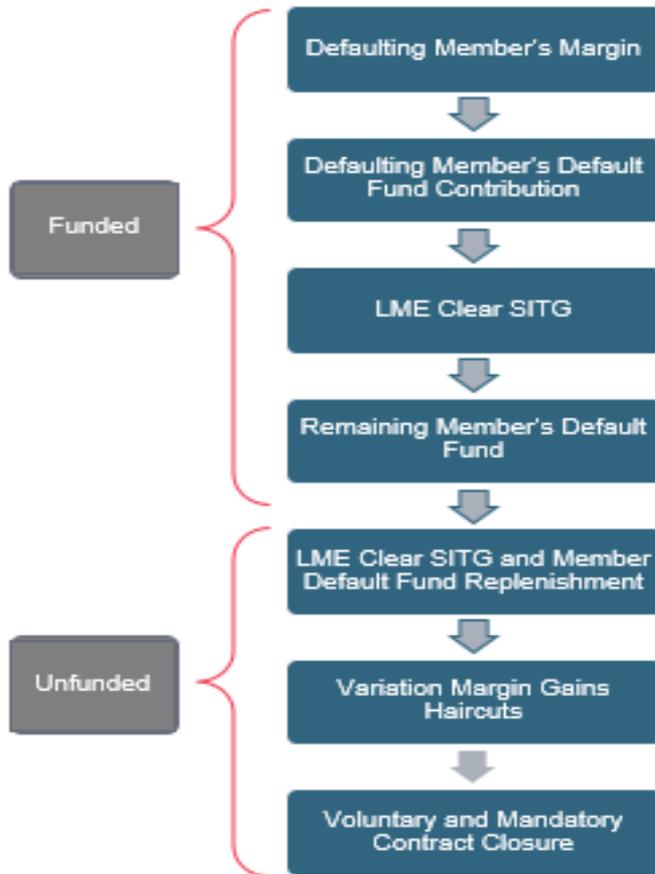


Default Management

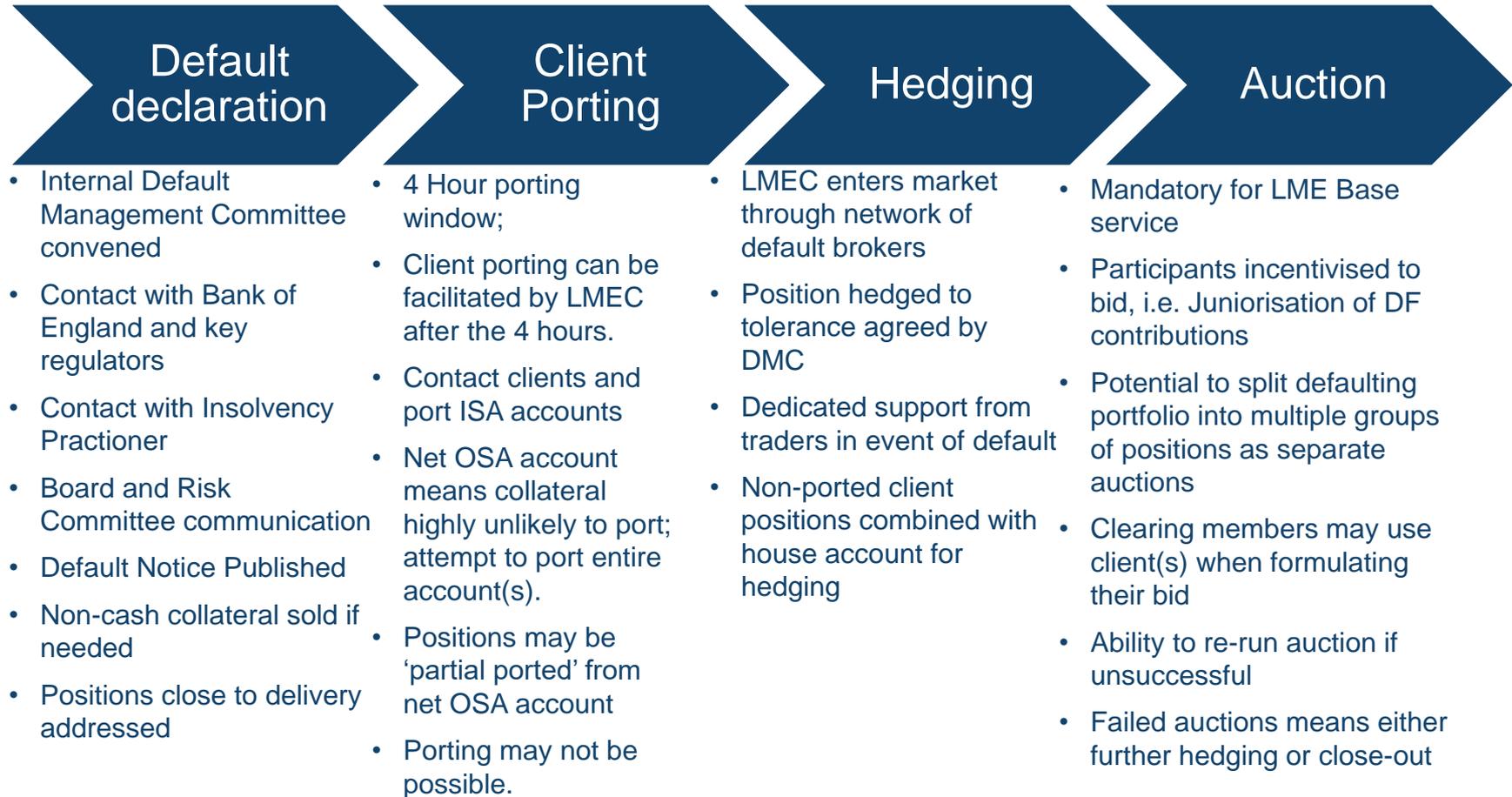
Default Management Waterfall



- 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

Client bid in Auction

- Clearing members may use client(s) when formulating their bid, specifically under the following scenarios:
 - Clearing Member would obtain a bid from a client and submit it in LMEmercury. If won, the default portfolio to be passed directly to the relevant client OSA
 - Clearing Member would obtain bids from clients per metal(s) and submit an amalgamated bid in LMEmercury. If won, the default portfolio to be split and passed directly to the relevant client OSAs, as applicable.
- Clients are required to sign non-disclosure agreements and be approved by the Default Management Committee ahead of a default period. Once a default is announced no new clients can participate.
- It is the clearing member's responsibility to manage instances of multiple bids, to ensure a single bid is provided by the member to LME Clear to satisfy the member's bidding obligation.
- Once the bid is entered by the clearing member to LME Clear, if the client withdraws the bid and the clearing member has not updated or removed the bid before the bidding window closes, then that bid will be used in determining the winning bidder and assignment of costs into the Default Fund.
- It remains the clearing member responsibility to ensure requirements regarding mandatory bidding are fulfilled in accordance with the Rulebook.

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