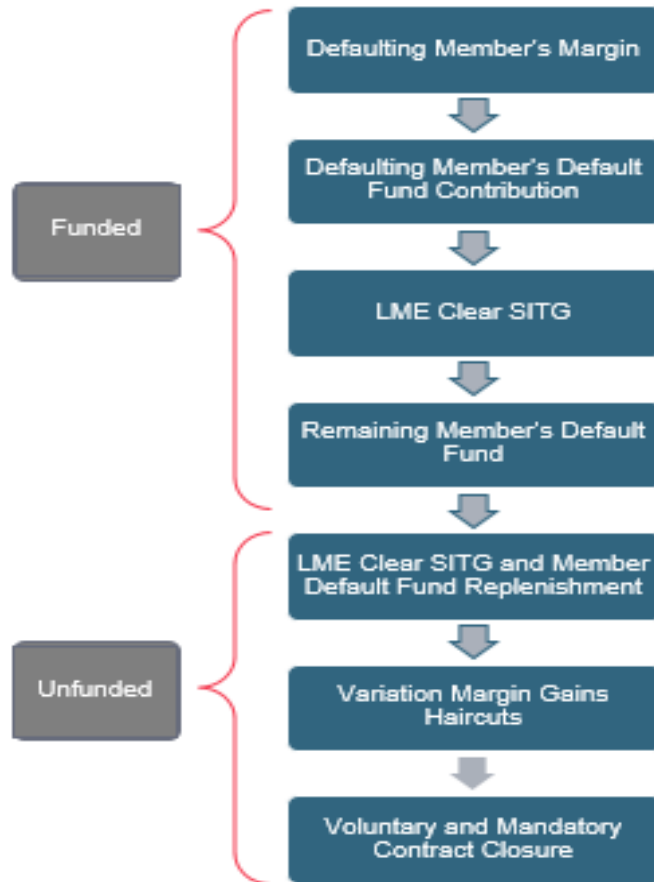


# Default Management

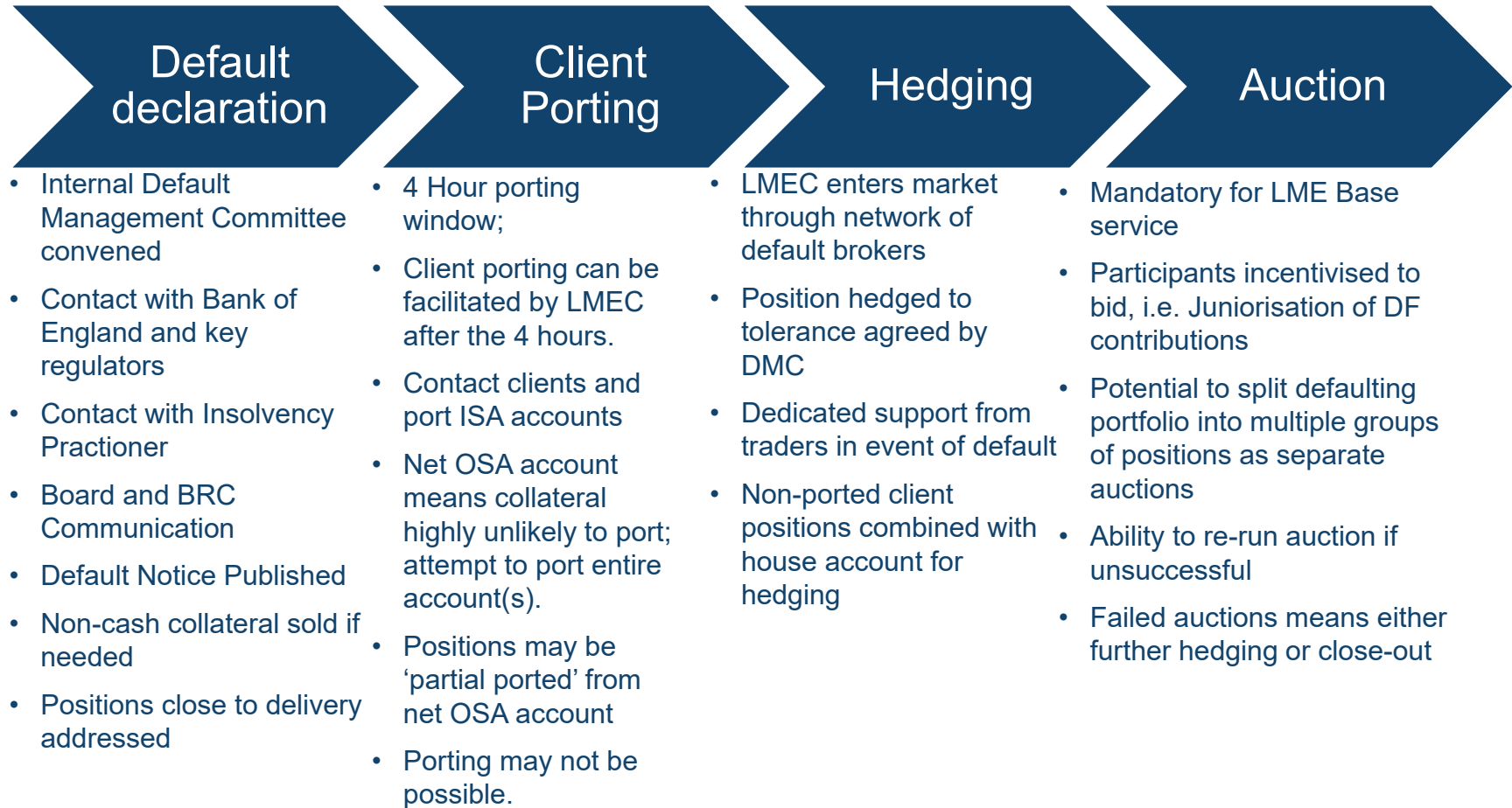
# Default Management Waterfall



- LME Clear capital contribution will be 25% of regulatory capital
- One mandatory replenishment
- One or more variation margin haircuts for "in the money" Members (to ensure that LME Clear is able to continue to have funds to meet the Default Loss)
- Waterfall is 'per default' and LMEC required to maintain 'minimum' default fund at all times
- Recovery plan culminates in 'full tear up' per metal if necessary
- Business viability review triggered by any utilisation of unfunded portion of waterfall

# Default Management

## Overview



# Default Management

## Communications

- LME Clear will inform the regulator before a default is notice is issued.
- A notice of default will be published on the LME website.
- Regular information will be disseminated throughout the default period to inform members of the progress of the default management process.
- Notification made on website of actions taken with regard to maturing positions or other LMEC actions that may impact exposures of clients.
- Members that have agreed to receive the positions of clients of the defaulting Clearing Members will be contacted to confirm their acceptance of the portfolio and arrange the porting process.
- Where client contact information is available and in priority of their risk mitigation potential, LMEC will attempt to transfer clients to new Clearing Members.

# Default Management

## Risk Mitigation Process

- Information gathering on detailed Member positions to provide trading and hedging view, together with significant client positions and financial status of portfolio versus collateral.
- Liquidity assessment carried out to identify requirements and to provision for necessary supporting cash flows to mature.
- Net maturing positions rolled forward for both house and client accounts to prevent delivery situations occurring.
- **House positions;**
  - Liquidate key exposures in outright positions
  - Identify large spreads or options to be reduced
  - Use prearranged default broker network
  - Prepare neutralised portfolio for auction

# Default Management

## Porting Process

Within rules agreed with BoE and capabilities to control risk, LMEC will endeavour to transfer client positions wherever possible.

- **ISA's;**

- Transfer positions and collateral of all identified clients to new Clearing Members.
- Where Clearing Member declines client, positions will be liquidated and net proceeds returned to client.

- **OSA's;**

- Clients will, where identified, be ported in accordance with the rules and procedures of LME Clear.
- If possible, transfer will be undertaken, or risk reduced and remaining positions combined with auction portfolio.
- Proceeds post liquidation and auction paid back to administrator for onward distribution.

# Default Management

## Mandatory Auction Process

- LME Base; Mandatory for members with a history of positions, as defined within the Rulebook, for all contracts in each auction.
- Further eligibility criteria detailed with the Rulebook, including credit rating.
- LME Clear have the ability to split defaulting portfolio to form multiple separate groups of positions as separate auctions.
- Auctions portfolio will be provided in pre-agreed format of positions sent in file to all bidding Members.
- Participants to bid on full portfolio with one clear winner for each auction.
- Fifteen minute window in which participants can bid repeatedly if necessary.
- The Default Management Committee, DMC, will decide the winner of the auction in accordance to the Rulebook.
- Winning bid identified and member notified - 'on risk' immediately with portfolio transferred as soon as possible in consultation with winning bidder.
- Default fund contribution juniorisation to apply where losses require use of the default fund.

# Default Management

## Fire Drills

- **At least 4 fire-drills are performed annually, out of which 1 will be an external fire-drills including clearing members.**
- **Test internal default management process;**
  - Internal and external communication process,
  - Information gathering
  - Default broker interaction
  - Client porting assessment and transfers
  - Liquidity assessment
  - Liquidity and collateral management
  - Key supplier failure and failover test
  - Specific risk scenarios e.g. settlement bank failure
- **Test auction process;**
  - File publication and receipt by members
  - Mock bid process on theoretical portfolio within production GUI
  - Full position transfer mechanism