

FX Smart Clearing overview

What is FX Smart Clearing?

Since the implementation of SA-CCR in June 2021, the FX industry has struggled to cope with the sharp increases in risk-weighted asset (RWA)/leverage ratio capital requirements.

FX Smart Clearing is the intelligent, purposeful, selective and optimised clearing of FX Swaps and FX Forwards for the purpose of financial resource optimisation, particularly counterparty credit risk capital under SA-CCR.

As these products are not subject to bilateral initial margin (IM) under Uncleared Margin Rules (UMR), clearing all trades would create a higher IM cost, potentially negating the capital benefits achieved. Therefore, FX Smart Clearing involves clearing only those trades (risk) that maximise capital savings, without materially increasing IM.

FX Smart Clearing can be achieved bilaterally or multilaterally, with or without an intermediate optimiser algorithm: essentially, it is agnostic to how the cleared trades reach LCH ForexClear.

The value proposition from a recent proof of concept suggests >60% savings when run on real data. Any residual FX risks can be subsequently sent to SwapAgent.

FX Smart Clearing also provides significant benefits for other target capital measures.

Benefit from the strong network, improved capital efficiency and further optimisation benefits from facing a CCP.

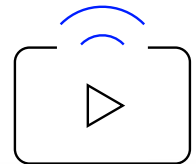
In a recent proof of concept with Quantile Technologies:

01.

13 member groups showed an average **51%** potential capital reduction, without increasing IM significantly, which has the scope to increase to >**70%** as the clearing network and eligible products grow (see charts on % capital saving of bilateral vs cleared optimisation below).

02.

US\$2.7trn of notional was identified for backloading, of which **71%** could be further compressed.



03.

Members with larger cleared NDF and FX Option portfolios registered larger potential savings than the average.

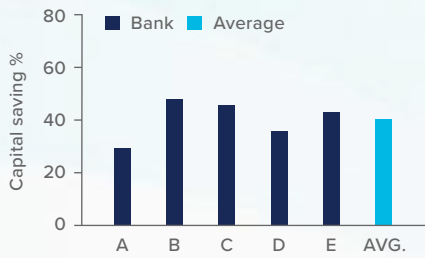
04.

The proof of concept (PoC) proved the network of banks would have made a **US\$240m** real-world saving in profit and loss (P&L) cost of capital.

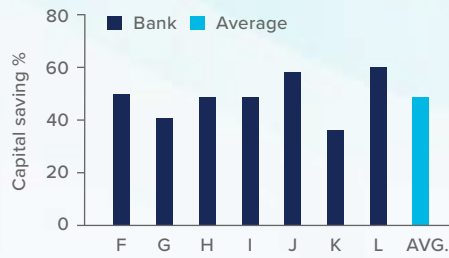
Attribute	PoC
Participants	13 banks/19 entities
Effective notional reduction	US\$484bn
Capital % reduction (target measure)	51%
Cleared notional (backload + overlays)	US\$2.7trn
Additional compression potential	US\$1.9trn (71%)
Capital P&L saving across the network	US\$240m p.a.

FX Clearing just got smarter – the more you clear, the more efficient optimisation becomes:

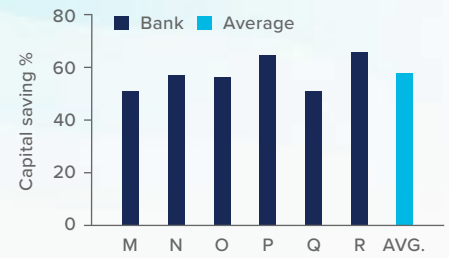
NON-CLEARING BANKS (41% average saving)



BANKS CLEARING NDF (49% average saving)



BANKS CLEARING NDF AND FXO (58% average saving)



How does FX Smart Clearing work?

A. Trade selection

FX Smart Clearing is facilitated through the introduction of an **Approved Trade Selection Provider (ATSP)**, where existing FX portfolios can be assessed for selection to be sent to the most appropriate LCH service (i.e., LCH ForexClear or SwapAgent).

B. Trade booking

FX Smart Clearing acts on existing bilateral portfolios, creating the first utility to manage **bulk novations and backloads for FX products**:

- The solution sends the **maximum amount of risk to LCH ForexClear within counterparty-defined IM tolerances**
- The residual risk is sent to SwapAgent to realise all of the benefits of our bilateral service

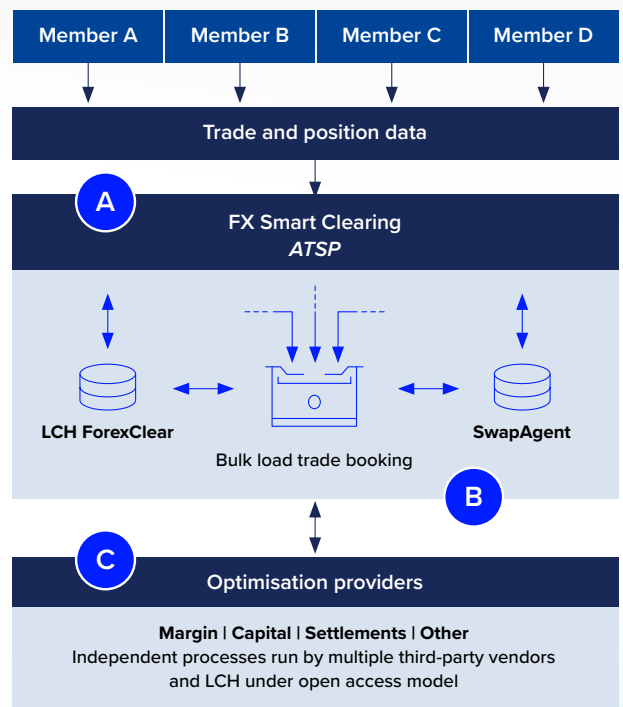
C. Ongoing management

In order for FX Smart Clearing to realise its potential in the target state, LCH will maintain its **open access model** so that optimisation providers can continue to treat each LCH service as a ‘node’ within their own processes to further optimise.

D. Go-to-market/Staging

Prototyping/real trades can be smart cleared via current ‘flat file’ backloads to LCH ForexClear. The current PoC group of banks support of this process during the build phase.

FX SMART CLEARING IN ACTION



LSEG POST TRADE

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To opt in to newsletters, visit: <https://solutions.lseg.com/Regular-ClearingVolumes-Update>

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