

# **LCH.Clearnet Limited's Default Protections**

# LCH.Clearnet Ltd's Default Protections

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Membership criteria

# LCH.Clearnet Ltd's Default Protections

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- Membership criteria act as:
  - An entry hurdle for membership;
  - A definition of LCH.Clearnet 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. LCH.Clearnet has the power to increase margins based on such monitoring.

Membership criteria

# LCH.Clearnet Ltd's Default Protections

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Variation Margin

Membership criteria

# LCH.Clearnet Ltd's Default Protections

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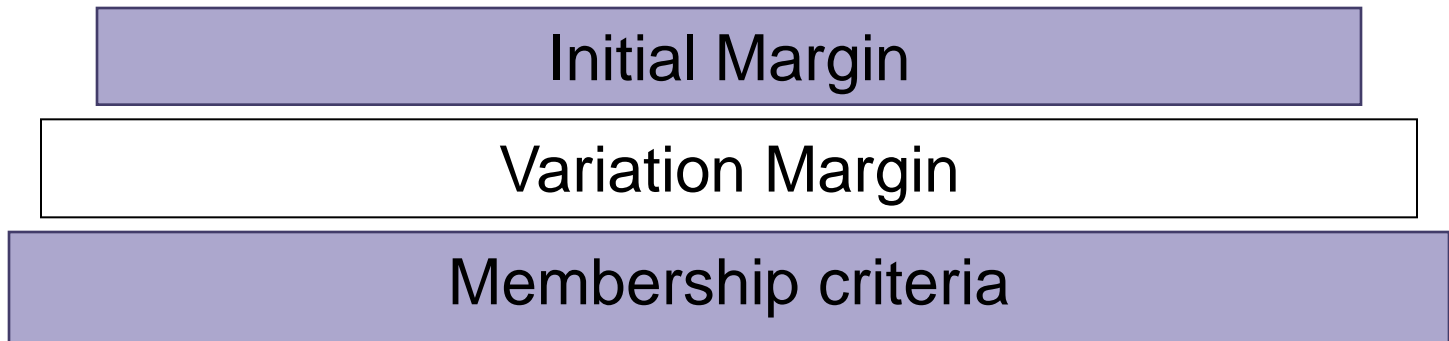
Variation margin is simply the daily debit and credit of profit and loss.

By effectively realising such P&L, it keeps LCH.Clearnet 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

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

# LCH.Clearnet Ltd's Default Protections

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Intra-day Margining

Initial Margin

Variation Margin

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- 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 LCH.Clearnet 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

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Defaulter's own Default Fund Contribution

Intra-day Margining

Initial Margin

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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 LCH.Clearnet Ltd needs additional protections starting with the defaulter's contribution to the Default Fund.

# LCH.Clearnet Ltd's Default Protections

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LCH.Clearnet Ltd's own capital (up to £20mn)

Defaulter's own Default Fund Contribution

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Intra-day Margining

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- And continuing with ...

LCH.Clearnet Ltd's own capital (up to £20mn)

- ... up to a maximum of £20mn.

# LCH.Clearnet Ltd's Default Protections

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Remaining Default Fund

LCH.Clearnet Ltd's own capital (up to £20mn)

Defaulter's own Default Fund Contribution

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Intra-day Margining

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

## Remaining Default Fund

- ... this currently stands at £584.5mn (as at February 2011) 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

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SwapClear Contributions

Remaining Default Fund

LCH.Clearnet Ltd's own capital (up to £20mn)

Defaulter's own Default Fund Contribution

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Intra-day Margining

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## SwapClear Contributions

- If the default of a SwapClear member were to use all of the Default Fund, LCH.Clearnet 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

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Remainder of LCH.Clearnet Ltd's capital

SwapClear Contributions

Remaining Default Fund

LCH.Clearnet Ltd's own capital (up to £20mn)

Defaulter's own Default Fund Contribution

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Intra-day Margining

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# LCH.Clearnet Ltd's Default Protections

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## Remainder of LCH.Clearnet Ltd's capital

- Were all of that to be insufficient we would use the remainder of our capital which is currently €153.6mn (as at end-2010)
- LCH.Clearnet 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

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

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