LCH.CLEARNET

# Tested model proves the clear choice in Europe and the US

*Increased fear of counterparty default since the collapse of Lehman Brothers, coupled with imminent regulation, is pushing many institutions to seek reliable clearing solutions. Now, for the first time, the US buy-side can access LCH.Clearnet's SwapClear – the world's leading interest rate swaps clearer – via a futures commission merchant model. Floyd Converse, head of SwapClear US sales and marketing, explains the offering*



With its wealth of experience in clearing interest rate swaps (IRS) and a product range covering almost 95% of the plain vanilla IRS market, LCH.Clearnet's SwapClear has long been the clear choice for the global interdealer market. LCH.Clearnet has been a Commodity Futures Trading Commission (CFTC)-registered derivatives clearing organisation since 2001, clearing over-the-counter (OTC) interest rate swaps. Since March 8 this year, the US buy-side has been able to access SwapClear's full range of IRS services via the futures commission merchant (FCM) model.

This means that, for the first time, the US buy-side can clear a range of interest rate derivatives via an FCM through an institution that has 12 years of experience in this field and the widest product range currently available.

"While it's a new effort for us here in the US, there's a wealth of experience behind it," says Floyd Converse, head of SwapClear US sales and marketing.

Founded in 1999, SwapClear currently has 880,000 trades outstanding with a notional value of $266 trillion. Since inception, it has cleared 1.5 million OTC IRS trades in 14 different currencies and currently has 49 members – 37 global clearing members and 12 FCMs. Its experience is proven. It is the only OTC clearing-house service to have successfully handled a default on the scale of Lehman Brothers' $9 trillion IRS default in 2008. In that instant, SwapClear's default management process ensured more than 66,000 trades in five currencies were hedged and auctioned to other clearing members and that no losses were incurred by any other market participants.

**Breadth of product**

The breadth of SwapClear's product offering – almost all of the plain vanilla market, as well as overnight index swaps (OISs), flexible payment dates and one-month, six-month and 12-month Libor on top of the standard three-month – is a result of SwapClear's longevity in the market.

"We've evolved over 12 years to expand our product line and that's not something you can do quickly," says Converse. "A lot of time and effort is required to get there. So, due to our experience, we offer a very strong product line compared to the competition," he adds.

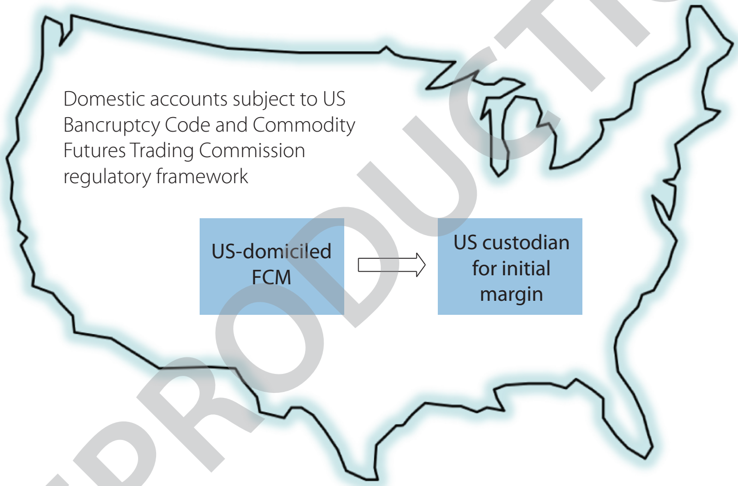
**Commitment to the US**

Extending the SwapClear offering to the US buy-side has been the result of extensive dialogue with the market. "We are in a working partnership with a lot of buy-side clients, seeking out their opinions on how to shape our offering," says Converse. "We know that our offering will evolve according to buy-side needs and as new regulations, in particular the Dodd-Frank Act, become effective. I expect us to see increasing velocity of clients and trades coming into our clearing business," he says.

The SwapClear model will offer US clients several key benefits including reduced counterparty risk, default protection under CFTC rules, portability of client collateral and positions, and initial margin collateral held solely in the US and fully subject to US law.

LCH.Clearnet margins the FCM according to the aggregated risk profile of the individual client portfolios.

1 Segregation of initial margin – cash and non-cash collateral




**A. Tenor, currencies and product types**

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|---|---|---|---|---|---|---|
| 0–2 years (OIS) | CHF | EUR | GBP | USD | | |
| 0–10 years (Libor) | DKK | HKD | NOK | NZD | PLN | ZAR |
| 0–30 years (Libor) | AUD | CAD | CHF | JPY | SEK | |
| 0–50 years (Libor) | EUR | GBP | USD | | | |
| Plain vanilla, compounding swaps, single-currency basis swaps, zero-coupon swaps, overnight index swaps, flexible payment and maturity dates | | | | | | |

"We're going to accommodate, to the best of our ability, what the buy-side wants as long as it's compliant with CFTC regulation and operationally possible," notes Converse. "In the future, if the buy-side or the regulators decide they want a greater degree of segregation, then we will deliver that. We're ready to do so if demands change."

Changing to market needs has been a hallmark of SwapClear's offering since its inception. In June 2010, following extensive dialogue with the industry, LCH.Clearnet became the first – and still is – the only clearing house to use OIS rate curves to discount IRS. "It became apparent after the Lehman Brothers collapse that OIS discounting had become a better indicator than Libor for portfolio valuations. We took the view that, to manage our risk responsibly, we should move our four major currencies to OIS discounting," says Converse. "This means we have a much more accurate picture from a risk management perspective of portfolio valuations."

**Further product enhancements**

As part of the evolution of SwapClear's product offering, new products are constantly considered. This year will see the addition of amortising IRS to its portfolio.

"As the economic cycle turns, loan demand for banks should increase and, as a result of that, there will be more need for amortising swaps," says Converse. "We recognised that and so we wanted to adapt our offering to buy-side clients to include that. It's a good example of how we tailor our product to meet a specific need of US-local clients."

And, although SwapClear has the support of a heavyweight institution behind it, it is also able to move nimbly and swiftly when required. "In January, we realised clients – particularly regional banks – really needed this. So we have looked into it and will be launching amortising swaps later this year," says Converse.

The development of SwapClear's amortising swaps product is an example of how active the organisation's dialogue is with the buy-side and how much they have shaped the offering. "It comes back to it being an evolutionary process – the more we learn about what clients want, the more we can adapt our offering," says Converse. "We're very keen to develop the service in line with how the market is moving. One of our key differentiators is that we always try to work with the way the market is trading at any one time and fit our service to it."

**Ready for regulation**

The provisions foreseen within the terms of the Dodd-Frank Act are likely to mandate a lot more clearing. As such, buy-side institutions will need to be ready. However, whether clearing is mandatory or not, there are a lot of benefits to it that US buy-side clients can enjoy now, before the regulation becomes compulsory.

"There are many benefits to clearing that we are now offering to people before they are mandated into it by regulations," says Converse.

"We're offering people the chance to get ahead of the regulations and put something in place in plenty of time. We want to be ready, and we want the buy-side to be ready for Dodd-Frank's Act."

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