

Frequently Asked Questions regarding Interoperability for Equities

Please see below a series of questions and answers from the LCH perspective. The information will help clearing members better understand the operational processing around the choice of CCP or (Interoperability).

1. What is Interoperability?

This is where some trading venues allow multiple CCPs to offer clearing services within their single market place. This in turn allows trading firms and clearing members the choice of clearing provider (CCP).

2. Do clearing members need to register for Interoperability?

No, however a clearing member must confirm with its CCP the markets/venues it wishes to clear.

3. What information does the CCP require from clearing members?

Clearing members and their clients will be required to complete the necessary legal documents including a static data form per market/venue. The static data form will determine which clearing member is using which CCP and for which market/venue.

4. Can a clearing member use multiple CCPs?

Yes, different CCPs can be used across different trading venues. All trading, clearing and settlement information is collated per trading venue.

5. Will LCH change the way it operates due to Interoperability?

No, we will continue to process all trades through our EquityClear service. All margins will be calculated using ERA, all Banking and EquityClear member reports will continue to be made available. We will continue to calculate member's volumes through our EquityClear tariff structure.

6. Will Interoperability result in additional cost?

There will be requirement for clearing members to provide their CCP with additional funds to cover open liabilities between interoperating CCPs.

7. How will the interoperable margin be calculated?

We will continue to use our Risk algorithm 'ERA', to calculate margin required from all interoperable CCPs. Likewise, the other CCPs will use their in house margin algorithms to calculate margin required from us.

8. How will the interoperable margin be apportioned to members?

Where there is a requirement for margin to cover Inter CCP liabilities, a risk multiplier will be applied to clearing member's daily initial margin. The multiplier will be apportioned to each EquityClear member.

9. Will all EquityClear clearing members be required to contribute to the Interoperable margin requirement?

Yes.

10. How much do you expect this to be?

It is difficult to calculate the overall cost as the interoperating CCPs use different methodologies to calculate their margin requirements. Also the exposure between the CCPs will be dependent on the overall size and direction of business generated by trading activity.

11. Will the interoperable margin be identifiable at a client level?

LCH will continue to margin at clearing member level. However, we also produce reports containing information at settlement firm level.

12. How will Interoperable margin be reported?

All interoperable requirements will be included in member overall obligation, which will be available in our reports that can be found within the member reporting environment. Also, margin parameter files will contain the risk multiplier.

13. Are there any other changes to margin calculation methodology?

No

14. Are there any changes to the rules, and what is the impact on members?

It is not expected that any changes will be made to the LCH rules therefore no member impact is expected.

15. Will LCH require additional default fund requirement from its members?

With the introduction of Interoperability, clearing members will not be required to increase their default fund contributions.

16. Will LCH be required to contribute to other CCPs default fund?

No

17. Will the revised LCH tariff be applicable across all Interoperable venues?

Yes, the EquityClear service operates a global tariff across all venues it serves. All cleared trades within the service are combined to accrue the lowest possible unit cost.

18. Other than additional margin requirements, will LCH apply any other additional costs associated with Interoperability?

No

19. In what form can interoperable margin be covered (cash, securities)?

Interoperable margin is a Legal requirement between the interoperating CCPs. A list of acceptable cash & non cash collateral will be agreed between the interoperating CCPs before live. This will have no affect on how or what collateral clearing members use to cover outstanding EquityClear liabilities.

20. What is the Interoperable CCPs margin cover process?

We will be required to meet our margin requirement with all interoperable CCPs. The requests from all interoperable CCP's will be processed daily. We will lodge sufficient collateral within LCH accounts at Clearstream bank Luxembourg as cover.

Each CCP will monitor that suitable and sufficient collateral is held within each account. The CCPs have agreed the types of collateral that can be used, (this will have no impact on clearing members). We will ensure that our daily requirement is met.

Upon notification of the margin requirement from the interoperable CCPs, we will apply a risk multiplier to calculate the requirement from each of our clearing members to cover the additional liability.

The risk multiplier will be available within the EquityClear parameter files on our website. The additional requirement will be included in the daily EquityClear margin requirement and be reported to members as a single combined figure. Clearing members will continue to use existing collateral lodgement processes and procedures and will continue to have the choice of cash or non cash collateral usage.

21. At what time will Interoperable margin be required?

Just as Clearing Members are required to cover their liabilities each morning, the Interoperating CCPs will also be required to post collateral as cover each morning. We will include any additional interoperable margin requirement in the daily margin call from our members, as stated above. Where necessary we will also inform and collect intra-day margin as required.

22. Where will Interoperable margin be held?

All collateral used as cover for interoperable liabilities between the CCPs will be held in an account of the CCP at Clearstream Bank Luxembourg. This does not alter how members pledge collateral or how it is held by LCH.

23. Can Interoperable margins be re-used by the receiving CCP?

No, the Interoperable agreements do not allow for any re-use of collateral.

24. What assurances can be given that member's day to day margin will not be re-used?

All margins come with the same assurances that exist within the LCH rules. If a member provides non cash collateral then the securities remain in the members name and cannot be re-used. However, if cash is pledged, the ownership changes to the receiver and can be re-used.

25. Do you see this as being a big bang approach?

As above, the implementation for both clearing members and CCPs should be in an agreed, and using a phased approach. However, discussions around the most suitable plan will be held before any implementation.

26. What are the key milestones leading to the implementation?

Confirm with trading venues their ability to offer multiple CCP clearing.
Confirm with clearing members their flexibility and appetite to change.
Formulate a plan for clearing members that wish to move.
Execute the plan in a controlled manner.

27. How will you ensure we (and other members) are ready for the changes?

We will be in close contact with all members. A plan and associated timelines will be agreed and no movement will be facilitated without all parties agreeing to the plan and providing the relevant service information.

28. Will LCH offer cross trading venue netting?

For settlement, where cross trading venue netting is possible, it will be offered.
For margin purposes, all open positions regardless of trading venue will be netted to achieve the most efficient margin output.

29. Will settlement be affected by Interoperability?

No, settlements will be instructed & processed as if a single CCP operated in the market and securities will settle in the relevant CSD.

30. How do Interoperable trades settle?

Where the seller of a security uses CCP1 and the buyer uses CCP2, it will be the responsibility of CCP1 to take delivery from its selling clearing member and deliver the securities to CCP2 for onward delivery to its buying member.

31. What happens if a CCP is unable to deliver securities?

The failing CCP will be subject to the agreed procedures between both CCPs

32. What happens if a CCP is unable to meet its margin requirement?

The failing CCP will be subject to the agreed procedures between both CCPs and could possibly be put into default by the requesting CCP.

33. What happens if a CCP goes into default?

The defaulting CCP will be put into default by the surviving CCP. It will be treated as a clearing member and be subject to the default rules of the surviving CCP. All lines of protection are used with the exception of access to the default fund. The LCH default waterfall is available on the LCH website.

34. Would LCH consult with its members if there are changes to the interoperable agreements between CCPs?

We would consult with our membership if any of the changes affected our clearing services we offer to our clearing members, or if clearing members are directly affected.

35. How does the consultation process work?

We will advise our members of the proposed changes via official notice issued by our corporate communications team. Within the notice members will be advised of a 30 day response period, if no objections are received during this period then we will proceed with the change. If objections are received we will consult with each objecting member, to ascertain their issues and try to find an agreeable solution.

36. Who would be at risk if Clearstream was to default?

The CCP will be at risk should their custodian default

37. Why would I choose LCH as my CCP?

LCH has vast experience in managing operational and counterparty risk and dealing with a member default.

It should be noted that in all previous member defaults handled by LCH, it has only been necessary to use the defaulting members margin requirement to manage all their outstanding obligations.

We offer clearing members a broad range of cleared products and services, benefiting the member with a single counterparty across many asset classes.

We allow clearing members to use a single account to process multiple services, making the clearing members back office processes more efficient. All LCH equity business is processed through its margining algorithm (ERA), calculating a single number per clearing member, per day. Also all equity business is processed through a single global tariff structure, resulting in the lowest possible unit cost.

LCH has dedicated relationship managers that are available to assist clearing members either by phone, email or member visit. The relationship managers will provide information relating to new and existing services and products and will answer specific or technical questions regarding all our services.

