Compression with SwapClear

Unmatched Efficiency and Freedom
Since its inception, we’ve designed and refined SwapClear to empower both buy-side and sell-side participants. Our compression offering is a prime example of this relentless innovation. With the introduction of blended rate compression, the benefits are even greater — ensuring you are better able to manage your market, operational, capital and legal exposure.

During 2015, our members and their clients compressed a record $328 trillion in notional at SwapClear, resulting in a year-on-year reduction in notional outstanding of $111 trillion. This generated a marked improvement in the capital efficiency of the world’s major financial institutions, while allowing all participants to enjoy significant operational benefits.

Our enhancements to compression continue today, delivering unmatched freedom, flexibility and choice, as together we meet the evolving demands of global regulation. It’s a level of service you should rightly expect from the clear industry leader.

Compress, Terminate, Net, Tear Up
There are a number of words used in association with trade compression. All mean essentially the same thing. Members and buy-side clients can “terminate,” “net” or “tear up” trades to reduce the overall notional and number of line items in a portfolio.
What Is Compression?

Compression is the process by which swap market participants can reduce the number of individual positions and overall notional value of a portfolio by combining or offsetting trades with compatible characteristics.

WHY IT IS IMPORTANT

Regulations require members to hold capital against their interest rate swap positions. These capital requirements are usually calculated based on a number of factors, including the gross notional outstanding of the portfolio. So reducing the overall gross notional through compression may yield capital requirement relief. In addition, there are substantial operational benefits.

By participating in compression, firms can benefit from significant efficiencies, including:

01. Reduction of operational risks
02. Simplified portfolio management due to fewer trades
03. Easier default management
04. More efficient portfolio transfers
05. Less cash flow needed and fewer reconciliations
06. Speed to auction in the event of a default
07. Capital savings in light of Basel III leverage ratios, as well as capital surcharges applied to G-SIBs

01.
A trade is agreed upon between two counterparties and then cleared by the clearinghouse.

02.
These positions then form a cleared swap portfolio.

03.
If a financial institution wants to reduce the number of line items in its portfolio, it can use SwapClear’s compression offering to tear up a trade by partially or wholly offsetting positions against other positions held by that financial institution or those of another financial institution.
SwapClear’s Compression Choices

You’re in control with SwapClear’s compression options. You choose what, when and how you compress your trades. In order to give you maximum freedom and flexibility, we offer different proprietary styles of compression, as well as access via an Approved Compression Service Provider (ACSP).

SOLO COMPRESSION
Enables a party to tear up its own eligible trades independent of their counterparty.

SOLO WITH BLENDED RATE COMPRESSION
Enables two SwapClear Members to compress trades together. Members will have the opportunity to reduce their portfolio of trades with a smaller number of standardised risk replacement trades.

DUO COMPRESSION
A risk-constrained form of compression that enables two members to compress their trades together. Through the SwapClear Portal, members may increase their overall compression opportunity by partnering with other counterparties who have similar offsetting positions. Members will have the opportunity to reduce their portfolio of trades with a smaller number of standardised risk replacement trades.

MULTI COMPRESSION
Enables two or more parties to compress trades together. Members and clients have the option of reducing their portfolio of trades with a smaller number of risk replacement trades. Also available through ACSPs is the added benefit of allowing clearing members and clients the ability to apply individual risk tolerances to achieve the most effective compression result.

DELIVERING REAL EFFICIENCIES TODAY
Thanks to the array of options available to members and clients, compression at SwapClear contributed to a $280 trillion fall in notional outstanding over two years. This reduction helped members better manage their capital requirements under Basel III, as well as generated significant operational efficiencies for all participants.

All trades cleared using SwapClear are now unlinked. Unlinked trades do not need the involvement of a counterparty to be compressed.

COMPRESSION ACTIVITY (to May 2019, in Trillions)

<table>
<thead>
<tr>
<th>Notional Cleared</th>
<th>$1,138 trn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maturing Trades</td>
<td>-$283 trn</td>
</tr>
<tr>
<td>Notional Compressed</td>
<td>-$837 trn</td>
</tr>
<tr>
<td>Increase in Notional Outstanding despite $1,138 trn cleared</td>
<td>$17 trn</td>
</tr>
<tr>
<td>Notional Outstanding</td>
<td>$372 trn</td>
</tr>
<tr>
<td>AS OF MAY 2019</td>
<td>AS OF JUN 2018</td>
</tr>
</tbody>
</table>

Notional Outstanding $355 trn AS OF JUN 2018

$17 trn Increase in Notional Outstanding despite $1,138 trn cleared

$372 trn Notional Outstanding AS OF MAY 2019

JUNE 2018

MAY 2019
Solo Compression

SwapClear’s Solo compression is an extremely flexible option because a member or client can terminate their offsetting trades, regardless of counterparties.

With the addition of Solo compression with blended rate, participants can now compress much more than they were previously able to.

The core Solo offering works for all unlinked trades but requires the economics of the trades to be identical. The addition of future cash-flow netting increases the efficiency of Solo by allowing trades with different start dates but the same future cash-flow characteristics to compress.

Solo compression is a fully automated process and does not need to be orchestrated as an event. To date, SwapClear has compressed more than $1,031* trillion through its Solo compression offering.

*As of January 2018
Solo with Blended Rate Compression

While Solo provides significant operational and capital benefits to participants, the option of blended rate compression enhances these benefits, enabling institutions to compress any trade with different interest rates but the same remaining cash-flow dates. This significantly expands the universe of eligible trades and the opportunity for portfolio efficiency. It also demonstrates how SwapClear works harder to make sure that you don’t have to.

The key attributes of Solo with blended rate compression are:

01. Trades will be terminated and/or replaced at a weighted average replacement rate
02. Replacement trades can be calculated to 6 decimal places
03. Reducing the number of open trades and corresponding notional helps meet investor preferences
04. Daily compression runs

SMART FOR COMPRESSION
SwapClear has harnessed its award-winning margin simulation technology, SMART, to provide similar capabilities for compression. This enables firms to more accurately and quickly determine their compression options.
Duo Compression

SwapClear’s Duo compression offering enables members to compress their portfolio by partnering with other members who have offsetting positions.

Through partnering with other counterparties who have similar offsetting positions, members may increase the universe of eligible trades and their overall compression opportunity.

Once an opportunity is identified over the SwapClear Portal, the two members may build a compression event where they agree to flatten their offsetting positions as well as using standardised trades to replicate their risk.

The key attributes of Duo compression are:

01. Members can view a daily, anonymised update of compression opportunities with other members

02. Initiating, building and agreeing a compression event is performed over the SwapClear Portal

03. An on-demand service where members initiate and progress compression runs on a daily basis

04. All approved trade events, terminations and replacements are created directly within SwapClear

05. Risk replacement trade templates are based on standardised trades so members may replace their risk with a smaller number of risk replacement trades

01. Members must mutually agree on a compression run.

02. Members will upload their in-scope trades to compress. LCH will identify and offset the similar positions across both portfolios.

03. Both parties will include agreed risk replacement trades to the run, which LCH will match.

04. Members will have a view of their run opportunity pre-execution, and, once agreed, LCH will execute the compression run.
It is a highly efficient option because a larger number of parties can participate to create a bigger pool with more opportunity for compression.

In addition, members and clients have the option of replacing the compressed trades with a smaller number of risk replacement trades.

SwapClear conducts weekly runs, with a single currency per cycle selected by the approved third-party provider.

ABOUT LCH AND SWAPCLEAR

LCH has always endeavoured to build strong relationships with partners across the global markets to deliver best-in-class risk management. With our accumulated experience and expertise, we are uniquely positioned to help participants increase capital and operational efficiency, while adhering to an expanding and complex set of cross-border regulations. Working together with our stakeholders, we have helped the market transition to central clearing by introducing an array of innovative enhancements. These include solo compression with blended rate, an expanded set of customer protection options, and the launch of LCH Spider, our portfolio margining tool. When combined with an uncompromising commitment to service delivery, it’s no surprise that LCH is the natural choice of the world’s leading market participants.

SwapClear, the world’s leading OTC interest rates derivatives clearing service, provides access to the deepest pool of dealer liquidity, with more than 225 market makers clearing in 21 currencies across 9 major products. Since the introduction of buy-side clearing, nearly $840 trillion notional has been cleared using SwapClear, more than four times that of the nearest competitor.

LCH works across a range of execution venues and is majority-owned by London Stock Exchange Group (LSEG), a diversified international exchange group that sits at the heart of the world’s financial community.

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