



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-103573; File No. SR-LCH SA-2025-007]

### **Self-Regulatory Organizations; LCH SA; Notice of Filing of Proposed Rule Change Relating to LCH SA’s Risk Governance Framework and Collateral, Financial, Credit, Operational and Third Party Risk Policies**

July 29, 2025.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“**Act**”),<sup>1</sup> and Rule 19b-4,<sup>2</sup> notice is hereby given that on July 15, 2025, 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, as described in Items I, II and III below, which Items have been prepared primarily by the clearing agency. 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**

LCH SA is submitting several risk policies (“**Risk Policies**”) which LCH SA has adopted, including: (i) the Collateral Risk Policy; (ii) the Financial Resource Adequacy Policy; (iii) the Counterparty Credit Risk Policy; (iv) the Operational Risk Management Policy; (v) the Third Party Risk Management Policy; and (vi) the Risk Governance

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<sup>1</sup> 15 USC 78s(b)(1).

<sup>2</sup> 17 CFR § 240.19b-4.

Framework. The Risk Policies have been issued by LCH Group Holdings Limited (“LCH Group”)<sup>3</sup> and adopted by the LCH SA Risk Committee and LCH SA Board.<sup>4</sup>

## **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 Risk Policies and discussed any comments it received on the Risk Policies. 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 such statements.

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

#### **1. Purpose**

The Risk Policies have been adopted by LCH SA in order to set out the specific risk management requirements that govern its operations as a clearing agency. Moreover, the Risk Policies clarify the roles and responsibilities within LCH SA for compliance with the Risk Policies. Finally, the Risk Policies have been designed to ensure consistency with all relevant laws and regulations, including the European Markets Infrastructure Regulation (“EMIR”) and Section 17A of the Act<sup>5</sup> and the regulations thereunder.<sup>6</sup>

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<sup>3</sup> LCH Group Holdings Limited is an indirect wholly owned subsidiary of the London Stock Exchange Group plc. In addition to LCH SA, LCH Group also owns LCH Limited, a recognized central counterparty supervised in the United Kingdom by the Bank of England and a derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission.

<sup>4</sup> The Risk Policies have been elaborated in common with LCH Ltd. in order to ensure risk management consistency within LCH Group. Identical risk policies have been approved by LCH Ltd.’s governance.

<sup>5</sup> 15 USC § 78q-1.

<sup>6</sup> The Risk Policies generally identify the relevant provisions of law and regulation applicable to that policy.

a. Collateral Risk Policy

The Collateral Risk Policy (“**CRP**”) sets out the LCH Group standards for the management of collateral risk at LCH SA, subject to the risk appetite defined in the Risk Governance Framework. The goal of the policy is to ensure that LCH SA has a robust mechanism in place to process and control the collateral posted by its members.

The CRP applies to collateral accepted by LCH SA to cover margin requirements and default fund contributions.<sup>7</sup> The CRP also clarifies the roles and responsibilities within LCH SA for compliance with the CRP. The policy owner is the LCH SA Chief Risk Officer (“**CRO**”). In addition:

- LCH SA Collateral and Liquidity Management team (“**CaLM**”) has a number of responsibilities under the CRP. CaLM’s primary responsibilities include: (i) daily monitoring of the pool of collateral lodged by its members in accordance with the policy;<sup>8</sup> (ii) calibrating collateral haircuts and performing daily monitoring in accordance with the CRP; (iii) supervising the delegated team LCH Ltd First Line Risk RepoClear with the sourcing and assessment<sup>9</sup> of collateral prices based on guidelines by CaLM First Line Risk SA, subject to the standards set out in the LCH Contract and Market Acceptability Policy; (iv) implementing collateral concentration limits on its members and monitoring against

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<sup>7</sup> Collateral accepted by LCH SA to cover risks associated with (i) securities accepted as part of the clearing services such as in RepoClear and Equity Clear; and (ii) secured cash investments (reverse repurchase agreements or outright purchases) conducted as part of CaLM’s investment activities, are outside the scope of the CRP and are covered by the Financial Resource Adequacy Policy (*see* paragraph below) and Investment Risk Policy, respectively.

<sup>8</sup> Such monitoring encompasses working with external stakeholders (*e.g.*, International Central Securities Depositories (“**ICSDs**”), Central Securities Depositories (“**CSDs**”)) and internal stakeholders (*e.g.*, Collateral Operations, as defined below) to update the list of eligible collateral in line with the acceptance criteria set out in the CRP.

<sup>9</sup> For example, this includes assessing the prices of collateral lodged bilaterally and collateral lodged via tri-party providers against published market prices. In addition, it assesses. In addition, where a material change in the collateral market is identified, CaLM will escalate the issue to CaLM Risk (as defined herein) and LCH SA senior management.

these on a daily basis; (v) handling general enquiries from members regarding collateral risk methodology; (vi) performing collateral stress testing in accordance with the CRP; and (vii) realizing the cash value of the collateral lodged by a defaulted member during the Default Management Process (“**DMP**”);<sup>10</sup>

- LCH SA Risk Collateral and Liquidity Risk Management team (“**CaLM Risk**”) is responsible for daily monitoring and managing risks associated with collateral activities and positions in line with the requirements of the CRP. This includes, *inter alia*, conducting independent assessments of the eligibility of collateral received and validating collateral haircuts in accordance with the policy;<sup>11</sup>
- LCH SA Collateral Operations team (“**Collateral Operations**”) is responsible for ensuring that member margin liabilities are covered with eligible non-cash collateral and/or cash and managing the corresponding margin and collateral flows and related investment flows. Most notably, Collateral Operations: (i) monitors securities settlement and interoperability account balances; (ii) tracks member requests to lodge and substitute collateral (seeking LCH SA Risk Department and CaLM Risk approval as necessary); (iii) oversees the system handling valuation of collateral lodged by members including the application of relevant haircuts; (iv) communicates to members changes in the population of

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<sup>10</sup> The governance of the DMP is laid out in the LCH Default Management Policy.

<sup>11</sup> CaLM Risk is also responsible for: (i) the independent assessment of the prices of collateral lodged bilaterally and the collateral market value lodged via tri-party providers against the published market prices, in line with second-line risk responsibilities for pricing set out in the LCH Contract and Market Acceptability Policy; (ii) validating and monitoring the collateral concentration limits on members; and (iii) the production of regular reports and management information for circulation with LCHA Risk Department, CaLM, and senior management, including escalation if there are material changes in the market value, credit quality or liquidity of collateral lodged (bilaterally or via tri-party).

acceptable collateral and haircuts; (v) handles general inquiries from members regarding member collateral pledged to cover margin requirements; and (vi) is responsible for static data, collateral pricing, and adding new ISINs approved as eligible collateral;<sup>12</sup> and

- LCH SA Compliance is responsible for notifying regulators of changes to collateral eligibility, limits and/or haircuts, where relevant.

The CRP also sets out requirements for the approval of eligible cash and non-cash collateral. In particular, the CRP establishes that margin requirements can be covered by a mixture of cash and eligible non-cash collateral (*i.e.*, traded securities and bank guarantees), subject to the criteria set out in the policy.

In respect of ‘cash’, LCH SA accepts EUR, GBP and USD<sup>13</sup> as the primary currencies for margin cover and default fund contributions. Further, the policy requires default fund contributions to be met by cash<sup>14</sup> in the primary currencies designated by each Clearing Service.<sup>15</sup>

With regards to non-cash collateral, the CRP limits the assets accepted as collateral to those with low credit, liquidity and market risks as required by SEC Rule

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<sup>12</sup> In addition, the CaLM team in Ltd is responsible for static data, collateral pricing, and adding of new ISINs approved as eligible non-cash collateral.

<sup>13</sup> LCH SA also accepts other currencies, subject to the minimum criteria set out in the CRP, including that the currency is used for clearing in LCH SA, has been approved for use by LCH SA Credit Risk, can be invested in accordance with the Investment Risk Policy, and CaLM Risk can manage the exchange risk associated with the currency.

<sup>14</sup> Default fund contributions can also be met by collateral equivalent to cash in the case of default such as Central Bank Guarantees, where authorized by the LCH SA Rulebook.

<sup>15</sup> LCH SA currently maintains three separate Clearing Services: (i) CDSClear, which provides clearing services for credit default swaps; (ii) RepoClear SA, which provides clearing services in respect of repo and cash transactions on Euro-denominated government and supra-national debts across 13 markets (France, Italy, Spain, Germany, Belgium, Austria, Finland, Ireland, The Netherlands, Portugal, Slovakia, Slovenia and Supranational), as well as a basket collateral service through the Euro GC+ clearing service; and (iii) DigitalAssetClear SA, which provides clearing services for cash-settled Bitcoin index futures and options contracts traded on GFO-X, an FCA-regulated, centrally-cleared multilateral trading facility dedicated to digital asset futures and options.

17ad-22(e)(5).<sup>16</sup> Specifically, in respect of ‘traded securities,’ the policy requires that all traded securities meet certain credit, liquidity and market risk requirements to be eligible as collateral for margin cover. For example, (i) the issuer must be reviewed and assigned an internal credit score (“ICS”) by LCH SA Credit Risk; (ii) the value of the securities must be established daily using observed prices obtained from published sources; (iii) the security must be in a currency that meets the minimum criteria set out in the CRP, and must be reviewed by LCH SA Credit Risk if such currency is not denominated in the domestic currency of the home country; (iv) the value of the shares can be established daily using observed prices obtained from published resources; (v) the CCP has the operational infrastructure in place to process the securities, market the positions, and apply appropriate haircuts; (vi) CaLM has the expertise and the operational capability to realize the value of the security in the event of a default, either directly or via contractual arrangements with a third party service provider; (vii) the CCP can hold and liquidate the securities without legal challenge; and (viii) there must be sufficient market liquidity available.<sup>17</sup> The full list of traded securities that qualify as eligible non-cash collateral<sup>18</sup> are set out in Appendix II of the CRP. In addition, the CRP provides a list of traded securities that are not eligible as collateral for margin cover, including perpetual bonds.<sup>19</sup>

In respect of ‘bank guarantees’, the policy provides that central bank guarantees are eligible as collateral for margin cover if they are issued by central banks in countries

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<sup>16</sup> 17 CFR § 240.17ad-22(e)(5).

<sup>17</sup> The policy provides that fixed income securities where the issuance size of a security is less than the minimum specified in Appendix III, CaLM will provide evidence of market liquidity to CaLM Risk and approval for eligibility will be required from the CRO (or the CRO’s delegate). Examples of such an issuance size include 800 mln for AUD and 5.5 bln for NOK.

<sup>18</sup> Such eligibility remains subject to the eligibility criteria for traded securities summarized above as well as to the margin collateral haircut schedules published on LCH SA’s website.

<sup>19</sup> Other traded securities not eligible include (i) zero coupon bond types (excluding treasury bills); (ii) strips (including principal and coupon strips); (iii) securities issued by credit and financial institutions; and (iv) securities which are close to maturity, subject to specific corporate events, or have optionality.

that are approved for investments by CaLM. Commercial bank guarantees are not eligible.<sup>20</sup>

The CRP also addresses changes to collateral eligibility. It provides that, for new currencies and new issuers within an approved collateral type to be accepted as collateral, approval from the LCH SA Executive Committee (“**ERCo**”) is required.<sup>21</sup> The ERCo also has the discretion to declare that eligible collateral is no longer acceptable.<sup>22</sup> New types of collateral that pose new or novel risk features, or that require a change to existing risk controls, require (i) CaLM to submit such request to the ERCo and the LCH SA Risk Committee;<sup>23</sup> (ii) the ERCo and the LCH SA Risk Committee to review such request; and (iii) the LCH SA Board to approve such request.<sup>24</sup> If no changes are required to existing risk controls,<sup>25</sup> CaLM Risk approval is sufficient. The CRP requires, where possible, that LCH SA provide a notice period to its clearing members to allow them sufficient time to adjust the portfolio of collateral lodged, provided that this will not impair LCH SA’s financial resources nor liquidity position.

The CRP also establishes a framework for monitoring market, credit, concentration/liquidity, wrong way and FX risks (the “**Risks**”). The Risks are covered by baseline haircuts, haircut add-ons, limits and/or price adjustments, detailed in the policy.<sup>26</sup> The policy provides that the ability of LCH SA to realize the value of a piece of collateral lodged by its member within the assumed holding period is affected by the

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<sup>20</sup> Such investments must comply with the Investment Risk Policy.

<sup>21</sup> In addition, the CRP requires appropriate regulatory approval to be obtained prior to LCH SA accepting new currencies. The ERCo may also request that new issuers be reviewed by the LCH SA Risk Committee and approved by the LCH SA Board.

<sup>22</sup> Such decisions are made upon the recommendation of CaLM and CaLM Risk, following which the ERCo must notify the Risk Committee of its decision.

<sup>23</sup> The request must be accompanied by its rational and supporting documentation.

<sup>24</sup> Appropriate regulatory approval must also be obtained prior to LCH SA’s acceptance of new collateral types.

<sup>25</sup> For example, adding new ISINs issued by sovereigns which LCH SA already accepts, provided that the ISINs meet the minimum eligibility requirements for non-cash collateral.

<sup>26</sup> In addition, the CRP requires collateral haircuts to comply with the FRAP.

collateral's market liquidity and the size of the position to be liquidated. Details of and the rationale for the holding period is detailed in Appendix I. In line with SEC Rule 17ad-22(e)(5), the framework aims to set and enforce appropriate conservative haircuts and concentration limits.

The policy provides that the ERCo may impose haircut add-ons and/or impose new limits or price adjustments on certain types of non-cash collateral based on their market liquidity, in particular, CaLM's ability to realize the value of the securities in the event of a default. In addition, the ERCo has the discretion to assess haircut add-ons on clearing members, based on their exposures, domicile, or portfolio of collateral posted, to protect LCH SA's financial resources and liquidity position. Collateral haircuts are subject to daily stress testing with any exceptions to be notified to the ERCo.<sup>27</sup>

The CRO is responsible for ensuring the review of collateral haircuts,<sup>28</sup> and changes to published haircuts must be submitted to the ERCo for approval.<sup>29</sup> Material changes, as agreed by the ERCo, are required under the CRP to be notified to the LCH SA Risk Committee. Changes are required to be notified to the regulators, where appropriate. In addition, the policy requires the appropriateness of the CRP to be reviewed by the ERCo and the LCH SA Risk Committee on an annual basis,<sup>30</sup> and requires approval by the LCH SA Board.

b. Financial Resource Adequacy Policy

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<sup>27</sup> Under the CRP, the Stress Resting Regime must include the following elements: (i) historical risk factor moves beyond the 99.7% level; (ii) theoretical scenarios which are extreme but plausible are to be used to complement the historical scenarios and provide better coverage of the tail losses of collateral portfolios. To the extent that similar securities are cleared by LCH SA, the same stress test scenarios applied on the clearing positions may be used to stress test collateral haircuts.

<sup>28</sup> With quarterly reviews to be submitted to the ERCo for approval; monthly reviews submitted to LCH SA CRO and/or the ERCo; and more frequent reviews where appropriate.

<sup>29</sup> Material changes (agreed by the ERCo) are to be notified to the LCH SA Risk Committee. Changes are required to be notified to the regulators where appropriate.

<sup>30</sup> In line with SEC Rule 17ad-22(e)(5), the sufficiency of collateral haircuts and concentration limits is performed no less than annually.

The Financial Resource Adequacy Policy (“FRAP”) sets out the standards governing the assessment of financial resources (initial margins, margin add-ons and default funds) against the Latent Market Risks<sup>31</sup> in clearing member portfolios at LCH SA. The FRAP also sets out the standards for addressing procyclicality in the risk frameworks and models used by the LCH CCPs. In particular, the FRAP (i) details the standards by which financial resources should be assessed against member exposures;<sup>32</sup> (ii) details the holding periods to be used for each product in the assessment of margins, providing the justification for each; (iii) articulates the rules governing the use of economic offsets between products; (iv) presents the limit framework to be used in assessing clearing exposures to members for each Clearing Service and across Clearing Services; (v) details the standards to be used for reverse stress testing the financial resources held against member portions; (vi) details the standards to be used for ensuring that procyclicality concerns are appropriately addressed in the risk frameworks and models used by the LCH CCPs; and (vii) describes the requirements for services within LCH Ltd that offer tiered participation arrangements in accordance with the Tiering Risks described in the Risk Governance Framework. Finally, the FRAP states that the Board’s appetite for Latent Market Risk and Procyclicality Risk is low.

The policy requires LCH SA to impose, call, and collect margins at least daily on each day when its Clearing Services are open and operating in order to limit its credit exposures<sup>33</sup> to its clearing members and, where relevant, from Central Clearing

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<sup>31</sup> ‘Latent Market Risk’ is defined in the Risk Governance Framework as the ‘risk that the exposure to a member’s portfolio value increases due to the impact of changing market factors on the valuation of the portfolio’. This risk is described as latent, in that LCH SA is only exposed in the event of the member’s default.

<sup>32</sup> This includes variation margins, initial margins, margin add-ons for liquidity risk, concentration risk, wrong way risk where appropriate, as well as the sizing and re-sizing of default funds.

<sup>33</sup> Such margins shall be sufficient to cover potential exposures that LCH SA estimates will occur until the liquidation of the relevant positions.

Counterparties (“CCPs”) with which it has interoperability arrangements.<sup>34</sup> In addition, the policy sets out the LCH SA standards for initial margin, margin add-ons, intraday margins and variation margin.<sup>35</sup> For example:

- Initial margin levels for each of LCH SA’s Clearing Services must be calibrated to the 99.7%<sup>36</sup> confidence level;<sup>37</sup>
- Additional margins must be held (where appropriate) to cover member specific portfolio risk arising from both house and client activity of the following types: (i) concentration/liquidity risk; (ii) sovereign risk; (iii) wrong way risk; and (iv) counterparty credit risk; and
- Each Clearing Service is expected to monitor margin levels intraday and to have the capacity to call for margin intraday should it be necessary to address any issues with member exposures.

The FRAP also sets out the minimum governance standards applicable to LCH SA’s default fund arrangements, including the requirement for all financial resources held by LCH SA (initial margins, additional margins, and the default funds) to meet the so-called “cover-2” standard, *i.e.* the potential losses from a close-out in an extreme event of

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<sup>34</sup> The FRAP also requires LCH SA to assess a number of risks prior to entering into any interoperating arrangements. For example, legal risk arising from the link, including each party’s rights and obligations, cross border legal issues, netting arrangements, enforceability of the LCH SA Rulebook, default procedures, collateral arrangements and dispute resolution.

<sup>35</sup> The standards for the calculation of variation margin depend on whether the price discovery takes place on a public venue/exchange or the price is determined via the “OTC” market. For example: (i) for exchanges and venues where pricing is transparent, each Clearing Service must have a well-documented routine for price capture, price verification and data cleansing where required; (ii) for OTC products, the model used to price instruments for variation margin purposes must be subjected to an “outputs” review; (iii) all inputs to the model must have a documented process for data capture and data cleansing; and (iv) standards for adequate price sources and controls should be equivalent to those described in the Contract, Market and Acceptability Policy.

<sup>36</sup> The rationale for the 99.7% confidence level is detailed in Appendix 2 of the FRAP.

<sup>37</sup> The policy explains that such levels ensure that enough margins are held to cover the potential loss from any member (including the clients of that member) to the defined service confidence levels under normal market conditions, should LCH SA need to close out that member’s portfolio within the holding periods prescribed by the policy. The FRAP also sets out a set of expectations surrounding initial margin. For example, any deterioration in backtesting results must be identified immediately and flagged to the CRO and/or the ERCo to assess whether mitigation actions are required.

the largest two (2) member portfolios and all clients of both of these members. Moreover, the policy details: (i) the order in which LCH SA must use its available resources to cover the losses from a defaulting member;<sup>38</sup> (ii) the predefined stress regime<sup>39</sup> to be used to identify ‘extreme but plausible’<sup>40</sup> tail losses in each member portfolio beyond the applicable initial margin confidence level; and (iii) the Stress Test Loss Over Additional Margin (“STLOAM”)<sup>41</sup> to be imposed on members in order to limit exposure by LCH SA to a single clearing member portfolio. The FRAP states that LCH SA applies a daily Clearing Limit on member exposures such that the STLOAM may not exceed 45% of the Default Fund for any member (the Daily Default Fund Additional Margin, or “DDFAM” threshold), and that should a member group breach the 45% limit, the excess amount must be called as DDFAM from that member group and such margin must be held until the member group’s exposure falls back below the 45% limit.<sup>42</sup>

The FRAP states that each service is expected to monitor intraday margin levels and have the capability to call for margin intraday should it be necessary to address any issues with member exposure. In addition, each service must calculate daily variation margin and such standards for calculation differ depending on whether the price

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<sup>38</sup> The order is as follows: (i) defaulter’s own financial resources (initial margins, variation margins, additional margins, default fund contributions); (ii) the Clearing House ‘skin in the game’; (iii) the default fund contributions of the non-defaulting members; (iv) second layer of skin in the game where required by applicable regulation; (v) default fund assessments of the non-defaulting members; (vi) service continuity and loss allocation mechanisms; and (vii) if the resources at this stage are still not enough to cover the losses, then a decision is made to either close or partially close (if applicable) the service and allocate the remaining losses, or raise more funds from the membership to continue the service.

<sup>39</sup> This includes Stress Test Loss Over Initial Margin (STLOIM) and default fund additional margin (DFAM) calculations, the frequency at which each default fund must be resized, and the prescribed Stress Testing Regime to be followed.

<sup>40</sup> The FRAP determines that a scenario is ‘plausible’ if it has happened over the last 30 years.

<sup>41</sup> This term and some other capitalized terms in the FRAP are defined in the glossary found in Appendix 4 thereof.

<sup>42</sup> The 45% DDFAM threshold may be increased to up to 50% for members with certain ICS scores, when additional risk management tools are in place subject to ERCo approval and Risk Committee notification.

discovery takes place on a public venue/exchange or the price is determined via the OTC market.

The FRAP provides, in addition, that offsets or reductions are allowed in the required margin, subject to certain conditions being met *e.g.*, where the economic offset must be demonstrably resilient during stressed market conditions and must be subject to the stress test regime. The policy also sets the standards to be applied to sources of procyclicality and requirements that were set out in the former Procyclicality Policy.<sup>43</sup> Specifically, the FRAP discusses how LCH SA manages the trade-off between increasing clearing member margins following a market stress event, with the potential resulting liquidity drain, which may be disruptive to the market. To address procyclicality risk, LCH SA will employ specific standards for each of its clearing services to comply with. This includes producing margin levels which avoid disruptive step changes in financial resources held, ensuring margin increases are driven by market pricing and not anticipatory of market movements and adequately estimating volatility to prevent the erosion of margin levels during quiet periods. The FRAP has a supplemental appendix that describes the key sources of procyclicality risk in more detail and specific considerations LCH SA will factor in to avoid procyclicality risk when assessing clearing members.

The FRAP sets out the limit framework for clearing exposures at the member and member group level, with the primary limit being that no one member or member group can use more than 45% of the default fund.<sup>44</sup> For lower credit quality members

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<sup>43</sup> As part of its annual review process, LCH SA moved the contents of its Procyclicality Policy into the FRAP and decommissioned the Procyclicality Policy. Section 9 of the FRAP includes detail on how LCH SA manages procyclicality risk, including by assessing changes in margin requirements, collateral haircuts, Clearing Member credit scoring and how LCH SA may assess Clearing Members for additional default fund contributions.

<sup>44</sup> This may be increased up to 50% for members which have an ICS of 1-4, for a given default fund, when additional risk management tools are in place to mitigate a decrease in the 10% buffer in financial resources held. This is subject to approval from the ERCo followed by a notification to the Risk Committee, and the approval from ERCo needs to be ratified annually. Any such increase

(beginning at an ICS score of 5), there is a limit of 25% usage of the Default Fund, progressively decreasing to zero for a member with an ICS score of 8 or higher. Finally, the FRAP provides that LCH SA will monitor these limits daily for each member in each Default Fund.

To address the risk of clearing members that also have exposure as CaLM counterparties, the FRAP establishes a concentration limit framework at the counterparty level. That is, the FRAP defines a Capital at Risk (“**CAR**”) amount for each member or member group which, together with the aggregate risk exposure of that member or member group, must not be greater than 30% of the entire LCH SA capital.

The FRAP, in addition, requires LCH SA to run liquidity stress tests,<sup>45</sup> collateral stress tests<sup>46</sup> and exposure stress testing.<sup>47</sup> The policy also describes LCH SA’s Reverse Stress Testing Framework to ascertain the adequacy of financial resources held against member positions.<sup>48</sup> A supplemental appendix also describes LCH SA’s reverse stress testing and sensitivity analysis processes in accordance with SEC regulations.

Specifically, the appendix states that LCH SA will conduct a comprehensive analysis of core stress testing scenarios, models, and underlying parameters and assumptions more frequently than the required monthly cadence when the products cleared or markets served display high volatility or become less liquid, or when the size or concentration of positions held by the participants increases significantly. The results of which will go

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in the threshold to 50% is not automatic and each clearing service will need to present and justify the request during the ERCo.

<sup>45</sup> These stresses are detailed in the Liquidity Risk Policy and must be run daily and reviewed at least quarterly or when there is a sudden change in liquidity conditions.

<sup>46</sup> These stresses are described in the Collateral Risk Policy and must be run daily. Collateral haircuts must be reviewed at least quarterly.

<sup>47</sup> This is the stress testing regime carried out in the default fund sizing described above in the FRAP, which ensures that the “cover 2” standard is being met relative to extreme but plausible scenarios above the service initial margin confidence level. These stress tests must be run daily.

<sup>48</sup> The financial resources considered by the policy include all margin coverage, default funds and liquidity resources.

through LCH SA's internal governance processes for the purposes of assessing the adequacy of and adjusting, as necessary, its margin methodology, model parameters, models used to generate clearing or guaranty fund requirements, and any other relevant aspects of its margin framework. In addition to its reverse stress testing processes, LCH SA will conduct a sensitivity analysis of its margin models and a review of its parameters and assumptions for back-testing on at least a monthly basis and consider modifications to ensure its back-testing practices are appropriate for determining the adequacy of margin resources. This may be performed more frequently than monthly during periods of time when the products cleared or markets served display high volatility or become less liquid, or when the size or concentration of positions held by the participants increases or decreases significantly. LCH SA will bring the results of this analysis through internal governance in order to evaluate the adequacy of its margin methodology, model parameters and any other relevant aspects of its margin framework.

c. Counterparty Credit Risk Policy

The Counterparty Credit Risk Policy (“**CCRP**”) describes the standards by which LCH Group and its entities manage and assess counterparty credit risk via an ICS and limit frameworks to manage the risk. Moreover, the policy clarifies the roles and responsibilities within LCH SA for compliance with the CCRP. LCH SA Credit Risk is responsible for monitoring<sup>49</sup> and managing counterparty credit risk. This includes: (i) assigning and maintaining the ICS; (ii) assigning, maintaining and monitoring the applicable limits under the policy; (iii) reporting to the responsible risk team of any change in the ICS which triggers actions under the CCRP and other LCH SA risk

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<sup>49</sup> LCH SA Credit Risk is also required to escalate to the ERCo if any concerns are raised as a result of the factors listed in Annex I, regardless of whether it directly impacts the Implied ICS. For example, where a counterparty reports a change to its external rating letter category from A to BBB and vice versa.

policies; and (iv) regular and ad-hoc reporting to other risk areas and senior management.

The policy is owned by the CRO.

The CCRP requires an ICS to be assigned to all clearing members and the sovereign of their country of risk (and that of their parent, if different); and all other counterparties, including intermediaries and countries which are subject to a minimum ICS as covered in other risk policies. The main scoring frameworks for each counterparty type are detailed in the ICS Frameworks Methodology Document (the “**IFMD**”) and are subject to annual model validation.

The CCRP and IFMD set out the factors to be used by LCH SA to assign an ICS<sup>50</sup> and derive the Implied ICS<sup>51</sup> for corporates (including banks, non-bank financial institutions and supranational entities), sovereigns (including “**Government Related Entities**”), interoperating CCPs, pension funds, regulated funds, and insurance funds.

The CCRP also requires all applicable counterparties, including “Dormant Sponsored Members,” to be subject to a formal documented ICS assessment before onboarding, and then at least once a year. Prospective clearing members and interoperating CCPs for all markets must meet the minimum entry ICS detailed in the policy.<sup>52</sup> For example, Clearing Members, including Interoperating CCPs, must have at least an ICS five (5) rating.

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<sup>50</sup> The frameworks assign an ICS between one (1) and ten (10), whereby one (1) represents low default probability in line with the AAA public ratings and ten (10) is equivalent to a defaulting counterparty.

<sup>51</sup> The ICS is calculated using quantitative and qualitative factors, which are also scored on a one (1) to ten (10) scale based on one or more metrics. Each factor is weighted and the sum of the weighted factors produces an “Implied ICS”. The Implied ICS can be adjusted up or down to arrive at the “Final ICS” based on specific “Adjustment factors” which capture: (i) third party guarantees or support; (ii) country risk: a sovereign ceiling applies to all corporates unless there is a demonstrated degree of diversification. Due to the high regulatory oversight, the country ceiling does not apply to interoperating CCPs; and (iii) specific reasons which make one of the factors over/under stated or particularly significant to dominate all other factors for the final score. The factors, metrics and adjustments are reviewed by the ERCo on at least an annual basis and independently validated in accordance with the Model Governance, Validation and Review Policy.

<sup>52</sup> All other counterparties must meet the minimum eligibility criteria detailed in the relevant LCH risk policies and Rulebooks.

The policy requires a Credit Assessment Review and ICS recommendation to be performed for all new clearing member applications, including the sovereign credit assessment and ICS recommendation of the prospective clearing member and its parent jurisdiction. The ERCo has the discretion to reject any member application regardless of the ICS assigned.

The CCRP and Annex I thereof detail the exposure monitoring thresholds, limits and tolerances applied to each clearing member. This includes: (i) STLOAM plus Default Fund Contribution/Net Capital ratio; (ii) T-ratio; and (iii) credit tolerances. All thresholds are monitored daily, and LCH SA Credit Risk decide on any action to be taken when a breach has occurred.

The CCRP also provides that the aim of additional margin is to ensure that as a clearing member's credit quality deteriorates to below its entry requirement, more resources are called progressively so that the stress losses are fully covered by eligible resources. Moreover, it ensures the relevant service confidence level, as detailed in the FRAP, continues to be met. Additional margin will be applied to house positions and, in general, additional margin will also be applied to client accounts.

The CCRP provides that, where appropriate, LCH SA Credit Risk and the business line may agree to separate procedures to apply additional margin to client accounts on a discretionary basis. Such procedures may include an assessment of the ability of a client to port and its underlying credit quality. Such procedures need to be approved by the ERCo upon LCH SA Credit Risk's recommendation. If such discretion is applied, the LCH SA Risk Committee will be notified of the ERCo's approval and the rationale for the decision.

d. Operational Risk Management Policy

The Operational Risk Management Policy (“**ORMP**”) sets out (i) the LCH Group Board’s<sup>53</sup> risk appetite and expectations for the management of operational risk (defined as the risk of loss arising from inadequate or failed internal processes, people and systems or from external events);<sup>54</sup> and (ii) the key features of the operational risk management framework for identifying, assessing, monitoring, mitigating and managing operational risk. The policy applies to all operations within LCH SA, including all LCH SA employees,<sup>55</sup> regardless of the basis or term of their employment. The standards of the ORMP must also be applied where business functions are outsourced to third parties, including intra-Group.

The ORMP clarifies and expands upon the roles and responsibilities within LCH SA for compliance with the ORMP. The LCH SA Board is responsible for: (i) determining risk appetite; (ii) overall compliance of the risk management framework; and (iii) ensuring that management maintains an adequate system of internal controls appropriate to LCH SA, and the risks to which it is exposed.<sup>56</sup> Moreover, the ORMP details the three lines of defence model, as defined in the Risk Governance Framework, operated by LCH SA:

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<sup>53</sup> In accordance with the Risk Governance Framework and unless otherwise stated, “LCH Group Board” refers to each respective Group entity board, including that of LCH SA, LCH Ltd. and SwapAgent Ltd.

<sup>54</sup> The policy acknowledges that regulations applicable to local entities may specify a more detailed definition of ‘operational risk’.

<sup>55</sup> An “employee” is defined as a permanent, temporary and contract member of staff, consultant and secondee, intern and any other such individual.

<sup>56</sup> The ORMP sets out the LCH SA Board’s expectations, including that (i) risks be identified, assessed, monitored and managed in a proactive manner to minimize the impact to the LCH Group; (ii) risk assessments be carried out using the risk severity matrix contained in Annex A; and (iii) each operational risk be identified as either ‘outside appetite’, ‘near limit (within appetite)’ or ‘within appetite’. Where risks are assessed as near or outside appetite, or where control weaknesses are identified, the First Line of Defence must develop solutions and implementation plans with clear interim milestones to address the weaknesses and bring the risks back to within appetite. The policy requires issues and actions to be raised at least for all risks assessed as near or outside appetite.

- All services and functions responsible for business as usual and change activities are responsible for ensuring adherence to the ORMP and being accountable for identifying, assessing, monitoring, mitigating and managing operational risk<sup>57</sup> (the “**First Line of Defence**”).
- LCH SA Risk Department<sup>58</sup> are responsible for (i) providing oversight, support, and challenge to the First Line of Defence;<sup>59</sup> (ii) ensuring that the ORMP is aligned to the LCH SA Board’s risk appetite; (iii) defining the risk management process and policy framework; (iv) assessing risks against policy standards; and (v) reporting to the Board and sub-committees on risk exposure (the “**Second Line of Defence**”). The Second Line of Defence is also responsible for providing appropriate training<sup>60</sup> on the risk management framework at least annually to relevant staff.<sup>61</sup>
- LCH SA Internal Audit team (“**Internal Audit**”) is responsible for developing and delivering a program of assurance aimed at validating that the control

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<sup>57</sup> This includes responsibility for the day-to-day management of risk by designing, operating and maintaining an effective system of internal controls and for promoting the development of a strong risk culture. The ORMP provides that business and department heads are responsible for ensuring all material risks, controls and mitigating actions are up to date and reflect the current risk assessment. In addition, all staff are responsible for the day-to-day management of risk by designing, operating and maintaining an effective system of internal controls.

<sup>58</sup> The LCH SA Risk Department is also responsible for approving all changes to appetite assessment, and reporting to the LCH SA Board and sub-committees on risk exposure.

<sup>59</sup> The Second Line of Defence must ensure that the First Line of Defence provides evidence of compliance with the principles and standards outlined in the ORMP in an appropriately frequent and detailed manner, having regard to the importance of the business and the services provided.

<sup>60</sup> In line with Annex D of the ORMP, LCH SA Compliance performs face-to-face training for new joiners on compliance topics, and at least every 2 years with critical staff. The purpose of risk management training is to (i) ensure the consistent application of the Operational Risk Management framework, including the tools and reporting processes; (ii) enhance the clarity of roles and responsibilities for risk management and embed these across the three lines of defense; and (iii) embed an effective risk culture for the group which maintains high standards or risk awareness, transparency and accountability.

<sup>61</sup> Compliance is also included as a Second Line of Defence, providing oversight, support and challenge to the First Line in addition to ensuring that this policy is aligned to the Board risk appetite and complies with all the applicable financial rules and regulations.

environment is operating in alignment with the LCH SA Board’s risk appetite and the policies approved by the LCH SA Board (“**Third Line of Defence**”).<sup>62</sup>

The ORMP requires the LCH Group to have a defined risk taxonomy for operational risks, as set out in Appendices 3 and 7 of the Risk Governance Framework (the “**Risk Taxonomy**”). Specifically, (i) the First Line of Defence must identify applicable operational risks and define associated controls applicable to their business or function, in line with the Risk Taxonomy; and (ii) any changes must be approved by the Second Line of Defence, in accordance with Annex C of the ORMP.

The policy confirms that the LCH SA risk assessment tools and processes must include the following minimum requirements:

- risk and control assessments<sup>63</sup> (“**RCAs**”) to be performed by the First Line of Defence<sup>64</sup> on an annual basis, and reviewed by the Second Line of Defence;<sup>65</sup>

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<sup>62</sup> In doing so, the Third Line of Defence provides independent assurance to the LCH SA Board and other key stakeholders over the effectiveness of the systems of internal controls and the Risk Governance Framework.

<sup>63</sup> Such assessments must consider a number of factors such as (i) critical and significant audit findings; (ii) policy breaches; and (iii) external events that may give rise to increased vulnerabilities. Change activities (including new products, processes and system changes), which, if not deployed correctly would have a material impact on LCH SA’s business activities or risk profile, must follow the defined change management process detailed in the ORMP and Annex E thereof.

<sup>64</sup> In carrying out its RCAs, the First Line of Defence must refer to the Risk Taxonomy and Control Guidance set in a dedicated Standard as set forth in the Risk Governance Framework in order to: (i) identify risks and controls which are applicable to their business or function; (ii) assess the inherent risk (*i.e.*, before considering mitigating controls); (iii) perform a control environment assessment; and (iv) assess the residual impact and likelihood of the risk after considering the control assessment.

<sup>65</sup> The Second Line of Defence must have a process in place to review and challenge First Line of Defence RCAs.

- a control assurance process,<sup>66</sup> covering key controls<sup>67</sup> in appropriate depth and frequency;
- deep dives<sup>68</sup> to be conducted by the First, Second and Third Lines of Defence in response to concerns, themes, management focus, triggers or external drivers; and
- a list of extreme but plausible operational risk scenarios relevant to the business or function, incorporating expert opinion<sup>69</sup> and data evaluating exposure to high severity events.

The ORMP also details the process to be followed when the following risk events occur triggering a re-assessment of risks and controls: (i) incidents and actual losses;<sup>70</sup>

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<sup>66</sup> Control assurance is an assessment of controls by a person independent of the day-to-day operation of those controls to confirm the control environment is adequately designed and operating effectively, providing a systematic view of which controls are effective in mitigating risk, which ones are not and where controls are missing. The control assurance also focuses on providing objective evidence that key controls are designed and operating effectively. This provides management the opportunity to respond where controls are not managing risks sufficiently. For the purposes of this control framework, 'control' is defined as 'an action taken (including verification action) to mitigate risk by either reducing the likelihood and/or the impact of an unwanted outcome'.

<sup>67</sup> The term 'key control' is defined as a control that '[p]revents a risk from materializing, detects it in a timely manner or significantly mitigates the consequences. The failure of the key control could have a material impact; financial, non-financial, reputational, regulatory, lead to service disruption and increase risk exposure for the entity'. Any key controls being assessed as being absent or ineffective must be reported to the Second Line of Defence with a remediation plan.

<sup>68</sup> Deep dives assess the controls and governance over a particular process. Any changes to risk profile or actions required as a result of a deep dive must be reported to Second Line of Defence, with a remediation plan.

<sup>69</sup> The ORMP provides that such scenario analysis should draw on the knowledge of experienced business managers and subject matter experts to derive reasoned assessments of plausible severe losses and impacts. As part of the RCA review, the Second Line of Defence will review and challenge the scenarios selected by First Line to ensure they are reflective of the key risks the business or function is exposed to. Over time, the ORMP requires such assessments to be validated and reassessed through comparison to actual loss experience to ensure their reasonableness.

<sup>70</sup> A process must be in place to monitor and manage all types of incidents including IT system failures, failure or delays in key business processes, in order to minimize interruptions to business services. The ORMP requires all incidents to be classified in accordance with their materiality under Annex B and recorded in an appropriate system to facilitate the immediate escalation and resolution of the incident.

(ii) audit<sup>71</sup> or risk and compliance issues, and external reviews;<sup>72</sup> (iii) key risk and control indicator breaches;<sup>73</sup> (iv) control weakness; (v) other internal events including process changes or restructuring;<sup>74</sup> and (vi) external events arising outside of LCH SA and LCH Group's control (e.g., natural disasters, pandemics, political changes, etc.).

Finally, the ORMP requires businesses and functions to maintain complete and accurate risk registers; risk indicators and evidence that supports the assessment of risk, including scenario testing, and ensure regular management information is available for reporting on the status of operational risk.

e. Third Party Risk Management Policy

The Third Party Risk Management Policy (“**TPRMP**”) and the associated Standard set forth in the Risk Governance Framework set out LCH Group's minimum requirements for managing potential risks when entering into and managing all third party relationships across the following four (4) phases of the Third Party<sup>75</sup> lifecycle: (i) identify the need to leverage third party services and select the most appropriate third party provider (“**Plan and Select**”); (ii) set the conditions for the third party relationship (“**Contract and Onboard**”); (iii) ensure that the service, relationship and risks are

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<sup>71</sup> Any audit issue rated ‘critical’ or ‘significant’ may impact the risk profile of the business/function and the risk must be re-assessed accordingly.

<sup>72</sup> External reviews can be initiated by LCH SA's regulators or management where a third party is engaged to perform a specific review and will include for example management recommendations arising as part of the annual external audit process.

<sup>73</sup> Key Risk Indicators (“KRI”) and Key Control Indicators (“KCI”) are metrics with thresholds designed for management to use in order to effectively identify, assess and monitor their current and emerging risks against risk appetite. All businesses and functions must implement them based on the operational risk library and control guidance.

<sup>74</sup> Changes such as process redesign or organizational restructuring may impact the risk profile and require re-assessment of relevant risks, as could a threat assessment triggered by senior management or the LCH SA Board.

<sup>75</sup> “Third Party” is defined in the TPRMP to mean a third party entity, whether internal or external, that provides goods or services to LSEG. The definition includes: (i) External service providers (also known as suppliers and vendors) where LSEG negotiate contractual terms and pay through invoiced arrangements; (ii) External Partners including Financial Market Utilities (FMUs) / Financial Market Institutions (FMIs) / Banks, etc. remunerated through indirect payments (e.g., settlements/deductions). These include CCPs; (iii) Internal Third Party: intragroup services provided from one LSEG entity to another. This definition does not include affiliates, charities, brokers, or joint ventures.

effectively managed (“**Manage and Monitor**”); and (iv) ensure orderly exit and transition at the completion of an engagement or an early termination (“**Terminate and Exit**”).

The Plan and Select section explain how a Risk Assessment must be performed on all new Third Party engagements.<sup>76</sup> Such assessment evaluates the importance and criticality of the third party dependencies across all dimensions and drives subsequent due diligence and procurement activities. Moreover, the policy requires due diligence conducted to be proportionate to the inherent risk and nature of the engagement prior to determining if the Third Party is an appropriate choice for LSEG and within the defined appetite, including concentration. Due diligence must include, but is not limited to, business facts,<sup>77</sup> know your third party,<sup>78</sup> due diligence<sup>79</sup> and conflicts of interest.<sup>80</sup> The TPRMP provides a detailed list of the events that trigger notification to the relevant regulators *e.g.*, when an existing arrangement turns from ‘non-critical’ to ‘critical’, and when there are changes<sup>81</sup> to the list of existing Critical Outsourcing Arrangements.<sup>82</sup>

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<sup>76</sup> In the event of a “Critical Outsourcing” arrangement, appropriate risk and LCH SA Board approval, including regulated entity boards, must be obtained prior to execution, including for the use of any subcontractors. In addition, where a third party provides details on its extended supply chain, LCH SA should establish if any of those parties meet the definition of ‘critical’. Where identified, these should be managed in line with the relevant requirements in the TPRM Standards. ‘Extended Supply Chain’ is defined as ‘Equivalent to 4<sup>th</sup> and n<sup>th</sup> suppliers. Aligns with the expectation that entities take steps to understand critical dependencies in their extended supply chain as far as they extend into the supply chain’. Moreover, Appendix D of the TPRMP provides that where LCH SA identifies an FMI, FMU or other entity directly regulated by a competent authority (regulator) as ‘critical’, the requirements of this policy and the associated TPRM standards will be applied on a best endeavors basis.

<sup>77</sup> For example, a check to ascertain that the Third Party is a valid entity registered in the jurisdiction(s) in which it operates and/or a check of the Third Party’s capability to deliver the desired goods/services.

<sup>78</sup> For example, compliance and financial crime screening, including sanctions, anti-bribery & corruption, anti-money laundering, country risk and fraud, as appropriate.

<sup>79</sup> The TPRMP provides that such due diligence is to be carried out in accordance with the risk profile of the service, *e.g.*, information and cyber security, data privacy, financial crime, and business continuity/resilience.

<sup>80</sup> All conflicts of interest relating to each third party arrangement must be identified, captured and managed in line with the Group Conflict of Interest Policy.

<sup>81</sup> This would include material changes, exits or replacements.

<sup>82</sup> A “Critical or Important Outsourcing Arrangement” is defined as a Third Party arrangement which meets both the definition of ‘Outsourcing’ and delivers services which meet the definition of

The Contract and Onboard section requires LCH SA to have appropriate written agreements<sup>83</sup> with the Third Party (including Intragroup engagements) that are commensurate with the nature, scale and complexity of the services and in line with the financial approval policy. The TPRMP also provides that the written agreement must consider the dependencies from the third party across all dimensions including technology and the potential impact on the continuity and availability of financial services and activities.<sup>84</sup> In addition and for engagements or Outsourcing contracts with Critical Third Parties,<sup>85</sup> the TPRMP requires LCH SA to engage with subject matter experts from Legal, the Business, Risk and Compliance during the contracting phase and the subsequent approval process.

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‘Critical Service’. Outsourcing is defined as an engagement of any form between LSEG and a service provider by which that service provider performs a service, function or an activity that would otherwise be undertaken by LSEG itself. A sub-set of Third Party provided services (either internal or external) where certain regulatory requirements are triggered based on the type and materiality of the service. Example regulatory requirements include increased governance, more frequent risk assessment and regulatory notification. The policy lists the circumstances and factors to be considered by LCH Group to deem a service a ‘Critical Service’.

- <sup>83</sup> A Written Agreement is defined as a binding, auditable commitment between LSEG, or an LSEG entity and a Third Party. It includes, but is not limited to, contracts, LSEG Legal preapproved standard Master Service Agreements (“MSA”) or other type of framework agreement along with Purchase Orders (“PO”), Statements of Work (“SoW”), Order Forms (“OF”), Access or Membership Agreement.
- <sup>84</sup> The TPRMP requires written arrangements related to critical outsourcing or critical services to ensure the service provider grants LSEG and its competent authorities certain access (*e.g.*, head offices and operation centers) and rights of inspection and auditing, to enable them to monitor such outsourcing arrangement, and to ensure compliance with all applicable regulatory and contractual requirements. Where the outsourcing of services is not critical, LCH Group should ensure the access and audit rights are appropriate taking a risk-based approach. The policy lists the circumstances and factors to be considered by LCH Group to deem a service a ‘Non-Critical Service’.
- <sup>85</sup> A Critical Third Party is defined in the TPRM as a Third Party where the continuous, secure and efficient delivery of their services to the regulated entity is critical to the operation of that regulated entity.

The Manage and Monitor<sup>86</sup> section requires an updated register of all current relationships with the third parties and outsourcing arrangements<sup>87</sup> to be regularly maintained. Moreover, Third Party performance,<sup>88</sup> together with that of any permitted subcontractors<sup>89</sup> (for example 4<sup>th</sup> and n<sup>th</sup> parties) supporting the delivery of services, must be monitored<sup>90</sup> on an ongoing basis using a risk-based, proportionate approach<sup>91</sup> and in line with the TPRM Manage and Monitor Standard to ensure the Third Party is delivering on their obligations under the written agreement. The policy also requires LSEG to exercise and apply audit rights (and supplier testing) in full to Critical Third Party arrangements and on a risk-based basis to non-critical outsourcing arrangements where required.<sup>92</sup>

The Termination and Exit section requires LCH SA to plan for both a ‘stressed’ (e.g., a third party becoming insolvent) and unstressed (e.g., termination for convenience/end of a contract) exit from each of its third party arrangements.<sup>93</sup> The

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<sup>86</sup> The TPRMP provides that the following key principles underpin LSEG’s approach to the management of Third Party arrangements: (i) a risk-based approach, with the highest level of oversight and due diligence on Critical Third Party services (which includes third parties which meet the regulatory definitions Critical Outsourcing Arrangements and Critical Third Parties); (ii) overall accountability by the Accountable Executive for overall resilience and any risks associated with it and for any activities conducted via an outsourcing arrangement; and (iii) standard processes and tools must be leveraged wherever possible to achieve consistency and efficiency.

<sup>87</sup> This includes critical 4<sup>th</sup> and n<sup>th</sup> parties where details of these are provided.

<sup>88</sup> The TPRMP sets out what the performance monitoring for Critical Third Parties should include. For example, Day-to-day monitoring of the Third Party’s performance and delivery against the measures defined in the written agreement and to ensure appropriate action is taken to resolve any operational issues that may arise with the Third Party.

<sup>89</sup> A subcontractor is defined as a provisioning party to whom the Third Party subsequently delegates all or part of the provision of a service (e.g., 4<sup>th</sup>+ party).

<sup>90</sup> Monitoring of Third Party arrangements must also include the appropriate assessment and management of changes to, and within, the arrangement in line with organizational change processes. Moreover, the policy provides that it is important that Business Continuity Plans and reviewed and where relevant testing in line with the Business Continuity Management Policy.

<sup>91</sup> Further detail on this approach can be found in the TPRMP and Appendix D thereto.

<sup>92</sup> For regulated areas, this may include third party certifications and pool audits, where appropriate. A full table of requirements is set out in the Risk Methodology document.

<sup>93</sup> Irrespective of the reason for exiting a Third Party relationship, LSEG aims to do so: without undue disruption to its business activities with minimal impact on the services provided to customers; and without limiting its compliance with legal or regulatory requirements.

policy states that the Accountable Executive<sup>94</sup> and Relationship Owner<sup>95</sup> for each Third Party arrangement is responsible for ensuring records and documentation are maintained in line with local regulatory records management requirements, in order to demonstrate ongoing compliance with the TPRMP and the associated standards.<sup>96</sup>

The TPRMP also sets out the roles and responsibility for implementing the above standards within LCH SA.<sup>97</sup> In this regard, LCH Group follows a third lines of defense model. The first line of defense, made up of the LCH SA Third Party Management Risk team and Procurement team, is responsible and accountable for identifying, assessing, monitoring, and managing third party risk. Moreover, it must ensure there are appropriate controls designed, implemented and assessed to ensure LCH SA can operate within the agreed risk appetite.

The Second Line of Defence, including Second Line Risk and Compliance team, is responsible for the oversight, support, and challenge in addition to ensuring that the policy is aligned to the LCH SA Board appetite.<sup>98</sup> The Third Line of Defence, made up of the Internal Audit function, is responsible for developing and delivering a program of assurance aimed at validating that the control environment is operating in alignment with

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<sup>94</sup> An Accountable Executive is defined as responsible for ensuring that the risks associated with the Third Party are managed as per this policy: (i) retain overall responsibility for the Third Party engagement; (ii) monitor Third Party engagement; (iii) manage incidents and disputes and oversee change control process’.

<sup>95</sup> A Relationship Owner is defined as a nominated individual within the Business Function who assumes responsibility for the ownership of goods or services from a designated Third Party. They are responsible for implementing and executing oversight and management activities across the Third Party lifecycle (i.e. from selection, contracting and onboarding service delivery through to exit activities). This role is limited to full time employees.

<sup>96</sup> The policy sets out the relevant LCH Group policies and guidelines, or equivalent entity policies and guidelines, that must be read in conjunction with the TPRMP. For example, the Anti-Bribery and Corruption Policy, the Business Continuity Policy, the Code of Conduct and Ethics, and the Conflicts of Interest Policy.

<sup>97</sup> Further detail on these roles and responsibilities can be found in Appendix E of the TPRMP. Please note that Appendix A has not been referred to as it is not applicable to LCH SA.

<sup>98</sup> The Second Line of Defence, including Compliance, must ensure that the First Line of Defence provides evidence of compliance with the principles and requirements outlined in this policy in an appropriately frequent and detailed manner, having regard to the importance of the business and the services provided.

the LCH SA Board's risk appetite and the policies approved by the LCH SA Board. In doing so, Third Line of Defence provides independent assurance to the LCH SA Board and other key stakeholders over the effectiveness of the systems of controls and the Risk Governance Framework.

f. Risk Governance Framework

The Risk Governance Framework (the “**RGF**”) identifies the Key Risks (as defined below) faced by LCH SA and sets out: (i) the LCH SA Board's appetite across the Key Risks; (ii) the taxonomy of the Key Risks; (iii) the roles and responsibilities within LCH SA for managing each identified Key Risk; (iv) the standards to be met by LCH SA when managing its business activities within the determined risk appetite; and (v) the indicators and tolerance thresholds by which each Key Risk is meant to be measured and reported.

The RGF aims to ensure that the risks assumed in executing LCH SA's business strategy are adequately understood and managed across all levels within LCH SA. Moreover, the framework supports LCH SA's Board and Executive Management in discharging their regulatory and corporate responsibilities.<sup>99</sup>

The RGF establishes a hierarchical risk taxonomy comprising of levels zero (0), one (1) and two (2). The key risks are set out at level zero (0) and include: (i) financial and model risks associated directly with clearing activities; (ii) risks relating to operational resilience; (iii) strategic risks; (iv) people and culture risks; and (v) regulatory compliance, legal and corporate disclosure risks (together, the “**Key Risks**”). Within the Key Risks, the RGF identifies 31 level one (1) risks, and a number of level two (2) sub-

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<sup>99</sup> The RGF provides that this is done through robust governance arrangements with (i) well-defined, transparent, and consistent lines of responsibility; (ii) effective processes to identify, manage, monitor and report the risks to which it is or might be exposed; and (iii) adequate internal control mechanisms.

risks where additional granularity is appropriate.<sup>100</sup> Moreover, the framework provides that LCH SA's appetite for the Key Risks is generally low,<sup>101</sup> and in some cases, very low, due to its core mission as a regulated clearing house that plays a vital role in ensuring the stability of the financial markets in which it operates.<sup>102</sup>

The RGF also identifies a range of quantitative and qualitative indicators and thresholds<sup>103</sup> tailored for specific risks, which are used to measure the extent to which a risk is considered within the LCH SA Board's appetite.<sup>104</sup> In addition to these indicators, the CRO, as owner of the RGF, will utilize the risk assessment grid<sup>105</sup> and process to compile LCH SA Board's appetite reports.<sup>106</sup>

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<sup>100</sup> Details on the taxonomy with level two (2) risk definitions can be found in Appendix 3 of the RGF.

<sup>101</sup> The framework establishes four levels of risk appetite: very low, low, medium and high. Moreover, each level is defined as follows: (i) 'very low' means LCH SA is not willing to accept risks in most circumstances. The LCH SA Board should decide if the benefits outweigh the costs and the risk is worth taking; (ii) 'low' means LCH SA is willing to accept risk in some circumstances whereby successful delivery is likely with an acceptable level of reward. Such risks should be managed at business unit level (as set out in the RGF), but escalated if the impact and/or probability of occurrence is increasing; and (iii) 'moderate' means LCH SA is eager to innovate or choose options based on potential higher rewards. Risks in the 'moderate' category should be monitored in accordance with the RGF to ensure that the cost/effort applied in managing such risks is appropriate given the potential downside. In relation to the 'high' risk appetite, the framework provides that while LCH SA does not expect to have a high-risk appetite for any risk, in exceptional circumstances, it may temporarily tolerate short periods of exposure to this risk level.

<sup>102</sup> Section C of the RGF expands upon each of the risks identified in the risk taxonomy, including the relevant risk appetite, a definition of each risk, the high level standards expected to be in place to manage such risks, as well as the relevant risk indicators and associated tolerance thresholds for assessing the management of each risk.

<sup>103</sup> The framework provides that the thresholds should be considered risk tolerances (*i.e.*, an 'outside' appetite threshold indicates the maximum tolerance for a particular risk). The LCH SA Board expects that such tolerance levels should be specific to each risk, and capable of quantitative measurement where possible, so that an accurate report can be made of the status of each risk against the LCH SA Board's appetite and maximum tolerance.

<sup>104</sup> The CRO will include these indicators and thresholds in his regular risk reporting to the LCH SA Board.

<sup>105</sup> The assessment of a risk being reported as 'within' (green), 'near' (amber), or 'outside' appetite (red) may be made by using the risk indicators described above and by comparing residual risk severity with the LCH SA Board's appetite, using the tables detailed in Section A3 and Appendix 6 of the RGF.

<sup>106</sup> The CRO may exercise judgement, both in the method utilized and in the final assessment *e.g.*, taking into account the existence of any appetite-related actions. The CRO's assessment will be validated through review at the Resilience Committee (ResCo) and the ERCo.

The framework highlights that risk culture is a vital element of the overall culture of the LCH SA organization. LCH SA values, as adopted by the LCH SA Board and Executive Management, communicated to all employees, and reflected in the LSEG Code of Conduct, provide the basis for measuring and assessing LCH SA's culture, and support the measurement of risk against appetite. For example, the RGF requires (i) senior management and employees at all levels to operate in a transparent way, and be held accountable for their behavior;<sup>107</sup> and (ii) mandatory training to be provided to employees to reinforce LCH SA's key cultural, behavioral, legal and regulatory obligations across all important topics.<sup>108</sup>

The framework requires LCH SA to follow the three lines of defense model (as described above). Like the ORMP,<sup>109</sup> LCH SA Function Heads and Business Heads (excluding the CRO, LCH SA Chief Compliance Officer (“CCO”) and Head of Internal Audit) manage the risks of all LCH SA's business activities and therefore constitute the First Line of Defence. The CRO,<sup>110</sup> as part of the Second Line of Defence, is responsible for: (i) measuring, monitoring and reporting the risks identified in the RGF and ORMP; and (ii) setting policies<sup>111</sup> consistent with the standards identified in the RGF. LCH SA Human Resources, Compliance, Finance and Legal are responsible for corporate risks and for setting policies consistent with the RGF and for the management, monitoring and

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<sup>107</sup> The RGF provides that the culture of transparency and accountability is embedded through establishing, monitoring and adhering to risk appetite, which is implemented through the framework and suite of LCH SA policies.

<sup>108</sup> The training is refreshed and rolled out throughout the year, requiring an assessment to be completed by all the staff to confirm that the materials have been understood. Non-completion is monitored and escalated to ensure that the training has been delivered to all intended recipients.

<sup>109</sup> The RGF details a specific Operational Risk Taxonomy in Appendix 7 thereof.

<sup>110</sup> The CRO has a dual reporting line to the LCH SA Chief Executive Officer (“CEO”) and to the Chair of the LCH SA Risk Committee. For compliance and regulatory risks, the CCO is responsible for the second-line risk function, supported by the CRO.

<sup>111</sup> The full list of LCH SA's Risk Policies can be found in Appendix 4 of the RGF.

reporting of any policy noncompliance within their specific areas. Internal Audit is the Third Line of Defence.

The RGF details, in table format, each of the Key Risks, including: (i) the LCH SA Board's risk appetite and standards; (ii) relevant risk indicators and tolerance thresholds to assist with the assessment of whether each risk should be assessed as 'within', 'near' or 'outside' appetite;<sup>112</sup> (iii) the internal LCH SA stakeholders responsible for each risk and associated policy; and (iv) the LCH SA policy detailing how the LCH SA Board standards are applied across the business.<sup>113</sup>

In relation to reputational risk, the framework:

- (i) defines reputational risk as “the risk of a failure to meet stakeholders’ expectations or the risk of unfavorable public perceptions of the LCH SA business and brand;”
- (ii) identifies stakeholder perceptions, brand risk and media engagement as level two (2) risks;
- (iii) describes the LCH SA Board risk appetite as ‘low’ and expresses that LCH SA will actively protect its brand by maintaining the integrity of services and actively review initiatives to ensure that its brand is protected;
- (iv) defines the CEO and Business Heads as the First Line of Defence, and the CRO as the Second Line of Defence;
- (v) states that this risk is covered by brand, media and communication policies;
- (vi) identifies ‘negative/damaging press coverage’ as a risk indicator;

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<sup>112</sup> Holistically, at each level, such risk status assessment will also take account of qualitative factors, tolerance thresholds, policies and culture.

<sup>113</sup> Such details can be found in Section C of the RGF.

- (vii) identifies ‘up to three (3) days of national/“trade” press coverage’ as the near appetite threshold; and
- (viii) identifies ‘more than three (3) days of national/“trade” press coverage as a proxy for maintaining a good reputation’ as the outside appetite tolerance limit.

Appendix 1 of the RGF details additional standards in relation to the subject of recovery, resolution and wind-down<sup>114</sup> (“**RRW**”) and Important Business Services. For example and in relation to RRW, the framework requires LCH SA to have a pre-arranged recovery plan which: (i) has been agreed with LCH SA clearing members and regulators; (ii) has been fully documented and gone through the appropriate internal governance; (iii) lists the recovery tools available to be used in the recovery process; and (iv) lists the decision points which trigger LCH SA to go into recovery mode.

The RGF is reviewed and signed off by the LCH SA Board at least annually, providing assurance that all risks continue to be appropriately identified and mapped, that the statement of risk appetite is clear and defined at the appropriate level of granularity, that ownership and responsibilities are clear, and that there is an appropriate process for monitoring and reporting on all risks against LCH SA’s appetite.

## 2. Statutory Basis

LCH SA has determined that the Risk Policies are consistent with the requirements of Section 17A of the Act<sup>115</sup> and regulations thereunder applicable to it, including Commission Rule 17ad-22(e).<sup>116</sup> In particular, Section 17A(b)(3)(F)<sup>117</sup> of the

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<sup>114</sup> Appendix 1 of the RGF defines such risk as “The risk stemming from LCH Ltd. or LCH SA not having in place a proper [r]ecover[y] [p]lan having identified and pre-agreed recovery tools to handle a loss event, remain solvent and to continue to operate smoothly in performing its central clearing role. Examples of such recovery tools can include member assessments, variation margin haircutting, cash settlement, etc.”

<sup>115</sup> 15 USC 78q-1.

<sup>116</sup> 17 CFR § 240.17ad-22(e).

<sup>117</sup> 15 USC 78q-1(b)(3)(F).

Act requires, *inter alia*, that the rules of a clearing agency “promote the prompt and accurate clearance and settlement of . . . derivatives agreements, contracts, and transactions” and “to protect investors and the public interest.”

In this regard, the CRP sets out more clearly LCH SA’s standards for the management of risks associated with LCH SA’s collateral activities, including collateral accepted to cover margin requirements and to satisfy default fund contributions. The policy establishes robust criteria for collateral eligibility, including concentration limits, as well as a rigorous oversight and monitoring framework to ensure that collateral is appropriately valued on an ongoing basis. In addition, the FRAP establishes a robust framework to ensure that the financial resources held by LCH SA against member exposures – including, most importantly, margin requirements – is sufficient to cover any potential losses of a defaulting clearing member. Insufficient financial resources, including margin, would impede LCH SA’s ability to promptly accept trades for clearing, hence the CRP and FRAP are consistent with Section 17A(b)(3)(F) of the Act.<sup>118</sup>

The CCRP is designed to identify, and manage, LCH SA’s counterparty credit risk, principally through the ICS framework applicable to members and the sovereign of their country of risk (as well as their parent entity, if different) as well as to all other investment and other counterparties. Applicants for clearing membership must meet a minimum ICS; a member’s ICS is monitored on an ongoing basis and the policy sets out a framework for responding to deteriorating credit risk. The CCRP is therefore an integral part of LCH SA’s arrangements to mitigate the risk of a clearing member default, which serves to protect investors as well as the public interest. The CCRP is therefore consistent with the requirements of Section 17A(b)(3)(F) of the Act.<sup>119</sup>

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<sup>118</sup> 15 USC 78q-1(b)(3)(F).

<sup>119</sup> *Id.*

To clear trades promptly and accurately, LCH SA must ensure that its systems, including those operated by third parties, are resilient. In this regard, the ORMP sets out LCH SA's arrangements for minimizing the risks of disruption to LCH SA's services and to LCH SA's ability to carry out its obligations to members, clients and other stakeholders. The ORMP therefore implements a suite of risk assessment controls and procedures, including a control framework, deep dive, and scenario analysis, to address operational risks. These arrangements are supported by a change control framework as well as a set of procedures to undertake an *ex-post* review of risk incidents. The TPRMP is designed to manage the risks of using third party service providers in relation to outsourcing critical or important functions. By establishing a risk control framework across the outsourcing life-cycle – from contracting/onboarding, to monitoring and managing performance, to exit/termination – the TPRM minimizes the risks that the use of third party service providers will impact LCH SA's ability to accept trades for clearing promptly and accurately. The ORMP and the TPRMP are therefore consistent with Section 17A(b)(3)(F) of the Act.<sup>120</sup>

The RGF sits above the CRP, FRAP, CCRP, ORMP and TPRMP, and identifies the key risks faced by LCH SA as well as the associated indicators and tolerance thresholds by which each such risk is to be measured and reported. By providing the wider risk governance framework within which the CRP, FRAP, CCRP, ORMP and TPRMP have been designed and adopted, the RGF supports how such risk policies facilitate the prompt and accurate settlement of transactions and protect investors and the public interest and is therefore consistent with Section 17A(b)(3)(F) of the Act.<sup>121</sup>

Commission Rule 17ad-22(e)(2)(i) provides that each covered clearing agency must establish, implement, maintain, and enforce written policies and procedures

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<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

reasonably designed to provide for governance arrangements that are clear and transparent.<sup>122</sup> As discussed above, each of the Risk Policies expands on and clarifies the standards by which LCH SA manages the various risks to which it is exposed as a CCP. Importantly, each Risk Policy clearly describes the roles and responsibilities of the various units within LCH SA or LCH Group, as applicable, responsible for compliance with each policy. For example, the CCRP specifies that LCH SA Credit Risk is responsible for monitoring and managing counterparty credit risk, including: (i) assigning and maintaining the ICS; (ii) assigning, maintaining and monitoring the applicable limits under the policy; (iii) reporting to the responsible risk team of any change in the ICS which triggers actions under the CCRP and other LCH SA risk policies; and (iv) regular and ad-hoc reporting to other risk areas and senior management. The CCRP also identifies the CRO as policy owner.

Similarly, the three lines of defense model set out in the TPRMP identifies the first line of defense as the LCH SA Third Party Management Risk and Procurement team Function Heads and Business Heads, which is responsible and accountable for identifying, assessing, monitoring, and managing third party risk and for ensuring that LCH SA can operate within the agreed risk appetite. Second Line Risk is responsible for the oversight, support, and challenge in addition to ensuring that the policy is aligned to the LCH SA Board risk appetite. The Internal Audit function, as the third line of defense, is responsible for developing and delivering a program of assurance aimed at validating that the control environment is operating in alignment with the LCH SA Board's risk appetite and the LCH SA Board's approved policies. For its part, the RGF specifies the internal LCH SA stakeholders responsible for each Key Risk and the associated policy framework generated to address such Key Risk.

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<sup>122</sup> 17 CFR § 240.17ad-22(e)(2)(i).

By expanding on and clarifying the standards by which LCH SA manages the various risks to which it is exposed as a CCP and more clearly describing the roles and responsibilities of the various units within LCH SA or LCH Group responsible for compliance with each Risk Policy, the Risk Policies provide for governance arrangements that are clear and transparent. As such, the Risk Policies are consistent with Commission Rule 17ad-22(e)(2)(i).<sup>123</sup>

Commission Rule 17ad-22(e)(2)(v)<sup>124</sup> provides that each covered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to specify clear and direct lines of responsibility. As discussed in detail immediately above, each Risk Policy clearly describes the roles and responsibilities of the various units within LCH SA or LCH Group responsible for compliance with each policy. By more clearly describing the roles and responsibilities of the various units within LCH SA or LCH Group, as applicable, responsible for compliance with each Risk Policy, the Risk Policies specify clear and direct lines of responsibility. As such, the Risk Policies are consistent with Commission Rule 17ad-22(e)(2)(v).

Commission Rule 17ad-22(e)(3)<sup>125</sup> requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the covered clearing agency, which includes, *inter alia*, (i) risk management policies, procedures, and systems designed to identify, measure, monitor, and manage the range of risks that arise in or are borne by the covered clearing agency, that are subject to review on a specified periodic basis and approved by the LCH SA Board annually; and (ii) plans for the recovery and orderly wind-down of the covered

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<sup>123</sup> *Id.*

<sup>125</sup> 17 CFR § 240.17ad-22(e)(3).

clearing agency necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses.<sup>126</sup>

In this regard, the RGF is a framework that: (i) identifies and categorizes Key Risks faced by LCH SA; (ii) sets out the roles and responsibilities within LCH SA for managing each identified Key Risk; (iii) provides the standards to be met by LCH SA when managing its business activities within the determined risk appetite; and (iv) establishes the indicators and tolerance thresholds by which each Key Risk is meant to be measured and reported. For example, and as noted above, the RGF identifies the standards that are specific to LCH SA in relation to the subject of RRW to ensure LCH SA has a proper recovery plan to handle a loss event, remain solvent and continue to operate smoothly in performing its central clearing role. The RGF also expects that the LCH SA Board establish a wind-down plan for non-critical services, to be tested annually and on a selected service. The RGF is signed off by the LCH SA Board at least annually. By providing (i) an overall risk management framework to comprehensively manage the Key Risks, subject to the LCH SA Board's annual review and sign-off; and (ii) a plan for the recovery and orderly wind-down of LCH SA, the RGF is consistent with Commission Rule 17ad-22(e)(3).<sup>127</sup>

Commission Rule 17ad-22(e)(4)(i) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed 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 resources to cover its credit exposure to each participant fully with a high degree of confidence.<sup>128</sup>

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<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> 17 CFR § 240.17ad-22(e)(4)(i).

The CCRP sets out the standards by which LCH SA manages and assesses counterparty credit risk. Specifically, the policy requires LCH SA Credit Risk to assign an ICS to: (i) all clearing members and the sovereign of their country of risk (and that of their parent, if different); and (ii) all counterparties, including intermediaries and countries which are subject to a minimum ICS as covered in other risk policies. In addition, the CCRP imposes credit exposure monitoring thresholds, limits and tolerances on each clearing member. the CCRP ensures LCH SA maintains sufficient financial resources (including prefunded financial resources) to cover its credit exposure to each participant by: (i) assigning an ICS to each counterparty based on an assessment of quantitative and qualitative factors; and (ii) detailing the policy on exposure monitoring thresholds, limits and tolerances applicable to each clearing member. The CCRP is therefore consistent with Commission Rules 17ad-22(e)(4)(i).<sup>129</sup>

Commission Rule 17ad-22(e)(4)(iii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining additional financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the participant family that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions.<sup>130</sup> In addition, Commission Rule 17ad-22(e)(4)(v) requires that such financial resources be maintained in combined or separately maintained clearing or guarantee funds.<sup>131</sup>

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<sup>129</sup> *Id.*

<sup>130</sup> 17 CFR § 240.17ad-22(e)(4)(iii).

<sup>131</sup> 17 CFR § 240.17ad-22(e)(4)(v).

The FRAP describes the standards governing the assessment of financial resources (initial margins, margin add-ons and default funds) against Latent Market Risks in clearing portfolios at LCH SA. Specifically, the policy requires additional margins to be held (where appropriate) to cover member specific portfolio risk arising from house and client activity of the following types: (i) concentration/liquidity risk; (ii) sovereign risk; (iii) wrong way risk; and (iv) counterparty credit risk. The FRAP details the stress regime to be used to identify ‘extreme but plausible’ tail losses in each member portfolio beyond the applicable initial margin confidence level. For instance, it requires liquidity stress tests, collateral stress tests, and exposure stress tests to be run daily. The policy also details the maximum credit tolerances to be applied per LCH SA clearing member every day. By confirming: (i) the requirements for LCH SA to impose, call and collect daily margins; (ii) the methodology for stress testing; and (iii) the allocation of financial resources per clearing member, the FRAP is consistent with Commission Rules 17ad-22(e)(4)(iii)<sup>132</sup> and 17ad-22(e)(4)(v).<sup>133</sup>

Commission Rule 17ad-22(e)(4)(vi)<sup>134</sup> requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit-exposures to participants and those arising from its payment, clearing, and settlement processes, including testing the sufficiency of its total financial resources available to meet its minimum financial resource requirements by: (i) conducting stress testing of its total financial resources once each day using standard predetermined parameters and assumptions; (ii) conducting a comprehensive analysis on at least a monthly basis of the existing stress testing scenarios, models, and underlying parameters and assumptions, and

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<sup>132</sup> 17 CFR § 240.17ad-22(e)(4)(iii).

<sup>133</sup> 17 CFR § 240.17ad-22(e)(4)(v).

<sup>134</sup> 17 CFR § 240.17ad-22(e)(4)(vi).

considering modifications to ensure they are appropriate for determining the covered clearing agency's required level of default protection in light of current and evolving market conditions; (iii) conducting a comprehensive analysis of stress testing scenarios, models, and underlying parameters and assumptions more frequently than monthly when the products cleared or markets served display high volatility or become less liquid, or when the size or concentration of positions held by the covered clearing agency's participants increases significantly; and (iv) reporting the results of its analyses under items (ii) and (iii) above to appropriate decision makers at the covered clearing agency, including but not limited to, its Risk Management Committee or LCH SA Board, and using these results to evaluate the adequacy of and adjust its margin methodology, model parameters, models used to generate clearing or guaranty fund requirements, and any other relevant aspects of its credit risk management framework, in supporting compliance with the minimum financial resources requirements set forth in paragraphs (e)(4)(i) and (iii) of this section.<sup>135</sup>

The FRAP (i) details the standards by which financial resources should be assessed against member exposures; (ii) details the holding periods to be used for each product in the assessment of margins, providing justification for each; (iii) articulates the predefined stress regime to be used by LCH SA to identify 'extreme but plausible' tail losses in each member portfolio beyond the applicable initial margin confidence level; (iv) sets the standards to be used for reverse stress testing the financial resources held against member positions; and (v) establishes the required daily liquidity stress, collateral stress and exposure stress testing. The policy also details a comprehensive process for LCH SA to monitor, analyze and resize each default fund on a monthly basis.

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<sup>135</sup> *Id.*

The FRAP also complements the Model Governance, Validation and Review Policy by adding further standards to be included in the testing and validation of margin models. For instance, it requires LCH SA to (i) list and justify its critical model assumptions and modelling methodology; and (ii) calculate and monitor the sensitivities of model outputs to key parameter changes. Moreover, the FRAP provides that the appropriateness of the policy relative to the LCH SA Board's risk appetite and regulatory requirements should be reviewed on an annual basis by ERCo with any significant findings reported to the LCH SA Risk Committee and LCH SA Board. The FRAP is therefore consistent with Commission Rule 17ad-22(e)(4)(vi).<sup>136</sup>

Commission Rule 17ad-22(e)(5)<sup>137</sup> requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to limit the assets it accepts as collateral to those with low credit, liquidity, and market risks, and set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its or its participants' credit exposures.

The CRP sets out the standards for the management of LCH SA's collateral risks. As noted above, the policy identifies the acceptance criteria for cash and non-cash collateral posted by its members to cover margin requirements and default fund contributions to those with low credit, liquidity and market risks. With regards to cash, as explained in the CRP and noted above, LCH SA limits the primary currencies accepted by LCH SA to EUR, GBP, and USD. In relation to non-cash collateral, the policy limits the assets to certain traded securities and central bank guarantees. Moreover, the CRP requires LCH SA to apply a defined haircut methodology and mandates additional haircuts and concentration limits to manage its or its participants' credit exposures when

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<sup>136</sup> *Id.*

<sup>137</sup> 17 CFR § 240.17ad-22(e)(5).

certain events are triggered. For instance, issuers are subject to a credit risk add-on where they are assigned an ICS of four or below.

By confirming (i) the principles and factors that will be applied when considering whether an asset can be accepted by LCH SA as collateral for margin cover; and (ii) the base haircuts, haircut add-ons, limits and/or price adjustments, the CRP is consistent with Commission Rule 17ad-22(e)(5).<sup>138</sup>

Commission Rule 17ad-22(e)(6)<sup>139</sup> requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover, if the covered clearing agency provides central counterparty services, its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, *inter alia*: (i) considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market; (ii) marks participant positions to market and collects margin, including variation margin or equivalent charges if relevant, at least daily and includes the authority and operational capacity to make intraday margin calls in defined circumstances; (iii) uses reliable sources of timely price data and uses procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable; and (iv) uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.

The FRAP sets out the standards governing the assessment of financial resources (initial margins, margin add-ons and default funds) against the Latent Market Risks in clearing member portfolios at LCH SA. As noted above, the FRAP requires LCH SA to impose, call and collect margins at least daily on each day when its Clearing Services are open and operating to limit its credit exposures to its clearing members and, where

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<sup>138</sup> *Id.*

<sup>139</sup> 17 CFR § 240.17ad-22(e)(6).

relevant, from CCPs with which it has interoperability arrangements. In addition, the policy sets out the LCH SA standards for initial margin, margin add-ons, intraday margins and variation margin. For instance, additional margins must be held (where appropriate) to cover member specific portfolio risk arising from both house and client activity of the following types: (i) concentration/liquidity risk; (ii) sovereign risk; (iii) wrong way risk; and (iv) counterparty credit risk. In addition, each Clearing Service is expected to monitor margin levels intraday and to have the capacity to call for margin intraday should it be necessary to address any issues with member exposures. The FRAP also details the standard for the calculation of margin, including the methods of price capture and verification.

By confirming: (i) the policy requiring LCH SA to impose, call and collect daily margins; (ii) the methods for calculating margins; and (iii) the ability for Clearing Services to call for intraday margin, where necessary, the FRAP is consistent with Commission Rule 17ad-22(e)(6).<sup>140</sup>

Commission Rule 17ad-22(e)(18) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation, which, *inter alia*: (i) require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency; and (ii) monitor compliance with such participation requirements on an ongoing basis.<sup>141</sup>

The CCRP describes the standards by which LCH SA manages and assesses counterparty credit risk via an ICS and limit frameworks. In addition to clarifying the roles and responsibilities within LCH SA for compliance with the policy, noted above, the CCRP requires LCH SA Credit Risk to: (i) assign and maintain the ICS for each

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<sup>140</sup> *Id.*

<sup>141</sup> 17 CFR § 240.17ad-22(e)(18).

counterparty; (ii) assign, maintain and monitor the applicable limits under the policy; (iii) report to the responsible risk team of any change in the ICS which triggers actions under the CCRP and other LCH SA risk policies; and (iv) provide regular and ad-hoc reporting to other risk areas and senior management. The CCRP requires an ICS to be assigned to all clearing members and the sovereign of their country of risk (and that of their parent, if different); and all other counterparties, including intermediaries and countries which are subject to a minimum ICS as covered in other risk policies. Furthermore, the CCRP sets out the factors used by LCH SA to assign an ICS and Implied ICS for each of the counterparty types it deals with. The CCRP also details the exposure monitoring thresholds, limits and tolerances applied to each clearing member; all thresholds are monitored daily, and LCH SA Credit Risk decide on any action to be taken when a breach has occurred.

By providing for the assignment, maintenance and monitoring of an ICS applied to each counterparty that LCH SA interacts with, as well as the monitoring of related counterparty credit risk thresholds, the CCRP is consistent with Commission Rule 17ad-22(e)(18).<sup>142</sup>

Commission Rule 17ad-25(i) requires a covered clearing agency to manage risks from relationships with its service providers for core services.<sup>143</sup> The TPRMP states that LCH SA consider a risk-based and proportionate approach to onboarding third parties (including service providers for core services). LCH SA adopts the highest level of oversight and due diligence for critical third party services. Third parties deemed critical in accordance with the TPRMP will have a high or very-high inherent risk rating and require more heightened due diligence (monitoring and testing) and approval by the LCH SA Board for any changes to the relationship with any critical third party engagements.

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<sup>142</sup> *Id.*

<sup>143</sup> 17 CFR § 240.17ad-25(i).

By considering this risks borne from its relationships with service providers of core services and applying a more stringent due diligence process for such service providers, LCH SA believes its TPRMP is consistent with Commission Rule 17ad-25(i).<sup>144</sup>

Rule 1001 of Regulation System Compliance and Integrity (“**Reg SCI**”)<sup>145</sup> requires SCI entities (which include registered clearing agencies), to: (i) establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems and, for purposes of security standards, indirect SCI systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity’s operational capability and promote the maintenance of fair and orderly markets; and (ii) establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems operate in a manner that complies with the Act and the rules and regulations thereunder and the entity’s rules and governing documents, as applicable.

The ORMP sets out (i) LCH SA’s appetite and expectations for the management of operational risk (defined as the risk of loss arising from inadequate or failed internal processes, people and systems or from external events); and (ii) the key features of the operational risk management framework for identifying, assessing, monitoring, mitigating and managing operational risk. In addition to clarifying the roles and responsibilities within LCH SA for compliance with the policy, noted above, the ORMP requires LCH SA to have a defined risk taxonomy for operational risks, and sets out the risk assessment tools and processes to be used, including RCAs, control assurance processes, and deep dives. Furthermore, the ORMP details the process to be followed when the following risk events occur triggering a re-assessment of risks and controls: (i) incidents and actual losses; (ii) audit or risk and compliance issues, and external reviews;

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<sup>144</sup> *Id.*

<sup>145</sup> 17 CFR § 242.1001.

(iii) key risk and control indicator breaches; (iv) control weakness; (v) other internal events including process changes or restructuring; and (vi) external events arising outside of LCH SA and LCH Group's control (e.g., natural disasters, pandemics, political changes, etc.).

By providing for the overall operational risk management framework of LCH SA, including the controls detailed thereunder, the ORMP is designed to ensure that LCH SA's systems and indirect systems have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain LCH SA's operational capability and ensure that its systems operate in a manner that complies with the Act and the rules and regulations thereunder. The ORMP is therefore consistent with Rule 1001 of Reg SCI.<sup>146</sup>

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 Act.<sup>147</sup> LCH SA does not believe the Risk Policies would have any impact or impose any burden on competition. The Risk Policies do not address any competitive issue or have any significant impact on the competition among central counterparties. LCH SA operates an open access clearing model, and the Risk Policies will have no direct effect on this access model subject to the regulatory requirements, our clearing rules provisions and our governance process on the clearing membership criteria and eligibility including the appropriate credit risk assessment.

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<sup>146</sup> *Id.*

<sup>147</sup> 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 Risk Policies 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**

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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include file number SR-LCH SA-2025-007 on the subject line.

*Paper Comments:*

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

All submissions should refer to file number SR-LCH SA-2025-007. 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 (<https://www.sec.gov/rules/sro.shtml>). Copies of the filing 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/rulebooks/proposed-rule-changes>).

Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted materials that is obscene or subject to copyright protection. All submissions should refer to file number SR-LCH SA-2025-007 and should be submitted on or before **[INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]**.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>148</sup>

**Sherry R. Haywood,**

*Assistant Secretary.*

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