

**LCH.CLEARNET LIMITED – FORM DCO AMENDMENT
EXHIBIT A-1.1 – JANUARY 10, 2014**

LCH.CLEARNET LIMITED (“LIMITED”)

FORM DCO AMENDMENT

COMPLIANCE WITH DCO CORE PRINCIPLES¹

<u>CORE PRINCIPLE</u>	<u>RELATED RULES/DOCUMENTS</u>	<u>APPLICANT COMMENTS</u>
<p>CORE PRINCIPLE A COMPLIANCE.—</p> <p>(i) IN GENERAL.—To be registered and to maintain registration as a derivatives clearing organization, a derivatives clearing organization shall comply with each core principle described in this paragraph and any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5).</p> <p>(ii) DISCRETION OF DERIVATIVES CLEARING ORGANIZATION.— Subject to any rule or regulation prescribed by the Commission, a derivatives clearing organization shall have reasonable discretion in establishing the manner by which the derivatives clearing organization complies with each core principle described in this paragraph.</p>	<p><u>Exhibit A</u> of Form DCO</p> <p><u>Exhibit A-1.1</u> (Compliance with DCO Core Principles)</p> <p><u>Exhibit A-2.1</u> (FCM Regulations)</p> <p><u>Exhibit A-2.2</u> (FCM Procedures)</p> <p><u>Exhibit A-2.3</u> (Default Rules)</p> <p><u>Exhibit A-2.4</u> (Default Fund Rules)</p>	<p>Limited is submitting a Form DCO application to amend and consolidate its existing DCO license: (1) to permit Limited to provide clearing services in respect of “swaps” as defined in the CEA and CFTC Regulations; and (2) to permit Limited to clear all futures contracts (and options thereon), regardless of the underlying asset class, that are listed for trading on, or pursuant to the rules of, a designated contract market (the “DCM Futures Clearing Business”), including the provision of clearing services for the contracts listed for trading on Nodal Exchange LLC (the “Nodal Clearing Service”) as well as for certain energy futures contracts that are, or may be, listed for trading on, or pursuant to the rules of, a DCM (the “Energy Futures Clearing Service”).</p> <p>The entirety of this application, including the Exhibits hereto, demonstrates Limited’s compliance with the DCO core principles impacted by the request to amend its DCO license.</p> <p>Capitalized terms not otherwise defined herein have the meanings ascribed to them in Limited’s FCM Procedures, FCM Regulations, Default Rules or Default Fund Rules, as appropriate.</p>
<p>CORE PRINCIPLE C PARTICIPANT AND PRODUCT ELIGIBILITY.—</p> <p>(i) IN GENERAL.—Each derivatives clearing organization shall establish—</p> <p>(I) appropriate admission and</p>	<p><u>Exhibit C</u> of Form DCO</p> <p><u>Exhibit C-1.1</u> (Risk Management Policy: Credit Assessment)</p> <p><u>Exhibit C-1.2</u> (Amended Internal Credit Score Model Documentation)</p> <p><u>Exhibit C-2.1</u> (List of Nodal</p>	<p>Limited operates a credit assessment policy that assesses each clearing member’s creditworthiness and financial condition in order to detect, as early as possible, events that may threaten the ability of a clearing member to continue to meet its obligations by reviewing each such</p>

¹ **NB:** This compliance chart addresses only those elements of the DCO Core Principles implicated by Limited’s application to amend its DCO registration.

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<p>continuing eligibility standards (including sufficient financial resources and operational capacity to meet obligations arising from participation in the derivatives clearing organization) for members of, and participants in, the derivatives clearing organization; and</p> <p>(II) appropriate standards for determining the eligibility of agreements, contracts, or transactions submitted to the derivatives clearing organization for clearing.</p> <p>(ii) REQUIRED PROCEDURES.—Each derivatives clearing organization shall establish and implement procedures to verify, on an ongoing basis, the compliance of each participation and membership requirement of the derivatives clearing organization.</p> <p>(iii) REQUIREMENTS.—The participation and membership requirements of each derivatives clearing organization shall—</p> <p>(I) be objective;</p> <p>(II) be publicly disclosed; and</p> <p>(III) permit fair and open access.</p>	<p>Contracts)</p> <p><u>Exhibit C-2.2</u> (List of Energy Futures Contracts)</p>	<p>member’s financial reports and regulatory returns, external credit-ratings and evaluating standards of management and control. Basic risk assessments are carried out on a daily basis, although Limited has full intra-day risk assessment capabilities.</p> <p>Each clearing member must submit ongoing financial reports to Limited and must further notify Limited upon the occurrence of certain events that may affect such member’s ability to discharge its obligations.</p> <p>In addition to ongoing monitoring, all clearing members are subject to a formal documented review on at least an annual basis, and a deterioration in a clearing member’s position may result in remedial action being taken by Limited.</p>
<p>CORE PRINCIPLE D</p> <p>RISK MANAGEMENT.—</p> <p>(i) IN GENERAL.—Each derivatives clearing organization shall ensure that the derivatives clearing organization possesses the ability to manage the risks associated with discharging the responsibilities of the derivatives clearing organization through the use of appropriate tools and procedures.</p> <p>(ii) MEASUREMENT OF CREDIT EXPOSURE.—Each derivatives clearing organization shall—</p> <p>(I) not less than once during each business day of the derivatives clearing organization, measure the credit exposures of the derivatives</p>	<p><u>Exhibit D</u> of Form DCO</p> <p><u>Exhibit D.1</u> (Risk Policy: Financial Resources Adequacy)</p> <p><u>Exhibit D.2</u> (Description of Liquidity Risk Add-On)</p> <p><u>Exhibit D.3</u> (Margin Model Validation Report – Nodal)</p> <p><u>Exhibit D.4</u> (Margin Model Validation Report – EnClear)</p> <p><u>Exhibit D.5</u> (Risk Policy: Collateral Risk)</p>	<p>In accordance with LCH.Clearnet Group Limited’s overall risk appetite, Limited is required to ensure that initial margin for its DCM Futures Clearing Business is sufficient to cover observed market risk losses to a 99.7 percent confidence level over a two-day holding period. To meet this 99.7 percent confidence target, Limited calculates initial margins as a function of the underlying positions of a clearing member’s portfolio and sets initial margin requirements on a clearing member’s portfolio to cover the worst loss, to a specified confidence level, that the portfolio could face over the period necessary to close out the portfolio in the event of the clearing member’s default. The initial</p>

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<p>clearing organization to each member and participant of the derivatives clearing organization; and</p> <p>(II) monitor each exposure described in subclause (I) periodically during the business day of the derivatives clearing organization.</p> <p>(iii) LIMITATION OF EXPOSURE TO POTENTIAL LOSSES FROM DEFAULTS.—Each derivatives clearing organization, through margin requirements and other risk control mechanisms, shall limit the exposure of the derivatives clearing organization to potential losses from defaults by members and participants of the derivatives clearing organization to ensure that—</p> <p>(I) the operations of the derivatives clearing organization would not be disrupted; and</p> <p>(II) nondefaulting members or participants would not be exposed to losses that nondefaulting members or participants cannot anticipate or control.</p> <p>(iv) MARGIN REQUIREMENTS.—The margin required from each member and participant of a derivatives clearing organization shall be sufficient to cover potential exposures in normal market conditions.</p> <p>(v) REQUIREMENTS REGARDING MODELS AND PARAMETERS.— Each model and parameter used in setting margin requirements under clause (iv) shall be—</p> <p>(I) risk-based; and</p> <p>(II) reviewed on a regular basis.</p>		<p>margin is set as the greater of: (1) the price risk of a clearing member’s portfolio, calculated using a historical value-at-risk simulation; and (2) the price risk of the portfolio, which is calculated by applying a minimum margin percentage to the total gross value of the portfolio. Limited also intends to introduce a liquidity credit risk margin calculation that may lead to an increase in the margin requirements applicable to clearing members with less-liquid portfolios.</p> <p>Limited only accepts collateral which is of a high credit quality, where there is demonstrable market liquidity and where Limited has appropriate procedures in place to realize the value of the collateral. Limited also has established a standard set of haircuts that are applied to collateral received from clearing members.</p>
<p>CORE PRINCIPLE E SETTLEMENT PROCEDURES.—Each derivatives clearing organization shall—</p> <p>(i) complete money settlements on</p>	<p><u>Exhibit E</u> of Form DCO</p> <p><u>Exhibit E-1.1</u> (Nodal-Limited Joint Operational Agreement)</p> <p><u>FCM Procedure 2D.11</u></p>	<p>In order to mark futures contracts to market, Limited relies on price information provided by the relevant futures exchange, subject to validation arrangements and spot checks to ensure the integrity of the prices received. Limited then</p>

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<p>a timely basis (but not less frequently than once each business day);</p> <p>(ii) employ money settlement arrangements to eliminate or strictly limit the exposure of the derivatives clearing organization to settlement bank risks (including credit and liquidity risks from the use of banks to effect money settlements);</p> <p>(iii) ensure that money settlements are final when effected;</p> <p>(iv) maintain an accurate record of the flow of funds associated with each money settlement;</p> <p>(v) possess the ability to comply with each term and condition of any permitted netting or offset arrangement with any other clearing organization;</p> <p>(vi) regarding physical settlements, establish rules that clearly state each obligation of the derivatives clearing organization with respect to physical deliveries; and</p> <p>(vii) ensure that each risk arising from an obligation described in clause (vi) is identified and managed.</p>		<p>calculates intra-day and end-of-day initial and variation margin amounts, which may lead to a margin call on any clearing member that does not have a sufficient amount of collateral in its accounts.</p> <p>In accordance with Limited’s Intraday Margining Policy, Limited assesses on a daily basis the need to make intra-day margin calls. As part of this process, Limited calculates the potential profit or loss due to the change in the market value of a clearing member’s cleared transactions and, if such clearing member does not have sufficient collateral in its settlement accounts, a variation margin call will be made.</p>
<p>CORE PRINCIPLE F</p> <p>TREATMENT OF FUNDS.—</p> <p>(i) REQUIRED STANDARDS AND PROCEDURES.—Each derivatives clearing organization shall establish standards and procedures that are designed to protect and ensure the safety of member and participant funds and assets.</p> <p>(ii) HOLDING OF FUNDS AND ASSETS.—Each derivatives clearing organization shall hold member and participant funds and assets in a manner by which to minimize the risk of loss or of delay in the access by the derivatives clearing organization to the assets and funds.</p> <p>(iii) PERMISSIBLE INVESTMENTS.—Funds and</p>	<p><u>Exhibit F</u> of Form DCO</p> <p><u>Exhibit F-1.1</u> (Intra-Day Liquidity Exposures – PPS Banks)</p> <p><u>Exhibit F-1.2</u> (Intra-Day Liquidity Exposures – Commercial Banks)</p> <p><u>Exhibit F-1.3</u> (Custodian Due Diligence Framework)</p> <p><u>Exhibit F-3.1</u> (Recordkeeping Policy)</p> <p><u>FCM Regulations 4, 5, 8, 9(i), 9(o)</u></p> <p><u>FCM Procedures 4.3, Appendix 4D</u></p>	<p>As described in greater detail in <u>Exhibit E</u>, all settlement payments for the DCM Futures Clearing Service – including the Nodal Clearing Service and the Energy Futures Clearing Service – will be made through Limited’s existing PPS arrangements. In addition, all eligible securities collateral must be deposited in the accounts opened by Limited for these purposes at a securities custodian identified in Appendix 4D to the FCM Procedures.</p> <p>Limited retains the right to access the collateral deposited by its FCM Clearing Members pursuant to a perfected New York security interest granted by FCM Clearing Members in the FCM Regulations.</p> <p>Limited may invest any cash and eligible securities collateral in</p>

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<p>assets invested by a derivatives clearing organization shall be held in instruments with minimal credit, market, and liquidity risks.</p>		<p>accordance with LCH.Clearnet Group’s investment risk management policy. The investment risk management policy expressly requires that all funds and assets held by Limited are invested solely in assets subject to minimal credit, market and liquidity risks. Limited also uses prudent valuation practices to value all eligible security collateral received from FCM Clearing Members.</p> <p>Finally, any investment of FCM Client funds by FCM Clearing Members and Limited may only be made subject to the terms and conditions set forth in CFTC Rule 1.25 and the provisions in the CEA. FCM Clearing Members and Limited must also maintain appropriate books and records in respect of investments of FCM Client funds.</p>
<p>CORE PRINCIPLE G DEFAULT RULES AND PROCEDURES.—</p> <p>(i) IN GENERAL.—Each derivatives clearing organization shall have rules and procedures designed to allow for the efficient, fair, and safe management of events during which members or participants—</p> <p>(I) become insolvent; or</p> <p>(II) otherwise default on the obligations of the members or participants to the derivatives clearing organization.</p> <p>(ii) DEFAULT PROCEDURES.—Each derivatives clearing organization shall—</p> <p>(I) clearly state the default procedures of the derivatives clearing organization;</p> <p>(II) make publicly available the default rules of the derivatives clearing organization; and</p> <p>(III) ensure that the derivatives clearing organization may take timely action—</p>	<p><u>Exhibit G</u> to Form DCO <u>Default Fund Rules (<i>passim</i>)</u></p>	<p>In the event of default of a clearing member participating in the DCM Futures Clearing Business, Limited has established arrangements to apply a series of financial resources to meet any monetary shortfalls, including the use of the defaulting clearing member’s collateral, Limited’s own resources and non-defaulting clearing member’s default fund contributions. For sufficiently large losses, Limited has established arrangements for an assessment of non-defaulting clearing members, the imposition of a loss distribution mechanism, and provisions for service closure.</p>

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(aa) to contain losses and liquidity pressures; and (bb) to continue meeting each obligation of the derivatives clearing organization.		
CORE PRINCIPLE R LEGAL RISK.—Each derivatives clearing organization shall have a well-founded, transparent, and enforceable legal framework for each aspect of the activities of the derivatives clearing organization.	<u>Exhibit R.1 (Ring-Fencing Memorandum)</u>	Limited has obtained a reasoned memorandum from outside counsel addressing the risks under English law that in an event of insolvency Limited’s customer protection arrangements established for FCM Clients may be challenged.