

# **LCH.Clearnet SA Default Protections**

# LCH.Clearnet SA Default Protections

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Replenishment

Remaining Clearing Fund

Defaulter's own Clearing Fund Contribution

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Intra-day Margining

Initial Margin

Variation Margin

Membership criteria

# LCH.Clearnet SA Default Protections

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



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Variation Margin

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- Variation margin covers the daily profits and losses.
- By, effectively calling margin for variations in the value of the positions, it keeps LCH.Clearnet SA risk current and ensures that losses cannot build up over time.
- Variation margin therefore covers market movements which have taken place before the default event.

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Initial Margin

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- ... Initial margin on the other hand covers any potential losses LCH.Clearnet SA could face in liquidating the position of a defaulting member after its default.
- Initial margin is designed to cover potential losses in normal market conditions.
- Initial margin is set using a confidence interval of 99,7% which means it may be insufficient only one day in a year.
- The level of Initial margin is regularly back tested and reviewed.



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- Initial and variation margin are calculated at end-of-day and received at start-of-day. However, during the day the risk run on a position may increase due to trading of large positions and/or significant price changes.
- LCH.Clearnet SA has the possibility to request for additional intra day margin, if needed, in order to reconstitute margin coverage.
- A full intra day re-evaluation and calculation of margin requirements for derivatives is currently being developed and will be implemented in Q1 2007.

# LCH.Clearnet SA Default Protections

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Defaulter's own Clearing Fund Contribution

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Intra-day Margining

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- Initial margin is designed to cover risk under normal market conditions, but a default could occur under extreme market conditions. In addition, a defaulter might not meet its margin calls.
- Therefore, LCH.Clearnet SA has implemented additional protections to cover risk in excess of available margin. The main protection is the mutualised clearing fund to which all relevant members contribute.
- LCH.Clearnet SA has fully segregated clearing funds:
  - One clearing fund covers the Euronext markets and LSE;
  - The second one covers LCH.Clearnet SA designated gateways and MTS Italy.



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- The size of the clearing fund is calibrated on the basis of daily stress tests using stress parameters which are reflective of abnormal market conditions.
- The clearing fund is sufficient to at least cover the risk run in case of the single largest member's default.
- Contributions for the clearing fund are called monthly.
- If a member's stress risk exceeds the level of the clearing fund on any given day, additional margin is called to cover the difference.

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- LCH.Clearnet SA will first use the defaulter's own contribution to the clearing fund.
- If the defaulter's contribution to the fund is not sufficient, LCH.Clearnet SA will use the contributions of surviving clearing members.

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- In case the clearing fund is fully used, LCH.Clearnet SA would seek to replenish it in order to ensure it could continue operating.
- The members are obliged to provide at least one contribution to ensure the replenishment of the clearing fund.
- The replenishment of the clearing fund can only be used to cover subsequent defaults.

# Contact Points at LCH.Clearnet SA

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- For further information on LCH.Clearnet SA's Default Protections, please contact one of the following staff:

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