

# Operational Risk Management

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## Overview

The LME Group has adopted the definition of operational risk provided by the Basel Committee on Banking Supervision (BCBS): “The risk of loss resulting from inadequate or failed internal processes, people or systems or from external events”

## LME Clear Statement

The purpose of LME Clear, as with any Central Counterparty (CCP), is to protect clearing members as well as the market itself by reducing risk. Whilst this remains the primary purpose of LME Clear, the organisation also aims to enhance the operating efficiency and reduce the processing costs of clearing for its clearing members and all other relevant market members. In achieving these goals, LME Clear, as a market infrastructure provider, shall always consider the needs and interests of the market as a whole, its shareholders and regulators whilst recognising the systemic obligation of its role as a CCP.

The Board acknowledges LME Clear’s status as a market infrastructure provider and the impact of its operations on systemic risk. The Board has a zero appetite for any breach of applicable regulatory & legal requirements, including any aspects of LME Clear's status as a Recognised CCP under the FSMA and Authorised (or, if relevant, Recognised) CCP under EMIR.

## Governance and Risk Appetite Statement

LME Clear has adopted a governance model which is in accordance with the best practices as defined by The Committee of Sponsoring Organisation of the Treadway Commission (COSO) and the ‘3 lines of defence’ governance structure as summarised in the Group Risk Management Policy. LME Clear also has an Executive Committee (Excom), an Executive Risk Committee (ERiC) and a Clearing Risk Committee (CLERiC) to assist the Chief Executive Officer and Chief Risk Officer respectively in managing the business of the CCP in line with authority from the LME Clear Board.

The Risk Appetite Statement is owned by the Board and is reviewed by them at least annually. In addition:

- Reviews of each of the Risk Appetite Statements are undertaken by the Audit or Board Risk Committee as appropriate and reported to the Board;
- The reporting of agreed metrics against the Risk Appetite is provided to the Executive Committee, Audit or Board Risk Committee as appropriate, and Board; and
- Any breach of the Risk Appetite will be immediately reported to the Executive Committee with subsequent reporting to the Audit or Board Risk Committee as appropriate and Board as well as to the Group Chief Risk Officer or his Deputy.

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## Three Lines of Defence

Consistent with industry good practice, the LME Group ERM framework includes the 'three lines of defence' to protect LME Group assets and business activity. The approach reinforces the principle that risk management is an activity embedded in the wider management of business. The first line of defence is the department heads that are responsible for the identification and management of risks within their departments. Risk specialists who create a second line of defence supplement the first 'line of defence' and the third line of defence is formed by Internal Audit and other sources of independent oversight and assurance.

## Key Objectives

LME Clear's risk management objectives are:

- Ensure that the EMIR Requirements and Recognition Requirements as well as other applicable statutory legal requirements are met;
- Ensure that the risk management statements in the annual reports are adequately supported and other relevant corporate governance requirements are met;
- Protect and enhance value by prioritising and focusing attention on managing risk across the CCP;
- Maintain clearing members positions and collateral in a safe and secure manner;
- Ensure sufficient financial resources to manage a default in stressed events that are extreme but plausible;
- Share risk information across the CCP to ensure the LME Clear is making informed decisions;
- Promote open discussion and appropriate escalation of significant risks as soon as they become apparent;
- Embed risk management into the culture and processes for day to day activities;
- Ensure awareness at Board level of the key risks and how they are being addressed;
- Ensure there is a rigorous review and due diligence process for all actual and potential members and other counterparts to whom an exposure is expected to arise;
- Maintain effective and efficient operational and change management procedures;
- Maintain robust processes and controls;
- Vigilant maintenance to the uninterrupted availability of systems, data and assistance where applicable;
- Have due regard to the reputation of LME Clear and the broader Group;
- Effective and cautious management and robust control of operations that are outsourced to third parties including LME Clear's systems and technology providers and investment managers;
- Maintain a high level of understanding of the markets and the products which are being cleared; and
- Maintain a high level of competence and experience among staff.

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## Operational Risk Framework

- LME Clear recognises that effective Operational Risk Management requires a consistent and integrated approach
- The approach is cyclical in process as activity in one phase may lead to the need to revisit a previous phase
- These phases of activity, in the diagram below, collectively form the Operational Risk Framework
- The use of 'loops' within this approach provides a basis for continuous improvement in the management of Operational Risk

