

## **LCH.Clearnet SA Cash Equity and Listed Derivatives**

Additional margins: Wrong Way Risk Principles

December 2013

# 1. Definition and scope

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**Wrong Way Risk (WWR)** margin is to cover the risk that occurs when exposure of a Clearing Member in its own products is adversely correlated with the credit quality of that Clearing Member.

- Positions on a security issued by the Clearing Member or its group company(ies) and held in its House and Client accounts will be subject to a WWR estimation.

**Positions on the following products are concerned:**

- For Derivatives markets:
  - ✓ Futures and options on equity issued by Clearing Members and their own group company(ies).
  - ✓ Consequently, Index and commodities derivatives are out of scope.
- For Cash equity markets:
  - ✓ All issued guaranteed securities (equities, bonds, warrants,...) by Clearing Members and their own group company(ies).
  - ✓ Note that trackers and funds are not concerned by WWR.

- Once the concerned products related to the Clearing Member are identified, the net position held on it will be used at Margin Account level to determine the WWR exposure and the corresponding additional margin.
- For each concerned position, at the Clearing Member Margin Accounts' level, a WWR additional margin is performed.
- A positive WWR is a risk when a negative amount is a right way risk. Both are gathered at Margin Account level and a right way risk offsets a Wrong Way Risk.

## 2. Margin calculation

2/3

➤ For Cash products:

$$WWR_{Margin\ Account\ i} = \sum_{trading\ code} \left( \text{Clearing Price X Net Position}_{trading\ code} - \text{Specific Risk}_{trading\ code} \right)$$

$$\text{Additional Margin}_{Margin\ Account\ i} = \max(0; WWR_{Margin\ Account\ i})$$

With:

- Net position : Buy – Sell (in number of securities at trading code level) to be settled on the positions identified as having a WWR exposure;
- Specific Risk is the “X” of Liquidation Risk applied to the gross position, with X depending on the Liquidity Class (see Margin Parameter Risk Notice).

For more details on Specific Risk and Liquidation Risk calculation, please refer to the document “Cash Product Margin Calculation method” at this path: [http://www.lchclearnet.com/Images/Brochure%20Span%20CashGB\\_tcm6-44566.pdf](http://www.lchclearnet.com/Images/Brochure%20Span%20CashGB_tcm6-44566.pdf)

➤ For Derivatives products:

- For Put options: 
$$WWR_{Margin\ Account\ i} = \sum_{\substack{\text{all puts of the} \\ \text{Margin Account}}} -Strike \times Net\ Position \times CVF$$

$$Additional\ Margin_{Margin\ Account\ i} = \max(0; WWR_{Margin\ Account\ i} + Net\ Option\ Value)$$

- For Call options: 
$$WWR_{Margin\ Account\ i} = \sum_{\substack{\text{All calls of the} \\ \text{Margin Account}}} Net\ Option\ Value$$

$$Additional\ Margin_{Margin\ Account\ i} = \max(0; WWR_{Margin\ Account\ i})$$

- For Futures: 
$$WWR_{Margin\ Account\ i} = \sum_{\substack{\text{All Futures of the} \\ \text{Margin Account}}} Clearing\ Price \times Net\ Position \times CVF$$

$$Additional\ Margin_{Margin\ Account\ i} = \max(0; WWR_{Margin\ Account\ i})$$

With:

- $Net\ Position = Long - Short$  (by trading code)
- $Net\ Option\ Value = Market\ closing\ premium \times Net\ position \times CVF$  (Contract Value Factor)

## 3. Margins calls

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### ➤ Monthly additional call:

The WWR will be called monthly on the same day as the Default Fund contribution (4<sup>th</sup> business day of the month) and will be based on the daily WWR average of the previous month. A positive value will generate a cover requirement at Collateral Account level if the WWR margin is greater than a threshold (A).

### ➤ Daily additional margin call:

The Additional Margin due to WWR is calculated daily. When the daily uncovered WWR exceeds a threshold (B), a daily additional margin requirement is performed.

- ✓ If Daily WWR >  $WWR_{\text{latest month}} + \text{Threshold}_B$       => Daily WWR is required as additional margin
- ✓ If Daily WWR <  $WWR_{\text{latest month}} + \text{Threshold}_B$       => WWR remains as additional margin

### ➤ Treasury reports:

WWR amount will be added to others additional margin amounts and will appear on the Treasury report under the “**Additional Margins**” tab.

*Note: the same will apply for Liquidity and Concentration margin when implemented.*

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