

LCH.Clearnet's Default History

LCH.Clearnet's Default History (1)

- There have been five defaults in LCH.Clearnet's history:
- Drexel Burnham Lambert (1990)
- Woodhouse, Drake and Carey (1991)
- Barings (1995)
- Griffin (1998) and
- Lehman Brothers (2008)
- Plus some near misses:
- Yamaichi International (Europe) (1997)
- Enron Metals (2001) and
- Refco Securities and Refco Overseas (2005)

LCH.Clearnet's Default History (2)

Drexel Burnham Lambert Limited (DBL) 1990

After the Drexel Burnham Lambert Group Inc. filed for US Chapter 11 bankruptcy protection in February 1990, its subsidiary DBL failed to meet margin calls and was declared a defaulter by LCH.Clearnet Ltd.

The settlement of DBL's positions by LCH.Clearnet Ltd left an overall net surplus on both house and client accounts.

Monies were returned with interest to the banks that had provided guarantees, and the surplus of approximately US\$18mn was repaid to DBL's administrator.

LCH.Clearnet's Default History (3)

Woodhouse Drake and Carey (Commodities) Limited (WDC) 1991

In February 1991 WDC experienced knock-on financial difficulties because of problems at its parent company.

The Association of Futures Brokers and Dealers issued an intervention order to prevent further trading by WDC, and LCH.Clearnet Ltd declared WDC a defaulter.

LCH.Clearnet Ltd subsequently closed out some of WDC's positions, transferred others and completed delivery on the remainder within two days of the default.

These actions resulted in a crystallised gross loss of approximately £0.9mn which was offset against a total of £4.1mn held by LCH.Clearnet Ltd, leaving a net surplus of £3.2mn.

LCH.Clearnet's Default History (4)

Woodhouse Drake and Carey (Commodities) Limited (WDC) (continued)

Four claims were subsequently made against LCH.Clearnet Ltd, all relating to the proceeds of sale of coffee, delivery of which was in progress at the time of the default.

All claims were discharged without loss to LCH.Clearnet Ltd.

After this discharge, LCH.Clearnet Ltd transferred the net surplus to the estate of the defaulter.

LCH.Clearnet's Default History (5)

Baring Brothers & Co. Limited (Barings) 1995

Following the discovery of substantial trading losses on overseas markets, administrators were appointed to take charge of Barings in February 1995.

This constituted an act of default under LCH.Clearnet Ltd's Default Rules and LCH.Clearnet Ltd took control of Barings' house and client account positions.

The client account was transferred to another member and the house account closed out at a gross loss of approximately £6,000, compared with total margin cover held by LCH.Clearnet Ltd of approximately £11mn.

The surplus of just under £11mn was returned to Barings' administrators and to a bank that had provided guarantees.

LCH.Clearnet's Default History (6)

Griffin Trading Company (GTC) 1998

GTC was unable to finance losses incurred on Eurex by one of its trader-clients. As a result it could not meet its regulatory or financial requirements.

In a co-ordinated action, LCH.Clearnet Ltd and Euronext.LIFFE declared GTC to be a defaulter before market opening on 24 December 1998.

LCH.Clearnet Ltd closed out the small house account position in Euronext.LIFFE contracts and, after liaison with all clients of GTC with Euronext.LIFFE positions, transferred 70% of those positions to other clearing members and closed out the remaining 30%.

The net effect of the close-outs and transfers, after allowing for LCH.Clearnet Ltd's costs, was to augment the total margin cover held by LCH.Clearnet Ltd on the day of default. LCH.Clearnet Ltd subsequently transferred the net surplus (margin and accrued interest) together with GTC's contribution to LCH.Clearnet Ltd's Default Fund to the liquidators of GTC.

LCH.Clearnet's Default History (7)

Lehman Brothers International Europe and Lehman Brothers Special Financing Inc (Lehman Brothers) 2008

Lehman Brothers suffered unprecedented losses and a collapse of their share price in 2008 as a result of holding sub-prime mortgage assets which were the source of a global credit crisis.

At 07:30 on September 15 2008 the London Stock Exchange suspended Lehman Brothers from trading, and at 09:15 LCH.Clearnet declared Lehman Brothers to be in Default.

The majority of Client positions were transferred to other clearing members within the first week.

House Liffe Equity, ICE and LME positions were sold by closed auction on 18 September, whilst House cash equity positions were settled by a buy-in process.

All house Repo positions on RepoClear were closed out, and the SWAP portfolio was initially hedged, and then auctioned 14 days after the default.

LCH.Clearnet's Default History (8) – summary

In all five cases, the defaults were successfully managed without any knock-on impact on any of LCH.Clearnet's other clearing members or on its cleared markets.

As noted previously, any losses were within initial margin held so LCH.Clearnet's clearing funds and insurance arrangements were not utilised.

LCH.Clearnet – near misses (1)

Yamaichi International (Europe) Limited (“YIEL”) 1997

YIEL was a subsidiary of Yamaichi Securities when it (Yamaichi Securities) announced in November 1997 that it was to close its business following issues surrounding the concealment of bad debts.

Following the announcement YIEL maintained additional margin at the clearing house and LCH.Clearnet Limited also applied pre-notification requirements and position limits on new trades.

YIEL then conducted an orderly wind-down of their business, culminating in resigning their membership of the clearing house in December 1997.

LCH.Clearnet – near misses (2)

Enron Metals Limited (“EML”) 2001

EML was a subsidiary of Enron Corp when it became apparent that the parent went bankrupt following widespread fraud.

EML maintained a sizeable and cash-rich balance sheet and continued to meet regulatory capital requirements and margin calls.

The administrators were confident that they had interested buyers for the EML business.

LCH.Clearnet Ltd held significant additional margin and all new trades and transfers were pre-notified.

EML was then bought by Sempra to form Sempra Metals Limited which still maintains its membership of LCH.Clearnet Ltd.

LCH.Clearnet – near misses (3)

Refco Securities and Overseas Limited 2005

Refco had three entities which were members of the clearing house: Refco Securities (“RRF”, on RepoClear), Refco Overseas Limited and Cargill Investor Services (“ROL” and “CIS” both trading futures and options); the latter had been bought by, but not yet integrated by, ROL.

All three maintained separate capital, retained excess funds at the clearing house, and continued to meet regulatory requirements and margin calls.

RRF wound-down their business, on a pre-notification and orderly basis, and resigned their clearing house membership.

ROL and CIS transferred some client business, also on a pre-notification basis, before being bought by Marex to form Marex Financial Limited, still a clearing house member.

LCH.Clearnet – default rules and framework

LCH.Clearnet’s rulebook includes rules on default handling which spell out LCH.Clearnet’s powers and obligations, including defining events that it will interpret as default and permissible post-default actions on its part.

It also maintains a default management framework which guides its handling of defaults and near misses.

This framework is kept under constant review and is tested in internal fire drills.

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Contact Points at LCH.Clearnet

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