capacity to meet the obligations arising from participation in LCH SA. Such membership requirements are set out by LCH SA in the Clearing Rules.

1.13 Clearing Members may clear their own trades as well as those executed on behalf of their clients. A client is a legal entity that has entered into a client clearing agreement with a clearing member, thus allowing it to submit trades to its Clearing Member for clearing. Clients can have multiple Clearing Members.

1.14 A specific membership is required for CDSClear. Existing LCH SA Clearing Members (in LCH SA or its sister subsidiary LCH Ltd.) benefit from a fast-track membership program, subject to LCH SA risk management criteria. The LCH SA website includes further details of the general criteria that must be met to gain the Clearing Member status and the supplementary criteria for CDSClear participants.

- 1.15 LCH SA plans to offer clearing activities to Ontario Clearing Members for the RepoClear and CDSClear services. This includes clients accessing the service through Ontario Clearing Members and Clearing Members from other jurisdictions.
- 1.16 The LCH SA Executive Risk Committee may approve an application to become a Clearing Member upon a determination that the applicant meets the membership criteria and after conducting a risk assessment and assigning an internal credit rating to the applicant.
- 1.17 The provisions of Article 2.1.1.2(5) of the LCH SA rulebook in compliance with article 541-16 of the *Règlement general de l'AMF* and article L 440-2 of the French Monetary Code provide that the French CCP membership of credit institutions (such as banks) and investment firms which are established in a country which is not part of the EEA such as Canada, is subject to a prior authorization from the AMF.
- 1.18 To achieve a balance between open access and risk, LCH SA continuously monitors a wide range of credit indicators for Clearing Members, including capital-to-risk ratios, and applies real-time risk management controls such as concentration limits and margin multipliers.
- 1.19 LCH SA's Clearing Rules contain specific quality requirements for Clearing Members which include organisational, risk management systems and procedural requirements. LCH SA may impose additional risk-based conditions which may require Clearing Members to post additional collateral from time to time.
- 1.20 LCH SA collects collateral from its Clearing Members several times a day, so as to always have enough collateral to cover potential losses that the Clearing Members' portfolios could suffer in a predefined period which varies from one clearing service to another.
- 1.21 Across LCH SA, mutualised default funds are calibrated monthly and tested daily to be sufficient to withstand the default of the two Clearing Members (at group level) giving rise to the largest losses calculated under scenarios of extreme conditions.
- 1.22 The LCH SA Rules (including in particular the default procedures stated in the rules) govern the processes that apply to Clearing Members in the case of a Clearing Member default; Clearing Members remain responsible for the credit risk of their clients.
- 1.23 LCH SA seeks an exemption from the clearing agency recognition requirement in relation to all transactions cleared by each of the LCH SA RepoClear and CDSClear services as described in representations 1.10.1 and 1.10.2.
- 1.24 LCH SA would provide its services to participants in Ontario without establishing an office or having a physical presence in Ontario or elsewhere in Canada.
- 1.25 LCH SA submits that it does not pose a significant risk to the Ontario capital markets and is subject to an appropriate regulatory and oversight regime in a foreign jurisdiction.

**AND WHEREAS** LCH SA has agreed to the respective terms and conditions as set out in Schedule "A" to this order;

**AND WHEREAS** based on the Application and the representations that LCH SA has made to the Commission, in the Commission's opinion LCH SA is subject to regulatory requirements in France that are comparable to the requirements set out in National Instrument 24-102 *Clearing Agency Requirements* and is subject to the NCA's supervision and granting an order to exempt LCH SA from the requirement to be recognized as a clearing agency would not be prejudicial to the public interest;

**AND WHEREAS** the Commission will monitor developments in international and domestic capital markets and LCH SA's activities on an ongoing basis to determine whether it is appropriate that LCH SA continues to be exempted from the requirement to be recognized as a clearing agency and, if so, whether it is appropriate that it continue to be subject to the terms and conditions attached hereto as Schedule "A" to this order;

**AND WHEREAS** LCH SA has acknowledged to the Commission that the scope of and the terms and conditions imposed by the Commission attached hereto as Schedule "A" to this order, or the determination whether it is appropriate that LCH SA continue to be exempted from the requirement to be recognized as a clearing agency, may change as a result of the Commission's monitoring of developments in international and domestic capital markets or LCH SA's activities, or as a result of any changes to the laws in Ontario affecting clearing and settlement of derivatives or securities;

**IT IS HEREBY ORDERED** by the Commission that, pursuant to section 147 of the OSA, LCH SA is exempt from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA;

**PROVIDED THAT** LCH SA complies with the terms and conditions attached hereto as Schedule "A"

DATED this [...] day of [...], 2019.

[NAME]

[NAME]

**SCHEDULE "A"**  
**Terms and Conditions**

Definitions:

For the purposes of this Schedule "A":

"client clearing" means the ability of a Clearing Member to clear transactions on LCH SA for and on behalf of a client. Unless the context requires otherwise, other terms used in this Schedule "A" shall have the meanings ascribed to them in Ontario securities law (including terms defined elsewhere in this order).

**COMPLIANCE WITH ONTARIO LAW**

1. LCH SA will comply with Ontario securities law (as defined in the OSA).

**SCOPE OF PERMITTED CLEARING SERVICES IN ONTARIO**

2. LCH SA's activities in Ontario will be limited to the clearing of transactions in the RepoClear and CDSClear services as generally described in subsections 1.10.1 and 1.10.2 of LCH SA's representations set out above in this order (**Permitted Clearing Services**).
3. LCH SA's offering of the CDSClear service will comply with National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*.
4. For purposes of this order, **Ontario Clearing Member** means a Clearing Member resident in Ontario that uses the Permitted Clearing Services.

**REGULATION OF LCH SA**

5. LCH SA will maintain its status as an authorised CCP under EMIR and will continue to be subject to the regulatory oversight of its NCAs or any successor(s).
6. LCH SA will continue to comply with its ongoing regulatory requirements as a CCP under EMIR, and with the ongoing regulatory requirements of its NCAs.

**GOVERNANCE**

7. LCH SA will promote within LCH SA a governance structure that minimizes the potential for any conflict of interest between LCH SA and its shareholders that could adversely affect the Permitted Clearing Services or the effectiveness of LCH SA's risk management policies, controls and standards.

**REPORTING REQUIREMENTS**

**Reporting with the NCAs**

8. LCH SA will promptly provide staff of the Commission the following information, to the extent that it is required to provide or submit such information to NCAs or their successors:
  - (a) details of any material legal proceeding instituted against LCH SA;
  - (b) notification that LCH SA has failed to comply with an undisputed obligation to pay money or deliver property to an Ontario Clearing Member for a period of thirty days after receiving notice from the Ontario Clearing Member of LCH SA's past due obligation;
  - (c) notification that LCH SA has instituted a petition for a judgment of bankruptcy or insolvency or similar relief, or to wind up or liquidate LCH SA or has a proceeding for any such petition instituted against it;
  - (d) material changes to its bylaws and rules where such changes would impact the Permitted Clearing Services used by Ontario residents (whether as a Ontario Clearing Member or otherwise);

- (e) new services or clearing of new type of products in the Permitted Services to be offered to Ontario Clearing Members or services or types of products that will no longer be available to Ontario members; and
- (f) any new category of membership in the Permitted Clearing Services if LCH SA expects that category of membership would be available to Ontario Clearing Members.

**Prompt Notice**

9. LCH SA will promptly notify staff of the Commission of any of the following:
- (a) any material change to its business or operations;
  - (b) any material change or proposed material change in LCH SA's status as a CCP under EMIR or in its regulatory oversight by NCAs or any successors;
  - (c) any material problem with the clearing and settlement of transactions that could materially affect the safety and soundness of LCH SA;
  - (d) the admission of any new Ontario Clearing Member;
  - (e) any event of default by, or removal from Permitted Clearing Services of, an Ontario Clearing Member;
  - (f) any material system failure of a Permitted Clearing Service utilized by an Ontario Clearing Member including cybersecurity breaches;
  - (g) initiation of LCH SA's recovery plan;
  - (h) the appointment of a receiver or the making of any voluntary arrangement with creditors; and
  - (i) the entering of LCH SA into any resolution regime or the placing of LCH SA into resolution by a resolution authority.

**Quarterly Reporting**

10. LCH SA will maintain and submit the following information to the Commission in a manner and form acceptable to the Commission on a quarterly basis within 30 days of the end of each calendar quarter, and at any time promptly upon the request of staff of the Commission:
- (a) a current list of all Ontario Clearing Members, and the legal entity identifier (LEI), if any, of each such Ontario Clearing Member;
  - (b) a list of all Ontario Clearing Members against whom disciplinary or legal action has been taken in the quarter by LCH SA with respect to activities at LCH SA, or to the best of LCH SA's knowledge, by its NCAs or any other authority in Europe or the United States that has or may have jurisdiction with respect to the relevant Ontario Clearing Members' clearing activities at LCH SA;
  - (c) a list of all investigations by LCH SA in the quarter relating to Ontario Clearing Members;
  - (d) a list of all Ontario-resident applicants who have been denied Clearing Member status in the quarter by LCH SA;
  - (e) quantitative information in respect of the Permitted Clearing Services used by Ontario Clearing Members for cleared transactions referred to in subsections 1.9.2 and 1.9.3, including in particular the following:
    - i) as at the end of the quarter, level, maximum and average daily open interest, number of transactions and notional value of transactions cleared during the quarter for each Ontario Clearing Member;
    - ii) the percentage of end of quarter level and average daily open interest, number of transactions and the notional value cleared during the quarter for all Clearing Members that represents the end of



- quarter and average daily open interest, number of transactions and the notional value of transactions cleared during the quarter for each Ontario Clearing Member;
- iii) the aggregate total margin amount required by LCH SA ending on the last trading day during the quarter for each Ontario Clearing Member;
  - iv) the portion of the total margin required by LCH SA ending on the last trading day of the quarter for all Clearing Members that represents the total margin required during the quarter for each Ontario Clearing Member; and
- (f) the default fund contribution, for each Ontario Clearing Member on the last trading day during the quarter, and its proportion of the total default fund contributions;
  - (g) a summary of risk management analysis related to the adequacy of the default fund requirement, including but not limited to stress testing and backtesting results;
  - (h) if known to LCH SA, for each Clearing Member (identified by its LEI) offering client clearing to an Ontario resident, the identity of the Ontario resident client (including LEI, if any) receiving such services, and the value and volume cleared by asset class or transaction type during the quarter for and on behalf of each Ontario resident client.

#### **INFORMATION SHARING**

- 11. LCH SA will promptly provide such information as may be requested from time to time by, and otherwise cooperate with, the Commission or its staff, subject to any applicable privacy or other laws that would prevent the sharing of such information and subject to the application of solicitor-client privilege.
- 12. Unless otherwise prohibited under applicable law, LCH SA will share information relating to regulatory and enforcement matters and otherwise cooperate with other recognized and exempt clearing agencies on such matters, as appropriate.