



LCH.Clearnet SA

how its risk management compares to external standards

LCH.Clearnet SA and external standards

- LCH.Clearnet SA has a stated aim that its risk management should be best practice.
- It reviews its risk management against the following external standards:
 - European Association of Central Counterparty Clearing Houses (EACH) standards of risk management control;
 - The CPSS-IOSCO Recommendations for Central Counterparties.

See notes for more detail

EACH Risk Management Standards (1)

○ A – Counterparty Risk

○ 1. Clearing Membership Requirements

LCH.Clearnet SA establishes net capital, regulatory and quality criteria, has the facility to charge additional margin, and insists that members have appropriate banking arrangements, operational capability and experience, and management oversight.

○ 2. Membership evaluation and monitoring

LCH.Clearnet SA monitors its members on a daily basis; it also shares information with other CCPs and with regulators.



EACH Risk Management Standards (2)

○ B – Valuation and Margining

○ 3. Revaluation of positions

LCH.Clearnet SA re-values all positions daily and makes assessments of settlement prices received from the exchanges.

○ 4. Risk-based initial margin requirements

LCH.Clearnet SA maintains appropriate margining models; regularly reviews and back tests parameters used in those models; uses an assumed close-out period of at least two days; calculates and collects initial margin daily; and maintains independence of decision-making on initial margins from the business.

EACH Risk Management Standards (3)

○ B – Valuation and Margining (continued)

○ 5. Initial margin cover

LCH.Clearnet SA's list of collateral eligible as margin cover is restricted to the types identified in the EACH standards; it also operates issuer-quality, illiquidity and holding restrictions, as well as daily re-valuations and prudent haircuts which are kept under review.

○ 6. Intra-day margining

LCH.Clearnet SA has the possibility in place to request for additional intra-day margin in order to avoid excessive margin erosion. A full intra-day re-evaluation and calculation of margin requirements for derivatives is currently being developed and will be implemented in Q1 2007.

EACH Risk Management Standards (4)

☉ C – Money settlement and custodial arrangements

☉ 7. Money Settlement

LCH.Clearnet SA uses central banks to concentrate euro payments. Very low volumes of payments in other currencies are handled by a well rated commercial bank. The commitments of banks are processed on an irrevocable basis.

☉ 8. Physical Delivery

LCH.Clearnet SA instructs its deliveries to (I)CSD which are processed on the basis of delivery-versus-payment.

EACH Risk Management Standards (5)

🕒 C – Money settlement and custodial arrangements (continued)

🕒 9. Custody and security of cash and non-cash collateral

LCH.Clearnet SA deposits its cash only with counterparties having a rating of at least A+ and with any single deposit being within its capital base; securities are held with (I)CSDs.

EACH Risk Management Standards (6)

○ D – Financial resources

○ 10 (i) ... to cover default

LCH.Clearnet SA maintains a clearing fund which is stress tested daily against a standard of the largest member exposure. The clearing fund is held in cash and government bonds. LCH.Clearnet SA has the possibility to require replenishment of the clearing fund from its clearing members to cover multiple defaults.

○ 10 (ii) ... to cover non-default risk

LCH.Clearnet SA has a regulatory capital base of € 127 mn (as of 1 January 2006), which is held in cash, well in excess of regulatory requirements.

EACH Risk Management Standards (7)

○ E – Default Arrangements

○ 11 (i) Rules

LCH.Clearnet SA Clearing Rules contain specific provisions on default which meet the requirements of the above-mentioned external standards.

○ 11 (ii) Management framework

LCH.Clearnet SA maintains a default management framework which is kept under constant review; key staff are aware of its requirements and involved in testing it.

EACH Risk Management Standards (8)

○ E – Default Arrangements (Continued)

○ 11 (iii) Legal protection in the event of insolvency

LCH.Clearnet SA is recognised as a clearing house under the French Monetary and Financial Code (*Code Monétaire et Financier*) and is allowed to close-out, liquidate or transfer the positions of a defaulting clearing member.

In addition, it is also recognised as a system pursuant to the Settlement Finality Directive and has been empowered to determine the moment the transactions are deemed irrevocable.

LCH.Clearnet SA's Clearing Rules are submitted to French law and can be considered as well founded, transparent and enforceable.

EACH Risk Management Standards (9)

○ F – Risk Management arrangements & resources

○ 12. Dedicated, specialist staff

LCH.Clearnet SA has a separate and independent Risk Management Department with specialist risk management staff.

○ G - IT arrangements and resources

○ 13. Robust arrangements and continuity

LCH.Clearnet SA has established standards for the performance and recovery times of all major systems. It also has a remote data centre and an operational back-up site and regularly tests its facilities by moving to back-up.

EACH Risk Management Standards (10)

- H – Disclosure of risk management practices and of the nature of the clearing house ‘guarantee’
 - LCH.Clearnet SA communicates on its risk management framework to its members via:
 - Rulebook and instructions,
 - Detailed description of margining methodology,
 - Risk info flashes.
 - LCH.Clearnet SA believes that these communications meet the requirements.
- LCH.Clearnet SA therefore believes it meets the EACH standards of risk management controls in full.

CPSS-IOSCO recommendations for CCPs



- In 2005, LCH.Clearnet SA has been assessed by the Banque de France against the CPSS-IOSCO recommendations for CCPs.
- As of May 2005, LCH.Clearnet SA was found to have:
 - Observed 13 recommendations in full,
 - “Broadly observed” recommendation 3 → Measurement and management of credit risk,
 - “Partly observed” recommendation 8 → Operational risk.
- LCH.Clearnet SA has immediately initiated actions to gain full observance with all CPSS-IOSCO recommendations.

CPSS-IOSCO recommendations for CCPs

- LCH.Clearnet SA has upgraded its disaster recovery capabilities and successfully tested these capabilities several times.
- When publishing the evaluation's results in Q4 2006 Banque de France underlined that these measures should result in an improvement of its assessment of recommendation 8.
- LCH.Clearnet SA has initiated a project to implement intra-day margin calculation for derivatives on the basis of real time positions and prices. According to the current planning this will be introduced in Q1 of 2007.
- LCH.Clearnet SA is of the opinion that it will fully observe all CPSS-IOSCO recommendations after the successful completion of the intra day margin project.

Contact Points at LCH.Clearnet SA

- For further information on LCH.Clearnet SA risk management, please contact one of the following staff:

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