

## LCH Ltd – FX Haircuts on Collateral

Dear LCH Member,

As first announced to Clearing Members on the 7<sup>th</sup> April 2017, LCH Ltd is enhancing its management of FX risk on collateral posted to the Clearing House as margin, with the objective to apply FX haircuts only on collateral where the collateral currency differs from the currency of risk\* in the cleared trade portfolio.

The following provides further details on the second phase of this programme, which subject to regulatory review/approval we aim to fully implement by the end of 2018.

This second phase will remove the FX haircut floor of 5.25% on securities and realise the full benefit of only applying an FX haircut on cash and securities collateral where the collateral currency differs from the currency of risk. For example: a cleared portfolio that only contains EUR positions and for which EUR securities cover the margin requirement, will no longer be subject to an FX haircut.

The changes are broadly categorised into the following areas:

- Collateral valuation – Q4 (exact date tbc);
- Collateral Reporting – 3<sup>rd</sup> September;
- The Collateral Management System (CMS) – 21<sup>st</sup> April;
- Tri-party collateral – Starting from 2<sup>nd</sup> July (dates differ per Clearing Member); and
- Margin calculations and reporting – Starting in Q4 (dates differ per Clearing Service);

Further details on implementation timelines, updated report samples and member testing guidance will be provided in due course.

The changes will also be further discussed with Clearing Members that are part of LCH Product Advisory Groups, Risk Working Groups and in the usual change forums.

Further information for each of the impacts listed above, is provided below.

### Collateral valuation

#### **Date of change: Q4 2018, all Clearing Services.**

The change in collateral valuation will remove the FX haircut floor on the securities collateral (currently 5.25%). Cash and securities collateral could have a different value depending on the currency of risk assigned to the account to which it is pledged. FX haircuts will be deducted from cash and securities collateral, where (and only where) the collateral currency differs from the currency of risk.

This will also impact cash only processes such as: margin calls (both intraday and end of day) and auto-repay functionality. For example:

- where FX haircuts are applied to margin calls – and there is a difference between the currency of risk and the Clearing Member's margin call preference currency - the resulting margin call amount will be higher than the liability shortage amount shown in certain reports; and

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\* The currency of risk is determined as the main currency for the cleared portfolio. It will always be an existing Initial Margin currency.

- where FX haircuts are applied to excess cash – and there is a difference between the currency of risk and the Clearing Member's excess collateral balance - the resulting amount to be repaid (auto-repay amount) will be higher than the unutilised cash amount shown in certain reports.

## Collateral Reporting

**Date of change: Expected from the 3<sup>rd</sup> September, all Clearing Services.**

To support the changes in collateral valuation as described above, additional information will need to be provided to Clearing Members in the LCH Banking Reports. The reports that will be impacted are as follows:

- Overnight Cover Distribution (Report 19)
- Cover Calling Summary (Report 30)
- Cash Collateral Holdings (NEW REPORT)

The changes to reports will be introduced in advance of the changes to the collateral valuation, and detailed specifications and examples will be communicated to Clearing Members shortly.

There are no changes to any of the Standard SWIFT reports (Statement - MT950, Statement of Holdings - MT535, or Margin Call - Colr.003.001.04) or to any of the CustodialSeg SWIFT reports (Triparty Status – MT558, Triparty Statement – MT569, Proposal - Colr.007.001.05, Cancellation – Colr.006.001.005)

## The Collateral Management System (CMS)

**Date of change: 21<sup>st</sup> April 2018, all Clearing Services.**

The Collateral Management System (CMS) will be updated in preparation to support the changes outlined above. As a result, users will notice additional place holders for information (see list below), however these will not become active until the changes in collateral valuation expected in Q4:

- A new Currency of Risk enquiry screen;
- Cash Deposit and Cash Transfer screens will now display Collateral Value information; and
- the Cash Balances screen will now display Haircut and Collateral Value information.

There will be no changes for Clearing Members in relation to how they instruct collateral via the CMS.

There will also be no changes for members using the SWIFT messaging service to propose collateral (Collateral Proposal – Colr.007.001.05, Collateral Proposal Response – Colr.008.001.05) or affirm collateral for CustodialSeg accounts (Proposal Response – Colr.008.001.05).

## Tri-party collateral

**Date of change: Starting from 2nd July (dates differ per Clearing Member), all Clearing Services**

Advance changes to tri-party transactions will be necessary for some Clearing Members who utilise tri-party to cover their LCH margin liabilities. These changes are required to enable the tri-party agent to apply specific FX haircuts on behalf of LCH, when it implements the collateral valuation changes in Q4 (subject to regulatory review/approval).

We will contact impacted Clearing Members in due course and begin implementing the advance changes from the 2<sup>nd</sup> July.

Clients who utilise tri-party for CustodialSeg accounts will not be impacted by these changes as these transactions can already support currency of risk specific FX Haircuts.

### Margin calculations and reporting (per Clearing Service)

**Date of change: Starting Q4 2018, dates differ per Clearing Service.**

Changes are anticipated across some LCH Clearing Services. As the specific details of these changes will vary per Clearing Service additional information will be communicated separately to members of those services.