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For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

**Eduardo A. Aleman,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–84410; File No. SR–LCH SA–2018–004]

### Self-Regulatory Organizations; LCH SA; Order Approving Proposed Rule Change Relating to Implementation of Electronic Exercise Platform

October 11, 2018.

#### I. Introduction

On August 24, 2018, Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b–4 thereunder,<sup>2</sup> a proposed rule change (the “Proposed Rule Change”) to amend its (i) CDS Clearing Rule Book (“Rule Book”), (ii) CDS Clearing Supplement (“Supplement”), and (iii) CDS Clearing Procedures (“Procedures”) to incorporate new terms and to make conforming, clarifying, and clean-up changes to implement a new electronic exercise platform (“EEP”) for the exercise of options on index credit default swaps (“CDS Options”) by Clearing Members and their Clients. The proposed rule change was published for comment in the **Federal Register** on September 5, 2018.<sup>3</sup> The Commission has not received any comments on the proposed rule change. For the reasons

discussed below, the Commission is approving the proposed rule change.

#### II. Description of the Proposed Rule Change

The proposed rule change would create an EEP for CDS Options to capture and support decisions to exercise CDS Options by Clearing Members and their Clients.<sup>4</sup> Currently, LCH SA matches a Clearing Member or Client holding the option to either buy or sell protection on the underlying index credit default swap (“CDS”) (“CDS Option buyer”), with a Clearing Member or Client obligated to either buy or sell protection, as applicable, on the underlying index CDS (“CDS Option seller”) (this transaction is a “matched pair”).<sup>5</sup> The creation of the matched pair allows the CDS Option buyer to exercise or abandon the CDS Option. If the CDS Option buyer exercises the CDS Option, the CDS Option buyer must notify the CDS Option seller manually via email and then inform LCH SA that the exercise notice has been successfully delivered. LCH SA then manually executes the exercise decisions and updates its risk system.

Under the proposed rule change, LCH would still create matched pairs to allow the exercise or abandonment of a CDS Option. The proposed rule change would, however, eliminate the manual notification process between the CDS Option buyer and CDS Option seller by providing, through the EEP, an electronic process for exercising CDS Options. Specifically, a CDS Option buyer would submit an intent through the EEP to either exercise or abandon the CDS Option (“Option Intent”). If validly submitted before the expiration date of the CDS Option, the Option Intent would serve as notice to the CDS Option seller that the CDS Option buyer is going to exercise or abandon the CDS Option. The proposed rule change would require Clearing Members and Clients to use the EEP system to exercise CDS Options. The proposed rule change would also require Clearing Members to delegate to Clients the ability to directly exercise CDS Options related to their cleared transactions (“Client Cleared Transactions”). The EEP would capture CDS Option buyers’ exercise decisions in real time and notify the relevant CDS Option sellers in real time. In addition,

<sup>4</sup> Capitalized terms used herein but not otherwise defined have the meaning set forth in the Rule Book, Supplement, and Procedures, which are available at <https://www.lch.com/resources/rules-and-regulations/sa-rulebooks>.

<sup>5</sup> For more information regarding the operation of CDS Options, see Exchange Act Release No. 34–82109 (Nov. 17, 2017), 82 FR 55905 (Nov. 24, 2017) (SR–LCH SA 2017–006; SR–LCH SA–2017–007).

the EEP would validate and check exercise decisions and facilitate the anonymous exercise of CDS Options.

The proposed rule change would create and implement the EEP through amendments to LCH SA’s Rule Book, Supplement, and Procedures. These amendments are summarized below according to how they affect: (i) The exercise of CDS Options directly by Clients; (ii) the operational process for the exercise of CDS Options in the EEP; and (iii) technical specifications of the EEP. The proposed rule change would also make other changes to the Rule Book, Supplement, and Procedures, as discussed below.

#### A. Exercise of CDS Options Directly by Clients

The proposed rule change would add new provisions to allow for the exercise of CDS Options in the EEP directly by Clients.<sup>6</sup> Specifically, with respect to those CDS Options transactions that are Client Cleared Transactions, new Section 6.4 of the Supplement would require Clearing Members to designate their relevant Clients to act on their behalf via the EEP.<sup>7</sup> The Client so designated would be the Exercise Delegation Beneficiary. Moreover, the proposed rule change would amend the Rule Book to require that Clearing Members delegate to their Clients sufficient power to act on their behalf via the EEP and to ensure that their Clients have created an account in the LCH Portal for use of the EEP (“Client Portal Account”) before delegating such power.<sup>8</sup> Finally, the proposed rule change would amend the Rule Book to require Clients to exercise their delegated power only through their Client Portal Account unless the EEP is or will be unavailable for the exercise of CDS Options (an “EEP Failure Event”).<sup>9</sup>

The proposed rule change would add similar provisions to Appendix VIII of the Supplement. Appendix VIII provides mandatory provisions that are incorporated into transactions between a Clearing Member and its Client. Changes to Appendix VIII are necessary to incorporate the conditions described above directly into the terms of the transaction between a Clearing Member and its Client. Specifically, the proposed rule change would add new Section 5, which would provide that the Clearing Member and its Client agree that the Clearing Member will designate

<sup>6</sup> The proposed rule change would also apply these provisions to FCM Clearing Members who clear credit-default swaps and CDS Options for their Clients. Notice, 83 FR at 45156.

<sup>7</sup> Notice, 83 FR at 45158.

<sup>8</sup> Notice, 83 FR at 45156.

<sup>9</sup> *Id.*

<sup>14</sup> 17 CFR 200.30–3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b–4.

<sup>3</sup> Securities Exchange Act Release No. 34–83983 (Aug. 29, 2018), 83 FR 45155 (Sept. 5, 2018) (SR–LCH SA–2018–004) (“Notice”).

its Client as its Exercise Delegation Beneficiary with respect to Client Cleared Transactions.<sup>10</sup> Moreover, new Section 5 would specify the conditions upon which an Option Intent submitted by an Exercise Delegation Beneficiary with respect to a Client Cleared Transaction will be deemed a valid notice to exercise or abandon a CDS Option.<sup>11</sup> Specifically, such an Option Intent will be deemed valid if (i) the Client submits the Option Intent through its Client Portal Account; (ii) the Option Intent is submitted prior to 4.00 p.m. (London time) on the expiration date of the CDS Option; and (iii) LCH SA completes the steps necessary to make the intent available for viewing in the EEP, including validation of the EEP Controls (these controls are described further below in subsection C as part of the technical specifications of the EEP).<sup>12</sup>

The proposed rule change would also limit LCH SA's liability associated with Clients using the EEP to exercise their CDS Options. The proposed rule change would amend the Rule Book to eliminate LCH SA's liability for (i) any damage caused to a Clearing Member by its Client exercising or not exercising a CDS Option in the EEP and (ii) any improper use or disclosure by a third party, including a Client, of information made available at the request of a Clearing Member.<sup>13</sup> The proposed rule change would add a new Section 13(b) to the Supplement to eliminate LCH SA's liability to a Clearing Member for any cost or expense arising out of any failure of an Exercise Delegation Beneficiary to perform its obligations in relation with a delegation or in connection with the exercise or abandonment of a CDS Option.<sup>14</sup> Additionally, the proposed rule change would amend Section 13(d), which currently provides that LCH SA will have no responsibility to verify the contents of any notice received by it from any Clearing Member under the terms of any Cleared Transaction.<sup>15</sup> The proposed rule change would amend Section 13(d) to clarify that this limitation on responsibility also applies

to any notice received from an Exercise Delegation Beneficiary of a Clearing Member.

#### *B. Operational Process for the Exercise of CDS Options in the EEP*

The proposed rule change would make a number of amendments to the Rule Book and Supplement to further specify the operational process for the exercise of CDS Options in the EEP.

First, the proposed rule change would add defined terms to the Rule Book and Supplement relevant to the creation and implementation of the EEP.<sup>16</sup> Moreover, the proposed rule change would amend existing defined terms both to account for exercise of CDS Options through the EEP and to correct typographical errors.<sup>17</sup>

Second, the proposed rule change would make a number of modifications and additions to Section 6 to provide for the operation of the new EEP. The proposed rule change would facilitate the anonymous exercise of CDS Options by removing the requirement that LCH SA notify the CDS Option buyer and CDS Option seller of their respective identities.<sup>18</sup> Instead, LCH SA would keep the identities and contact information of the CDS Option buyer and CDS Option seller in a protected report (the "Protected Exercise Matched Pair Report"), and it would provide access to this report only during an EEP Failure Event, as discussed below.<sup>19</sup>

The proposed rule change would also describe the circumstances in which LCH SA would consider the exercise of a CDS Option via the EEP to be valid in new Section 6.3. Specifically, the proposed rule change would provide that an Option Intent is a valid notice to exercise or abandon a CDS Option if the CDS Option buyer submits the Option Intent prior to 4.00 p.m. (London time) and LCH SA has completed those steps necessary to make such Option Intent available for viewing in the EEP, including validation of the EEP Controls (discussed below).<sup>20</sup>

The proposed rule change would also provide procedures for exercise of CDS Options during an EEP Failure Event.<sup>21</sup>

Specifically, new Section 6.5 would require LCH SA to notify Clearing Members and their Exercise Delegation Beneficiaries of the EEP Failure Event and the subsequent resolution of the event.<sup>22</sup> Following the occurrence of the EEP Failure Event, Clearing Members (or their Exercise Delegation Beneficiaries, as applicable) would be authorized to access the information contained in the Protected Exercise Matched Pair Report regarding the identity and contact information of the other Clearing Member (or Exercise Delegation Beneficiary) within the matched pair.<sup>23</sup> During an EEP Failure Event, exercise or abandonment of CDS Options would fall back to the existing manual delivery process using the contact information from the Protected Exercise Matched Pair Report. For an exercise or abandonment to be effective, a Clearing Member (or its Exercise Delegation Beneficiary) would be required to notify LCH SA of such exercise or abandonment by no later than 5.00 p.m. (Central European Time) on the expiration date of the CDS Option.<sup>24</sup>

The proposed rule change would also address the circumstances under which a CDS Option transaction will be terminated taking into account implementation of the EEP. Specifically, the proposed rule change would terminate a CDS Option where the CDS Option buyer elects to abandon the CDS Option or fails to submit an Option Intent by the expiration date of the CDS Option.<sup>25</sup> Moreover, the proposed rule change would allow LCH SA to terminate a CDS Option if the CDS Option buyer does not submit an Option Intent by the expiration date of the CDS Option or if there is an EEP Failure Event and LCH SA does not receive a notice of exercise or abandonment by 5.00 p.m. (Central European Time) on the expiration date.<sup>26</sup>

mandatory terms that are incorporated into transactions between a Clearing Member and its Client, to add provisions that mirror these procedures.

<sup>22</sup> Notice, 83 FR at 45158.

<sup>23</sup> Notice, 83 FR at 45158.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> If there is an EEP Failure Event and LCH SA does not receive a notice of exercise or abandonment by 5.00 p.m. (Central European Time) on the expiration date, the proposed rule change would provide that LCH may, in its sole discretion, give effect to the terms of the notice if LCH determines that the notice was in fact delivered and would have been effective. If LCH SA determines that it is not possible to give effect to the terms of such notice, then the relevant Clearing Members in a matched pair (or their Exercise Delegation Beneficiaries, as applicable) would have rights against each other for settlement payment as though parties to a bilateral credit default swap transaction

<sup>10</sup> Notice, 83 FR at 45161.

<sup>11</sup> *Id.*

<sup>12</sup> Notice, 83 FR at 45161. The proposed rule change would define the term "EEP Controls" as the controls that LCH SA performs immediately following the submission of an Option Intent. These controls are described in Section 5 of the Procedures. If an Option Intent does not pass these controls it is not made available for viewing in the EEP by the Option Seller, and thus will not be deemed a valid notice to exercise or abandon a CDS Option.

<sup>13</sup> Notice, 83 FR at 45156.

<sup>14</sup> Notice, 83 FR at 45160.

<sup>15</sup> Notice, 83 FR at 45160.

<sup>16</sup> For an explanation of the definition of each of these terms, see Notice, 83 FR at 45156–45157.

<sup>17</sup> Notice, 83 FR at 45156–45157.

<sup>18</sup> Notice, 83 FR at 45157.

<sup>19</sup> The proposed rule change would add a new Section 5.8 to Appendix VIII of the Supplement to require Clients to consent to the disclosure of their address, fax number, telephone number, contact email address (and any other applicable notice details) by their Clearing Members to LCH SA and by LCH SA in any Protected Exercise Matched Pair Report. Notice, 83 FR at 45162.

<sup>20</sup> Notice, 83 FR at 45157–45158.

<sup>21</sup> The proposed rule change would also amend Appendix VIII of the Supplement, regarding

The proposed rule change would address situations where communications failures at Clearing Members and their Clients prohibit access to the EEP.<sup>27</sup> Specifically, new Section 6.10 would provide that if a Clearing Member or its Exercise Delegation Beneficiary experiences a significant communications or information technology failure resulting in it being impossible or impracticable to use EEP (a “Clearing Member Communications Failure Event”), such Clearing Member or its Exercise Delegation Beneficiary shall deliver notices to, and receive notices from, LCH SA using the existing manual exercise process.<sup>28</sup> New Section 6.10 would further specify that upon receipt of such notice, LCH SA will submit the notice to the EEP system for processing by submitting an Option Intent in respect of such notice. New Section 6.10 would further specify the conditions in which such a notice would be deemed valid, including submission of the Option Intent prior to 4.00 p.m. (London time) and LCH SA has completed those steps necessary to make such Option Intent available for viewing in the EEP, including validation of the EEP Controls (discussed below).<sup>29</sup>

New Section 6.10 would further require a Clearing Member or Exercise Delegation Beneficiary affected by a Clearing Member Communications Failure Event to notify LCH SA of the occurrence of the communications failure event using the form notice set out in the Appendix of the Supplement.<sup>30</sup> Similarly, section 6.10 would require an affected Clearing Member or Exercise Delegation Beneficiary to notify LCH SA as soon as reasonably practicable when no longer subject to a communications failure event, in which case the requirement to use the EEP would resume.<sup>31</sup>

Finally, new Section 6.10(e) would require a Clearing Member or Exercise Delegation Beneficiary subject to a Clearing Member Communications Failure Event to use reasonable efforts to (i) mitigate the operational impact on other Clearing Members and LCH SA of any such event; (ii) cure such event as soon as reasonably practicable; and (iii)

ensure that the circumstances which caused such event do not recur.<sup>32</sup>

Third, the proposed rule change would also make various changes to Section 8 of the Supplement regarding delivery of notices. The proposed rule change would first amend Section 8.1(a) to make clear that Section 8.1(a) is subject to new Section 6.3.<sup>33</sup> Section 8.1(a) provides general conditions for the effectiveness of notices delivered in respect of cleared transactions, and Section 6.3, as discussed above, provides specific conditions for the effectiveness of notices delivered via the EEP. The proposed rule change would next amend Section 8.1(b) to implement certain conforming changes regarding notices from or to LCH SA in the EEP, including with respect to the occurrence of an EEP Failure Event.<sup>34</sup> Additionally, the proposed rule change would amend Section 8.1(c) to provide that notices shall be given to the name and address provided in the Protected Exercise Matched Pair Report.<sup>35</sup>

The proposed rule change would also renumber Section 8.2 as new Section 8.3. The proposed rule change would then delete the existing Section 8.3 as well as the existing Section 8.4.<sup>36</sup> Both of these sections would no longer be applicable after the implementation of EEP. The proposed rule change would renumber Section 8.5 as new Section 8.2 and make certain conforming changes to account for the delivery of the Protected Exercise Matched Pair Report.<sup>37</sup> The proposed rule change would also describe the procedures to be used if LCH SA does not provide the Protected Exercise Matched Pair Report. In such a case, clearing members may deliver notices to exercise or abandon CDS Options directly to LCH SA and *vice versa*.<sup>38</sup>

Fourth, the proposed rule change would add a new Appendix VI to serve as the form to be used by a Clearing Member or Client to notify LCH SA that it is subject to a Clearing Member Communications Failure Event and a new Appendix VII to serve as the form to notify LCH SA that it is no longer subject to such an event.<sup>39</sup>

### C. Technical Specifications of the EEP

The technical specifications of the EEP would be set out in amendments to Section 5 of the Procedures. Specifically, the proposed rule change

would add a definition of “LCH Portal” to Section 5.3(f). “LCH Portal” would be defined as a single sign-on solution for various LCH SA applications to which Clearing Members may have access over secured internet.<sup>40</sup> The proposed rule change would revise Section 5.16 to add a new paragraph entitling a Clearing Member to request that all or part of the reports provided under Section 5.16 be made available on the Client Portal Account.<sup>41</sup>

The proposed rule change would also amend Section 5.16(a)(i)(j) to replace all references to “Cleared Transaction Exercise Report” with “Protected Exercise Matched Pairs Report” to reflect the new reporting structure in EEP.<sup>42</sup> The proposed rule change would further specify the timing for ICEEU’s preparation of the Protected Exercise Matched Pairs Report and that such report will only be made accessible following the occurrence of an EEP Failure Event.<sup>43</sup>

The proposed rule change would delete the current Section 5.16(c)(ii), regarding reports of open interest in CDS Options, because such a report would no longer be applicable after the proposed rule change.<sup>44</sup> The proposed rule change would renumber current Section 5.16(c)(iii) as a new Section 5.16(c)(ii) and current Section 5.16(c)(iv) as a new Section 5.16(c)(iii).

The proposed rule change would add a new Section 5.19 to require Clearing Members to notify LCH SA when they delegate power to exercise or abandon CDS Options to their Clients by sending a completed and signed notification form to LCH SA via email.<sup>45</sup>

The proposed rule change would add a new Section 5.19.2 to describe the EEP Controls that LCH SA will use to determine that an Option Intent is validly submitted. Specifically, upon a submission of an Option Intent in the EEP, LCH SA will carry out logicity controls to identify an intent which could have been submitted in the EEP in error.<sup>46</sup> The controls will be based on the relative position or the price of the exercise compared to reference prices provided in the EEP.<sup>47</sup> LCH SA will not register in the EEP any intent which does not pass such controls, and LCH SA will inform the applicable Clearing Member or Exercise Delegation Beneficiary. The Clearing Member or

on the terms of the relevant underlying index. Notice, 83 FR at 45158–45159.

<sup>27</sup> The proposed rule change would also amend Appendix VIII of the Supplement, regarding mandatory terms that are incorporated into transactions between a Clearing Member and its Client, to add provisions that mirror these procedures. Notice, 83 FR at 45161.

<sup>28</sup> Notice, 83 FR at 45159.

<sup>29</sup> *Id.*

<sup>30</sup> Notice, 83 FR at 45159.

<sup>31</sup> *Id.*

<sup>32</sup> Notice, 83 FR at 45159.

<sup>33</sup> Notice, 83 FR at 45160.

<sup>34</sup> *Id.*

<sup>35</sup> Notice, 83 FR at 45160.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> Notice, 83 FR at 45162.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> Notice, 83 FR at 45162.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

Exercise Delegation Beneficiary may then choose to re-submit such intent or make a “Force Submission.”<sup>48</sup> A Force Submission occurs when the Clearing Member or its Exercise Delegation Beneficiary elects to bypass the controls by specifying “Confirm” or “Force” when submitting the Option Intent.<sup>49</sup> LCH SA will not carry out controls on such an Option Intent.<sup>50</sup>

New Section 5.19.2 would further specify that, before registering any Option Intent, LCH SA will ensure that such intent (i) is submitted by a user who (a) is connected with the proper user ID and password and (b) based on such ID and password, is duly authorized to exercise or abandon, as applicable, the relevant CDS Options; (ii) has not already been submitted in the EEP (other than as a partial Exercise); and (iii) passes the logicity controls or is a Force Submission.<sup>51</sup>

#### D. Other Changes

The proposed rule change would make a number of other changes related to CDS Options. First, the proposed rule change would make a number of amendments regarding restructuring of CDS Options following a credit event in respect of an entity referenced by the index underlying the CDS Option.<sup>52</sup> The proposed rule change would maintain the existing manual notification process for transactions in restructured CDS Options. To that end, the proposed rule change would delete a number of provisions from Section 8 of the Supplement, which currently contains the manual notification process, and reinstate them in Section 5, which sets out the procedures for restructured CDS Options.<sup>53</sup> Similarly, the proposed rule change would make changes to Section 7 of the Supplement regarding settlement of restructured CDS Options. The proposed rule change would also amend Section 7.2 of the Supplement to incorporate the term “Auction Final Price Determination Date” in order to correct an inaccurate reference in the current version of the Supplement.<sup>54</sup> Additionally, the proposed rule change would amend Section 7.3(b)(ii) of the Supplement to clarify that a valid Credit Event Notice must be delivered or deemed to be delivered in respect for subsections (x) and (y) of Section 7.3(b)(ii) to apply.<sup>55</sup> Finally, the proposed rule change would correct

typographical errors in Sections 7.3 and 7.4(a) of the Supplement.<sup>56</sup>

Second, the proposed rule change would update Section 9 of the Supplement, regarding the creation of matched pairs. The proposed rule change would delete Sections 9.1(c) and (d) to remove the requirement that, to the extent possible, each matched pair of a CDS Option have an amount which is an integral multiple of Euro 1,000,000 subject to a maximum of Euro 100,000,000.<sup>57</sup> Although this change is unrelated to the implementation of EEP, LCH SA does not believe this condition is necessary any longer, so the proposed rule change would update the Supplement accordingly.

Finally, the proposed rule change would make typographical corrections, update conforming references, and revise numbering throughout the Rule Book, Supplement, and Procedures, as necessary.

### III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.<sup>58</sup> For the reasons given below, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act<sup>59</sup> and Rules 17Ad-22(e)(1), (e)(17)(i)–(ii), and (e)(18) thereunder.<sup>60</sup>

#### A. Consistency With Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of LCH SA be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, as well as to assure the safeguarding of securities and funds which are in the custody or control of LCH SA or for which it is responsible, and, in general, to protect investors and the public interest.<sup>61</sup>

The Commission believes that by eliminating the existing manual notification process and replacing it with an electronic one, the EEP, in general, would promote the efficient

and effective exercise of CDS Options. The EEP would eliminate the possible delays, errors, and miscommunications that can result from manual notification via email. In doing so, the Commission believes the EEP would promote the prompt and accurate clearance and settlement of CDS Options transactions by providing a means for the efficient exercise of CDS Options. Moreover, in reducing the likelihood of delays, errors, and miscommunications as compared to the existing manual notification process, the Commission believes that the EEP would reduce the likelihood of disputes over the exercise of CDS Options and the possibility that LCH SA may not accurately capture a CDS Option buyer’s intent to abandon or exercise a CDS Option. In this regard, the Commission believes the EEP would help assure the safeguarding of securities and funds relating to CDS Options which are in the custody or control of LCH SA or for which it is responsible by helping LCH SA to avoid disruptions to its operations which could, in turn, impede access to securities and funds required in connection with the exercise or abandonment of CDS Options. For both of these reasons, the Commission also believes that the EEP, in general, would protect investors and the public interest. Thus, the Commission believes that the EEP, in general, would be consistent with Section 17A(b)(3)(F) of the Act.<sup>62</sup>

The Commission further believes that the specific aspects of the proposed rule change that would facilitate the operation of the EEP would also be consistent with Section 17A(b)(3)(F).<sup>63</sup> Specifically, the Commission believes that in (i) adding new defined terms (and modifying existing defined terms accordingly); (ii) defining the circumstances in which LCH SA would consider the exercise of a CDS Option via the EEP to be valid; (iii) providing the circumstances in which LCH SA would terminate a CDS Option; and (iv) establishing the enforceability of notices delivered via the EEP, the proposed rule change would provide the legal basis for operation of the EEP. Similarly, by providing the technical specifications of the EEP (including defining the applications and reports associated with the EEP) and establishing the controls LCH SA would use to determine if an Option Intent was submitted correctly and by an authorized user, the Commission believes the proposed rule change would provide the technological basis for operation of the EEP. The Commission believes that these aspects of the proposed rule change would

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> Notice, 83 FR at 45162.

<sup>52</sup> Notice, 83 FR at 45157.

<sup>53</sup> *Id.*

<sup>54</sup> Notice, 83 FR at 45160.

<sup>55</sup> Notice, 83 FR at 45160.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>59</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>60</sup> 17 CFR 240.17Ad-22(e)(1), (e)(17)(i)–(ii), and (e)(18).

<sup>61</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>62</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>63</sup> 15 U.S.C. 78q-1(b)(3)(F).

thereby promote the use and operation of the EEP for executing CDS Options transactions and therefore would promote the prompt and accurate clearance and settlement of such transactions, consistent with Section 17A(b)(3)(F).<sup>64</sup>

Similarly, the Commission believes that the provisions of the proposed rule change facilitating the exercise of CDS Options in the EEP directly by Clients would promote the prompt and accurate clearance and settlement of CDS Options. The Commission believes that if Clients were not able to exercise their CDS Options directly in the EEP they would have to rely on Clearing Members to do so on their behalf, which would require communicating their intentions to Clearing Members accurately and with sufficient time to allow Clearing Members to act before expiration of the CDS Options. In contrast, allowing Clients to exercise their CDS Options directly in the EEP should be more efficient than, and avoid possible delays and miscommunications associated with, Clearing Members exercising CDS Options on behalf of Clients. As a result, the Commission believes the proposed rule change would promote the prompt and accurate clearance and settlement of CDS Option transactions by providing Clients a more efficient means for the exercise of their CDS Options.

Finally, the Commission believes that the other changes discussed above are consistent with Section 17A(b)(3)(F) of the Act.<sup>65</sup> Specifically, by consolidating provisions regarding delivery of notices with provisions regarding restructuring of CDS Options and making other updates regarding restructuring of CDS Options, the Commission believes the proposed rule change would allow the existing notification process for restructuring of CDS Options to continue after implementation of the EEP. This would allow LCH SA to continue clearing and settling restructured CDS Options outside of the EEP, thereby helping to promote the prompt and accurate clearance and settlement of restructured CDS Options. Moreover, the Commission believes that updating Section 9 of the Supplement to remove the inapplicable provisions regarding the creation of matched pairs would help ensure that LCH SA continues to create matched pairs consistently, which is necessary to pair CDS Option buyers and CDS Option sellers for purposes of executing or abandoning CDS Options. The Commission therefore believes that these aspects of the proposed rule

change would promote the prompt and accurate clearance and settlement of CDS Option transactions.

Therefore, for all of the above reasons the Commission finds that the proposed rule change would promote the prompt and accurate clearance and settlement of CDS Options transactions, assure the safeguarding of securities and funds in LCH SA's custody and control, and, in general, protect investors and the public interest, consistent with the Section 17A(b)(3)(F) of the Act.<sup>66</sup>

#### *B. Consistency With Rule 17Ad-22(e)(1) of the Act*

Rule 17Ad-22(e)(1) requires that LCH SA establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.<sup>67</sup>

As discussed above, the Commission believes that the proposed rule change would provide the legal basis for operation of the EEP by (i) adding new defined terms (and modifying existing defined terms accordingly); (ii) establishing the circumstances in which LCH SA would consider the exercise of a CDS Option via the EEP to be valid; and (iii) defining the circumstances in which LCH SA would terminate a CDS Option. Moreover, the Commission believes the proposed rule change, in making typographical corrections, updating conforming references, and revising numbering throughout the Rule Book, Supplement, and Procedures, would help ensure the consistency and accuracy of the Rule Book, Supplement, and Procedures after implementation of the EEP, thereby further helping to establish the legal basis for operation of the EEP.

Therefore, for the above reasons the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(1).<sup>68</sup>

#### *C. Consistency With Rules 17Ad-22(e)(17)(i)-(ii) of the Act*

Rule 17Ad-22(e)(17)(i)-(ii) requires that LCH SA establish, implement, maintain and enforce written policies and procedures reasonably designed to manage its operational risks by identifying the plausible sources of operational risk, both internal and external, and mitigating their impact through the use of appropriate systems, policies, procedures, and controls and ensuring that systems have a high

degree of security, resiliency, operational reliability, and adequate, scalable capacity.<sup>69</sup>

The Commission believes that, in replacing the existing manual notification process, the EEP would reduce LCH SA's operational risks associated with clearing and settling CDS Options. For example, the EEP would check whether an Option Intent was erroneous based on the relative position or the price in the Option Intent compared to reference prices provided in the EEP. Such validity checks are not a feature of the current notification process, and the Commission believes that these checks would reduce the likelihood that an Option Intent is submitted in error or otherwise miscommunicated. This, in turn, would reduce the risk to LCH SA that it does not accurately capture or execute a Clearing Member's or a Client's intent in exercising or abandoning a CDS Option. Moreover, under the EEP, if a CDS Option buyer submits an Option Intent before the exercise deadline and it passes the EEP validation checks, the notice of exercise or abandonment would be deemed legally delivered by LCH SA to the CDS Option seller on a real time basis. The Commission believes that this feature of the EEP would help reduce the possibility that LCH SA could fail to carry out a Clearing Member's or a Client's intent in exercising a CDS Option, further reducing LCH SA's operational risks in clearing and settling CDS Option transactions.

The proposed rule change would establish procedures for the exercise of CDS Options in the case of the EEP not being operational or a Clearing Member or Client being unable to access the EEP due to a Clearing Member Communications Failure Event. In addition, the proposed rule change would require Clearing Members and Clients to (i) mitigate the impact of a Clearing Member Communications Failure Event; (ii) cure such event as soon as reasonably practicable; and (iii) ensure that the circumstances which caused such event do not recur. The Commission believes that these procedures, which would fall back on the existing manual notification process in place of the EEP, would provide a reasonable alternative in circumstances where the EEP is unavailable or inaccessible. The Commission further believes that these procedures, in providing another means to exercise CDS Options, would help mitigate the impact to Clearing Members and Clients from a malfunction of the EEP or a

<sup>64</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>65</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>66</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>67</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>68</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>69</sup> 17 CFR 240.17Ad-22(e)(17)(i), (ii).

communications failure. Thus, the Commission believes that these alternative procedures would help ensure the resiliency and operational reliability of the EEP by providing a means to exercise CDS Options where the EEP is unavailable or inaccessible.

Therefore, for the above reasons the Commission finds that the proposed rule change is consistent with Rules 17Ad-22(e)(17)(i)-(ii).<sup>70</sup>

#### *D. Consistency With Rule 17Ad-22(e)(18)*

Rule 17Ad-22(e)(18) requires that LCH SA establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access by direct and, where relevant, indirect participants and other financial market utilities, require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, and monitor compliance with such participation requirements on an ongoing basis.<sup>71</sup>

The Commission believes that by allowing Clients to exercise CDS Options in the EEP directly, the proposed rule change would establish objective and publicly disclosed criteria for Clients to participate in the EEP. Specifically, the proposed rule change would, as discussed above, require Clearing Members to designate their relevant Clients to act on their behalf via the EEP with respect to those CDS Options transactions that are Client Cleared Transactions. The proposed rule change would also require that Clearing Members delegate to their Clients sufficient power to act on their behalf via the EEP and require Clients to exercise that power through their Client Portal Account on the EEP. Finally, the proposed rule change would add provisions to Appendix VIII of the Supplement to incorporate these conditions directly into the terms of the transaction between a Clearing Member and its Client. The Commission believes that these aspects of the proposed rule change would establish the objective and public criteria that Clients must follow to directly access the EEP and participate in exercising CDS Options at LCH SA. Moreover, the Commission believes these aspects of the proposed rule change would permit fair and open access by Clients by requiring Clearing Members to designate their relevant

Clients to act on their behalf in exercising their CDS Options.

Therefore, for the above reasons the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(18).<sup>72</sup>

#### **IV. Conclusion**

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and in particular, Section 17A(b)(3)(F) of the Act<sup>73</sup> and Rules 17Ad-22(e)(1), (e)(17)(i)-(ii), and (e)(18) thereunder.<sup>74</sup>

*It is therefore ordered* pursuant to Section 19(b)(2) of the Act that the proposed rule change (SR-LCH SA-2018-004) be, and hereby is, approved.<sup>75</sup>

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>76</sup>

**Eduardo A. Aleman,**  
*Assistant Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-84412; File No. SR-NYSEAMER-2018-45]**

### **Self-Regulatory Organizations; NYSE American LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Rule 7.14E, Clearance and Settlement**

October 11, 2018.

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (“Act”)<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that on September 27, 2018, NYSE American LLC (“Exchange” or “NYSE American”) 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 by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

<sup>72</sup> 17 CFR 240.17Ad-22(e)(18).

<sup>73</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>74</sup> 17 CFR 240.17Ad-22(e)(1), (e)(17)(i)-(ii), (e)(18).

<sup>75</sup> In approving the proposed rule change, the Commission considered the proposal’s impacts on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>76</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 15 U.S.C. 78a.

<sup>3</sup> 17 CFR 240.19b-4.

### **I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

The Exchange proposes to amend Rule 7.14E, Clearance and Settlement, to remove language that is inconsistent with the Exchange’s Price List. The proposed rule change is available on the Exchange’s website at [www.nyse.com](http://www.nyse.com), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

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

##### **1. Purpose**

The Exchange proposes to amend Rule 7.14E, Clearance and Settlement, to remove language that was inadvertently included when the rule was first adopted and that is inconsistent with the Exchange’s Price List. The Exchange adopted Rule 7.14E as part of a proposed rule change to adopt rules for trading on the Exchange’s new trading technology platform.<sup>4</sup> Rule 7.14E was based on similar rules of its affiliate, NYSE Arca, Inc. (“NYSE Arca”) Rule 7.14-E and adopted by the Exchange without any substantive differences.<sup>5</sup>

Paragraph (c) of Rule 7.14E states that “[e]ach clearing firm must be admitted to the Exchange as an ETP Holder by meeting the qualification requirements set forth in Rule 2—Equities.” Paragraph (c) of Rule 7.14E also includes language that exempts clearing firms from paying the regular ETP Holder fee where that clearing firm became an ETP Holder for the sole purpose of acting as a clearing firm on the Exchange. This language

<sup>4</sup> See Securities Exchange Act Release Nos. 79242 (November 4, 2016), 81 FR 79081 (November 10, 2016) (SR-NYSEMKT-2016-97); 80590 (May 4, 2017), 82 FR 21843 (May 10, 2017) (SR-NYSEMKT-2017-01); and 79982 (February 7, 2017), 82 FR 105008 (February 13, 2017) (Notice) and 80577 (May 2, 2017), 82 FR 21446 (May 8, 2017) (SR-NYSEMKT-2017-04).

<sup>5</sup> *Id.*

<sup>70</sup> 17 CFR 240.17Ad-22(e)(17)(i)-(ii).

<sup>71</sup> 17 CFR 240.17Ad-22(e)(18).