

LCH.Clearnet Limited's Default Protections

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Membership criteria

LCH.Clearnet Ltd's Default Protections

- Membership criteria act as:
 - An entry hurdle for membership;
 - A definition of Ltd's counterparty risk appetite.
- In doing so, they ensure that members have sufficient financial resources and operational capability to perform in the markets they clear.
- All members are monitored daily and subject to credit reviews and member visits. Ltd has the power to increase margins based on such monitoring.

Membership criteria

LCH.Clearnet Ltd's Default Protections

Variation Margin

Membership criteria

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- Variation margin is simply the daily debit and credit of profit and loss.
- By effectively realising such P&L, it keeps Ltd's risk current, meaning that losses cannot build up over time: they can only occur in a default; and this risk is covered by initial margin.

Variation Margin

LCH.Clearnet Ltd's Default Protections

Initial Margin

Variation Margin

Membership criteria

LCH.Clearnet Ltd's Default Protections

- Initial Margin (IM) is designed to ensure that Ltd has sufficient funds to cover potential losses in a default in normal market conditions.
- Initial margin is calculated using a variety of models from SPAN to historical simulation based value at risk (VaR).
- The level of initial margin is back-tested and reviewed regularly.

Initial Margin

- In Ltd's default history IM has always been sufficient.



LCH.Clearnet Ltd's Default Protections

Intra-day Margining

Initial Margin

Variation Margin

Membership criteria

LCH.Clearnet Ltd's Default Protections

- Because initial and variation margin are only calculated at end-of-day and received at start-of-day, they may be insufficient to cover large intra-day position and price changes.

Intra-day Margining

- So Ltd monitors market prices, member positions and changes in margin liabilities intra-day, and can and regularly does call for additional margin if needed.

LCH.Clearnet Ltd's Default Protections

Defaulter's own Default Fund Contribution

Intra-day Margining

Initial Margin

Variation Margin

Membership criteria

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- But if there's a default, the defaulter will not meet such margin calls and their initial margin may be insufficient because it's designed to only cover normal market conditions ...

Defaulter's own Default Fund Contribution

- ... so Ltd needs additional protections starting with the defaulter's contribution to the Default Fund.

LCH.Clearnet Ltd's Default Protections

Ltd's own capital (up to £20mn)

Defaulter's own Default Fund Contribution

Intra-day Margining

Initial Margin

Variation Margin

Membership criteria

LCH.Clearnet Ltd's Default Protections

☉ And continuing with ...

Ltd's own capital (up to £20mn)

☉ ... up to a maximum of £20mn.

LCH.Clearnet Ltd's Default Protections

Remaining Default Fund

Ltd's own capital (up to £20mn)

Defaulter's own Default Fund Contribution

Intra-day Margining

Initial Margin

Variation Margin

Membership criteria

LCH.Clearnet Ltd's Default Protections

- Ltd's main protection if initial margin is insufficient is the Default Fund ...

Remaining Default Fund

- ... this currently stands at £590.7mn (as at February 2010) and is stress tested daily using a variety of historical and theoretical major market moves (i.e. abnormal market conditions) to ensure that it is sufficient to at least cover the default of the single largest member.

LCH.Clearnet Ltd's Default Protections

SwapClear Contributions

Remaining Default Fund

Ltd's own capital (up to £20mn)

Defaulter's own Default Fund Contribution

Intra-day Margining

Initial Margin

Variation Margin

Membership criteria

LCH.Clearnet Ltd's Default Protections

SwapClear Contributions

- If the default of a SwapClear member were to use all of the Default Fund, Ltd has the right to request £50mn from each remaining SwapClear member on a non-voluntary basis. This can then be used to cover any further losses resulting from the defaulted member's Swaps portfolio.
- As with the Default Fund, these additional contributions would be fully mutualised. Any remaining funds would be returned to the SwapClear members, on a pro rata basis, following the successful management of the default.

LCH.Clearnet Ltd's Default Protections

Remainder of Ltd's capital

SwapClear Contributions

Remaining Default Fund

Ltd's own capital (up to £20mn)

Defaulter's own Default Fund Contribution

Intra-day Margining

Initial Margin

Variation Margin

Membership criteria

LCH.Clearnet Ltd's Default Protections

Remainder of Ltd's capital

- Were all of that to be insufficient we would use the remainder of our capital which is currently €268.4mn (as at end-2008)
- Ltd would also be seeking to replenish the Default Fund in order to ensure it could continue operating.
- It would do so by asking each member to re-contribute to the Default Fund on a voluntary basis.

Contact Points at LCH.Clearnet Ltd

🕒 For further information on LCH.Clearnet's Default Protections, please contact:

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