

2.2 Orders

Headnote

Section 144 of the Securities Act (Ontario) – application for an order varying the Commission’s order recognising LCH Limited as a clearing agency – variation required to streamline the regulatory requirements applicable and to update the order – requested order granted.

Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5 as am., ss. 21.2, 144.

**IN THE MATTER OF
THE SECURITIES ACT,
RSO 1990, CHAPTER S. 5
(the Act)**

AND

**IN THE MATTER OF
LCH LIMITED**

**ORDER
(Sections 21.2 and 144 of the Act)**

WHEREAS the Ontario Securities Commission (**Commission**) issued an order dated September 10, 2013, which was varied on September 28, 2018 and December 17, 2020, effective as of January 1, 2021, recognizing LCH Limited (**LCH**) as a clearing agency pursuant to section 21.2 of the Act (**LCH Recognition Order**);

AND WHEREAS the Commission considers the proper operation of a clearing agency as essential to investor protection and maintaining a fair and efficient capital market, and the Commission may recognize a clearing agency, pursuant to section 21.2 of the Act, if it is satisfied that it is in the public interest to do so;

AND WHEREAS the Commission has received an application under section 144 of the Act to vary and restate the LCH Recognition Order to reflect the streamlining of certain reporting requirements and to otherwise update the order (**Application**);

AND WHEREAS LCH has agreed to the respective terms and conditions that are set out in Schedule “A” to the LCH Recognition Order;

AND WHEREAS LCH has represented to the Commission that:

1. LCH is a clearing house incorporated under the laws of England and Wales. LCH operates as a central counterparty (**CCP**) clearing house and receives most of its revenue from treasury income and clearing fees charged to its clearing members (**Clearing Members**);
2. LCH Group Holdings Ltd (**LCH Group**), the parent holding company of LCH, is majority owned by the London Stock Exchange (C) Limited, a 100% subsidiary of London Stock Exchange Group PLC, with the remainder being owned by its users (banks and brokerage firms);
3. LCH is a Recognised Clearing House (**RCH**) in the U.K. under the U.K.’s Financial Services and Markets Act 2000 (FSMA). In addition, LCH is subject to the European Market Infrastructure Regulation (**EMIR**), as it has become retained EU law and effective in the UK under the European Union (Withdrawal) Act 2018 (**EUWA**) and as it is amended (**UK EMIR**). The Bank of England is LCH’s primary regulator;
4. In the European Union (**EU**) LCH is a recognised Tier 2 (i.e. systemically important or likely to become systemically important) third country (i.e. non-EU) CCP under EMIR and is subject to regulatory supervision by the European Securities and Market Authority (**ESMA**);
5. As part of its regulatory oversight of LCH, the Bank of England reviews, assesses and enforces the on-going compliance by LCH with the requirements set out in FSMA, UK EMIR and the CPMI-IOSCO Principles for Financial Market Infrastructures (**PFMIs**);
6. LCH currently also has regulatory licenses in the United States, Switzerland, Singapore, Hong Kong, Japan, Australia, and Mexico. LCH has also been recognised as a Clearing House by the Autorite des Marches Financiers (**AMF**) in Quebec and LCH’s SwapClear service is designated under the Payment Clearing and Settlement Act (Canada) which brings LCH’s SwapClear service under the formal oversight of the Bank of Canada;

7. Ontario Clearing Members currently qualify as “Canadian financial institutions” (within the meaning of that term in subsection 1.1(3) of National Instrument 14-101 *Definitions*) and that have a head office or principal place of business in Ontario;
8. LCH is currently offering the following three clearing services to Ontario resident Clearing Members: RepoClear, SwapClear, and ForexClear. LCH offers client clearing services to Ontario residents through both Ontario and non-Ontario resident SwapClear and ForexClear Clearing Members. Within the RepoClear Service, LCH also offers a “sponsored clearing service” which is targeted to buy-side investment firms (for example, pension funds) to extend direct CCP membership to the broader investor community. The sponsored clearing service is currently not offered in Ontario;
9. The RepoClear service currently clears cash bond and repurchase trades in U.K. government bonds. The SwapClear service currently clears a range of over-the-counter (OTC) swaps, including Interest Rate Swaps (IRS), Inflation Swaps, Overnight Indexed Swaps (OIS), Forward Rate Agreements (FRAs) and Variable Notional Swaps (VNS). The ForexClear Service currently clears over-the-counter (OTC) non-deliverable forwards, non-deliverable FX Options, and deliverable FX Options and Forwards and Spot Contracts;
10. Transactions cleared through SwapClear, ForexClear and RepoClear are traded by Clearing Members on a bilateral basis, either inter-office, or through brokers, or on automated trading systems;
11. Alongside regulatory compliance LCH adheres to the international PFMI standards and performs a full self-assessment every two years and a targeted assessment every other year of its observance with the PFMIs. A version of the biennial full self-assessment is publicly available; and
12. LCH does not have any office or maintain other physical installations in Ontario or any other Canadian province or territory. LCH does not currently have any plans to open such an office or to establish any such physical installations in Ontario or elsewhere in Canada.

AND WHEREAS LCH permits Ontario residents who meet the criteria set out in its rules to become registered as Clearing Members, and as a result, is carrying on business as a clearing agency in Ontario. LCH cannot carry on business in Ontario as a clearing agency unless it is recognized by the Commission as a clearing agency under section 21.2 of the Act or exempted from such recognition under section 147 of the Act.

AND WHEREAS LCH as a recognised clearing agency is required to comply with National Instrument 24-102 *Clearing Agency Requirements* (NI 24-102);

AND WHEREAS based on the Application and the representations LCH has made to the Commission, the Commission has determined that:

- (a) LCH continues to satisfy the criteria for recognition set out in NI 24-102;
- (b) it is in the public interest to continue to recognize LCH as a clearing agency pursuant to section 21.2 of the Act, subject to terms and conditions that are set out in Schedule “A” to the LCH Recognition Order;
- (c) it is not prejudicial to the public interest to vary and restate the current LCH Recognition Order pursuant to section 144 of the Act;

AND WHEREAS the Commission will monitor developments in international and domestic capital markets and LCH’s activities on an ongoing basis to determine whether it is appropriate that LCH continues to be recognized subject to the terms and conditions in the LCH Recognition Order;

IT IS ORDERED, pursuant to section 144 of the Act, that the Application to vary and restate the LCH Recognition Order is granted.

IT IS ORDERED, pursuant to section 21.2 of the Act, that LCH continues to be recognized as a clearing agency; provided LCH complies with the terms and conditions set out in Schedule “A” to the LCH Recognition Order.

DATED this 20th day of December 2021.

“Cathy Singer”
Commissioner
Ontario Securities Commission

“Mary Anne De Monte-Whelan”
Commissioner
Ontario Securities Commission

SCHEDULE "A"
TERMS AND CONDITIONS

DEFINITIONS

For the purposes of this Schedule:

"Central counterparty (CCP) Link": means one or more agreements governing the relationship between two or more CCPs, which include provisions regarding the collateralisation of an interoperable link between the parties and / or to consider positions and supporting collateral at their respective CCPs as a common portfolio for participants that are members of two or more of the CCPs;

"Clearing Member" means a clearing member as defined in LCH's rulebooks;

"clearing services" means the services offered by LCH in relation to its role as central counterparty (CCP) to Clearing Members;

"client clearing" means a Clearing Member(s) clearing transactions on behalf of their clients who are not Clearing Members;

"Crisis" means (i) when one or more of LCH's major Clearing Members default on their obligations to LCH that might place LCH under financial distress that is handled with significant difficulties; (ii) when LCH experiences operational problems which results in the delay of the processing of the clearance of trades for more than two hours following the disruptive event, such as an IT system or process failure, human error, management failure, fraud, or disruption from external events, such as natural disasters, physical attacks by terrorists, or cyber attacks; (iii) any material problem with the clearance of transactions that could materially affect the safety and soundness of LCH; (iv) when LCH's assets and those of its Clearing Members and/or their clients held by or on behalf of LCH suffer significant loss due to market risk or due to custody risk following the failure of the third party commercial custody bank holding such assets; (v) a default of an Ontario Clearing Member; (vi) a default of a Clearing Member where the Clearing Member is clearing on behalf of Ontario residents or (vii) any expectation of LCH that any of the foregoing is reasonably likely to occur;

"Ontario Clearing Member" means an Ontario resident who is a Clearing Member of LCH:

"Ontario Clearing Participant" means an Ontario resident who is a Clearing Member, Agent Member or Sponsored Member, as defined in LCH's rulebooks, as applicable;

"Ontario securities law" has the meaning ascribed to it in subsection 1(1) of the Act: and

"sponsored clearing service" means a service which enables buy-side investment firms (for example, pension funds) to be sponsored by an Agent Member of LCH in order to clear contracts as Sponsored Members of LCH.

REGULATION OF LCH

1. LCH must maintain its status as a RCH with the Bank of England and must continue to be subject to the regulatory oversight of the Bank of England.
2. LCH must continue to comply with applicable Ontario securities law.

OWNERSHIP OF LCH

3. LCH must provide to the Commission 60 days prior, written notice and a detailed description, and impact on any proposed change to its ownership (direct and indirect) including an assessment of how the change is consistent with the PFMI's applicable to LCH.

PUBLIC INTEREST

4. LCH must conduct its businesses and operations in a manner that is consistent with the public interest.

ACCESS

5. LCH must request the Commission's prior written approval before (i) providing access to any new clearing service including client clearing or any sponsored clearing service to Ontario Clearing Participants, or (ii) offering any new CCP Link to be utilized by Ontario Clearing Participants. Any such request must be made at least 75 days prior to the offering of the new clearing service, sponsored clearing service, or CCP Link to Ontario Clearing Participants, and must be accompanied by a written notice and detailed description and impact of the new clearing service, sponsored clearing service or CCP Link as to the safety and soundness of LCH and the existing clearing services offered to Ontario Clearing Members.

FEES

6. LCH must not modify a fee or introduce a new fee for any of the clearing services it provides to Ontario Clearing Members unless it has provided a written notice of the fee change with the Commission at least 20 days before implementing the fee change. The written notice must include an assessment of how the fee change is consistent with the PFMI's applicable to LCH.

RULES AND RULEMAKING

7. LCH must provide to the Commission a written notice and detailed description of any new material rules or material changes to current rules relating to LCH's access criteria, default management and risk management model that are specific to the clearing services or sponsored clearing services utilized by Ontario Clearing Participants 30 days prior to the effective date of the rule or change.
8. Notwithstanding paragraph 7, where LCH needs to implement a new material rule or a material rule change resulting in an effective date of less than 30 days, LCH must provide to the Commission as soon as possible prior to the effective date, a written notice and detailed description of the new material rule or material rule change and the reasons for the shorter implementation.

RISK CONTROLS

9. LCH must have clearly defined and transparent procedures for the management of risk which specify the respective responsibilities of LCH, Clearing Members and Ontario Clearing Participants.

RISK MANAGEMENT REPORTS

10. LCH must submit to staff of the Commission any reports, electronic data files or similar documents that provide risk management information, as requested by staff of the Commission.

CRISIS MANAGEMENT

11. In the event of a Crisis, LCH must promptly share with and provide periodic updates to the Commission on the following information:
 - (a) details of the Crisis;
 - (b) any actions likely to be taken by LCH including details of the use of LCH's default protections and default management processes that have occurred and which impact the resilience of the LCH clearing services and the total level of financial resources remaining at LCH for default management purposes with regard to cleared products;
 - (c) actions likely to be taken by the Bank of England if known to LCH; and
 - (d) any other information and documentation requested by the Commission related to the Crisis.

COMPLIANCE

12. LCH must immediately notify staff of the Commission of any event, circumstance, or situation concerning any of LCH's operations that could materially prevent LCH's ability to continue to comply with the terms and conditions of the order.
13. LCH must promptly notify staff of the Commission if LCH is not in compliance with any applicable requirements arising from its supervision by the Bank of England, and where it is required to report such non-compliance to the Bank of England.

INFORMATION SHARING AND REGULATORY COOPERATION

14. LCH must provide such information as may be requested from time to time, and otherwise cooperate with, the Commission or its staff with respect to matters subject to the Commission's jurisdiction.
15. Unless otherwise prohibited under applicable law, LCH must share information and otherwise cooperate with other recognized or exempt clearing agencies, recognized or exempt self-regulatory organizations, investor protection funds, marketplaces, and other regulatory bodies as appropriate.
16. LCH must comply with Appendix "A" to this Schedule setting out the reporting requirements, as amended from time to time, regarding the reporting of information to the Commission.

Appendix “A” to Schedule “A”

Reporting Requirements

REPORTING REQUIREMENTS

Bank of England Reporting

1. LCH must provide to staff of the Commission, concurrently, the following information that it is required to submit to the Bank of England:
 - (a) the audited and unaudited financial statements of LCH;
 - (b) the institution of any legal proceeding against it;
 - (c) notification that LCH has instituted a petition for judgement of bankruptcy or insolvency or similar relief, or to wind up or liquidate LCH or has a proceeding for any such petition instituted against it;
 - (d) the appointment of a receiver or the making of any voluntary arrangement with creditors;
 - (e) notification that LCH has initiated the recovery plan;
 - (f) the entering into any resolution regime or the placing of LCH into resolution by a resolution authority;
 - (g) notification that LCH has failed to comply with an undisputed obligation to pay money or deliver property to a Clearing Member or an Ontario Clearing Participant for a period of thirty days after receiving notice from the Clearing Member or Ontario Clearing Participant of LCH's past due obligation;
 - (h) any material changes and proposed material changes to its bylaws, constating documents, rules (other than the rules identified in paragraphs 7 and 8 of Schedule “A”), operations manual, participant agreements and other similar instruments or documents of LCH which contain any contractual terms setting out the respective rights and obligations between LCH and Clearing Members or among Clearing Members or between LCH and Ontario Clearing Participants; and
 - (i) any regulatory assessments or self-assessments against international standards or requirements.

Prior Notification

2. LCH must provide prior notification to staff of the Commission of any of the following:
 - (a) any material change to the design, operation or functionality of any of the operations, or clearing services or sponsored clearing services, as applicable, offered to Ontario Clearing Participants; and
 - (b) any material change to LCH's corporate governance or corporate structure.

Prompt Notification

3. LCH must promptly notify staff of the Commission of any of the following:
 - (a) any Ontario residents who have received Ontario Clearing Participant status from LCH;
 - (b) any Ontario residents who have been denied Ontario Clearing Participant status by LCH;
 - (c) any disciplinary action against an Ontario Clearing Participant(s) that has been taken by LCH or the Bank of England with respect to activities at LCH;
 - (d) any investigations by LCH relating to an Ontario Clearing Participant(s);
 - (e) an event of default by a Clearing Member that does not constitute a Crisis, including details of the use of LCH's default protections and default management processes that have occurred and the total level of financial resources remaining at LCH for a default management purposes with regard to cleared products in the clearing services offered to Ontario Clearing Members;
 - (f) any material change or proposed material change in status or the regulatory oversight by the Bank of England;
 - (g) the clearing of new products that are proposed to be offered to Ontario Clearing Participants or products that will no longer be available to Ontario Clearing Participants; and

- (h) in relation to client clearing and based on the information available to LCH, the identity of any new Ontario Clearing Member or any other Ontario resident that has entered into a direct or indirect arrangement with LCH for the provision of clearing services.

Quarterly Reporting

- 4. LCH must maintain the following updated information and submit such information to the Commission in a manner and form acceptable to the Commission on at least a quarterly basis within 30 days of the end of the quarter, and at any time promptly upon the request of staff of the Commission:
 - (a) a current list of all Ontario Clearing Participants and the legal entity identifier (**LEI**), if any, of each such Ontario Clearing Participant;
 - (b) for each LCH clearing service or sponsored clearing service, as applicable, provided to Ontario Clearing Participants, the aggregate nominal volumes during the period and the level of open interest as of the end of the period (by currency) in cleared products; the high and low daily nominal volumes and level of open interest during that period (with breakdowns by currency where relevant) in cleared products; the level and composition of margin and default fund collateral held with regard to cleared products (with breakdowns by currency where relevant) for each Ontario Clearing Participant;
 - (c) the proportion of the metrics identified in paragraph (b) above for Ontario Clearing Participants related to the activity of all Clearing Members or Sponsored Members in each of the LCH clearing services or sponsored clearing services, as applicable, provided to Ontario Clearing Participants;
 - (d) for each LCH clearing service or sponsored clearing service, as applicable, provided to Ontario Clearing Participants, a summary of risk management test results related to the adequacy of required margin and the adequacy of the level of the default fund, including but not limited to stress testing and back testing results;
 - (e) for each LCH clearing service or sponsored clearing service, as applicable, provided to Ontario Clearing Participants the total level of default protection with regard to cleared products; anonymized aggregated average daily notional position of the five and ten largest Clearing Members or Sponsored Members, as applicable in cleared product;
 - (f) for each LCH clearing service or sponsored clearing service, as applicable, provided to Ontario Clearing Participants, a description of any services outages that are graded P"2" (High) with regard to cleared products that have occurred since the last quarterly report;
 - (g) based on the information available to LCH, a list of all Clearing Members (identified by their LEI and grouped by country of incorporation of the ultimate parent) who offer client clearing services to Ontario residents; and
 - (h) based on the information available to LCH, for each Clearing Member offering client clearing to Ontario residents (including their LEI, if available), the identity of the Ontario resident client receiving such services and the end of quarter open interest and aggregate total margin amount required by LCH and the value and volume by asset class of their client clearing transactions during the quarter.