LCH

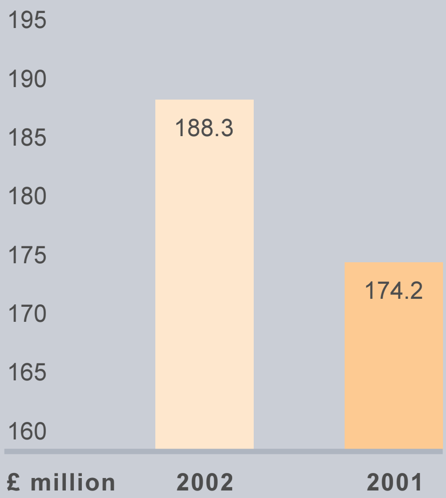
Annual Report and Accounts

2002

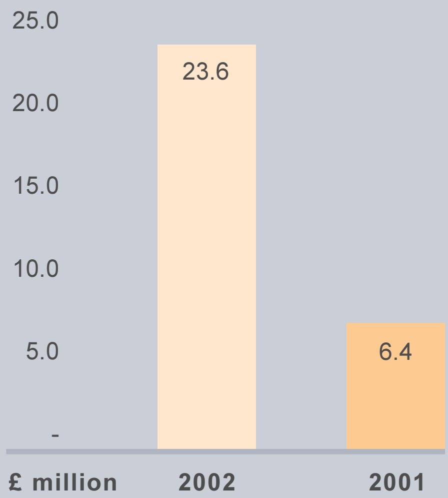
LCH seeks to be the first choice central counterparty clearing house for exchange-traded and over-the-counter markets

- *Turnover - £188 million*
- *Profit before tax - £23.6 million*

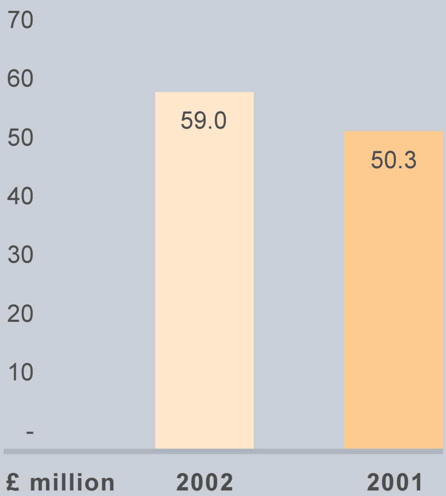
Turnover



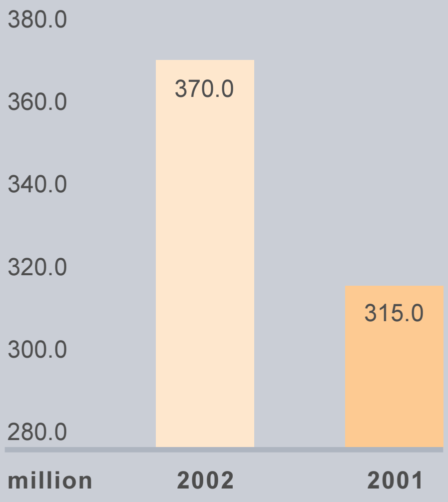
Profit before tax



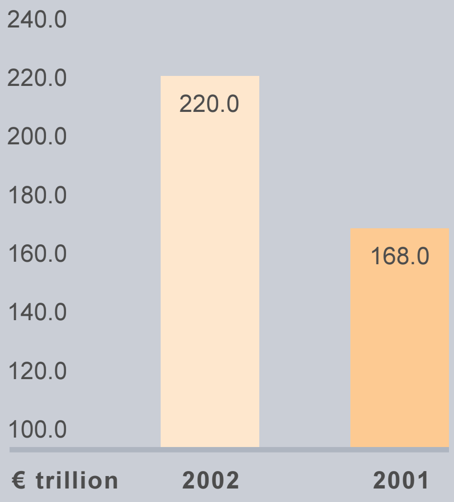
Administrative expenditure



Contracts cleared



Notional values cleared



Chairman's Statement

2002 was a successful year for LCH. It saw substantial growth in the volume, value and range of services provided by the company. The policy of diversification, which has been pursued since its re-structuring in 1996, is set to continue with new markets in energy, cash equities and equity derivatives being added during the next twelve months.

The financial results show a healthy surplus with all principal services making a contribution. This is essential because the growth in the range and volume of services requires continuing investment by the company; in particular, as noted by the Chief Executive in his report, we face the necessity of a major investment in our IT infrastructure. LCH fees remain low by industry standards and I believe our users consider its services represent good value for money. However, there is a need to upgrade our services so that users can maximise the cost effectiveness of their own systems.

I referred to this topic in my letter to shareholders dated 30 April 2002, where I outlined the changes to LCH's operating policies which were viewed as necessary by the Board. I said then that three changes were necessary. Firstly, LCH should be managed as an integrated business, a policy which the company has adopted implicitly for some time. Secondly, the company would operate a reserves policy based on the business's medium term plans. Thirdly, rebates would not be paid on a routine basis. In fact, as the Chief Executive reports, the Board has recommended that the profit for the year be retained as reserves but that £13 million of rebates, deferred in previous years to finance the expansion of the company, will be paid and this will happen in March.

I also discussed in that letter the case for consolidation of clearing houses to bring a better organised and more cost effective post trade infrastructure. I indicated that any consolidation would need to recognise the value of in-house clearing houses to exchanges as a source of revenue and a means of protecting their products from competition. Your Board remains convinced that some consolidation of CCPs in Europe would bring benefits to the industry but, to be realised, it must be on terms that are acceptable to the shareholders of each company. Therefore, the business model would need to reflect the interests of the shareholders, users (who may also be shareholders) and exchanges, and would inevitably operate on a for-profit basis. The LCH Board also consider it vital that a merged entity should be independent of any one shareholder or trade provider. It is well-known that LCH has been discussing with Clearnet a possible merger. As shareholders will appreciate, such a transaction involves a number of complex issues and at present I am not in a position to comment on the likely outcome.

I am again indebted to members of the Board and to those serving on LCH committees for their advice and the valuable time that they devote to the company. The appointment in 2001 of two independent non-executive directors, David Pritchard and David Robins, has been a great success with both now playing a vital part on the Board and in LCH committees. There has been quite a lot of change in the user membership of the Board with a number of long standing members retiring and new recruits filling their places. Mark Eynon, who retired in March on his retirement from UBS Warburg, made a large contribution to the company during his six years on the Board, particularly as Chairman of the Risk Committee throughout much of that time. Catherine FitzMaurice retired in October on her retirement from Citigroup, Larry Scott of Bank of Nova Scotia also resigned due to his business commitments. I would like to thank them all for the contribution they have made to the Board. We are extremely fortunate to have secured the services of a number of highly competent directors from the user community to maintain the strength of the Board. Gary Anderson of Deutsche Bank, William Higgins of ABN AMRO, Julian Rogers-Coltman of GNI and Trevor Spanner of Merrill Lynch were all appointed at the EGM on 31 October.

The company's success rests on the continuing bedrock of its sound risk management and the reliable operation of its systems. LCH staff, under the strong leadership of David Hardy, have never lost sight of this imperative, despite the many other issues and opportunities with which they have to deal. I would like to thank them for their commitment and hard work.

Sir Michael Jenkins
Chairman

Chief Executive's Report

2002 was an important year for LCH. It was not only the first year in which LCH operated its new financial model, as discussed in the Chairman's statement, but also a year that saw the company strengthen its market position across all its business streams: the Futures & Options business stream handled ever greater business volumes across a broader business base and launched new products; LCH EquityClear became firmly established as a key element of the London cash equity trading infrastructure; clear critical mass was established in LCH RepoClear; whilst LCH SwapClear built real market presence and provided valuable change to that market's working practices. Growth in the number of contracts cleared and their underlying value firmly positions LCH as the largest central counterparty in Europe by value cleared, and unquestionably the leading global central counterparty by range of services provided.

Financial performance

2002 was a year of strong financial growth, which reflected the continuing broadening of the product range of LCH. Turnover increased by 8% to £188 million and profit before tax by more than twofold to £23.6 million, demonstrating the continuing strong performance of the futures and options business and the growing financial benefits from the newer business streams.

As may be expected with growth in business levels accompanied by volatile markets, the amount of collateral assets under management grew, resulting in higher Treasury revenue. Treasury income totalled £119.1 million from earnings on member balances, default fund balances and shareholders' funds. Members continued to benefit from our practice of making interest payments to them, amounting in the year to £105.7 million, giving a net Treasury income of £13.4 million (2001: £9.3 million).

Fee income increased across all business streams, reaching a total in the year of £69.2 million (2001: £46.6 million), broken down as follows: Futures & Options £37.5 million, EquityClear £8.4 million, RepoClear £6.9 million and SwapClear £16.4 million. The new business streams are now making a significant contribution - more than a third of total fee income now comes from them.

Administrative expenditure increased by 17% during the year to £59.0 million, an increase of £8.7 million. Staff costs increased by 41% (£6.9 million) to £23.4 million due to an increase in headcount, including the full year effect of significant staff growth in 2001.

...Financial performance

Our headcount, which has roughly doubled over the past four years as a result of business expansion, is now broadly sufficient to carry forward LCH as it grows, and total non-IT staff levels are not expected to increase further. However, the IT strategy outlined below will lead to a temporary increase in IT headcount during the 2003 financial year. The increased staff costs also include a full year effect of the increase in the level of pension contributions.

Depreciation increased by £1.1 million, an 18% increase reflecting the continuing investment in enhanced and new systems during recent years.

Balances with members increased during the year by 9% to £45,830 million, reflecting the general growth in activity across the four business streams, but principally from RepoClear. LCH operates on a matched basis and holds full cash collateral, non-cash collateral and bank guarantees in respect of its member balances.

The Board has decided to continue its policy, outlined by the Chairman last year, to reserve the profits of the year for use within the business in order to meet the considerable expectations of both members and Exchanges, to enable the continued growth of the services provided by LCH, and to help fund the IT renewal programme outlined below. Consequently, the Board has decided not to pay a dividend out of the profits of the year.

The company continues its policy of not routinely paying rebates, but in recognition of the successful development of the EquityClear, RepoClear and SwapClear services, a rebate of £13 million is to be paid in respect of the amounts reserved but held back in previous years. This does not have a net effect on the profit and loss account in the year. The rebate will be paid to Futures & Options members in respect of their clearing activity in the financial years 1997/8 and 1998/9.

During the course of the year the shares of twelve retired members were redeemed at a cost of £3.6 million out of the reserves created by the financial year 2001 profits.

In line with many other companies the continuing fall in the value of the equity markets, allied to the increase in headcount in recent years, has led to a further deterioration in the funding of the LCH pension scheme. LCH has acted on the advice of its actuary and increased its pension-funding rate from 5% to 15% of salaries from November 2001. It is anticipated that this action will solve this pension funding issue, over a number of years.

Business streams report

Futures & Options

As I said in my introduction, 2002 was a year of record clearing volumes, and nowhere more so than in the Futures & Options business stream. Both Euronext.liffe, in its first year within the Euronext group, and International Petroleum Exchange (IPE) saw substantial increases in volumes. Euronext.liffe also introduced its new Maxi Stock Futures contract, as well as further increasing the number of Universal Stock Futures available for trade. There are now well over 100 USF contracts available in this market - a clear indication of their success - and there will be a considerable number of further USF contracts for physical delivery becoming available in the coming months. We were pleased to work with London Metal Exchange (LME) in providing clearing services for its new North American Aluminium Alloy contract, which will doubtless prove to be yet another powerful attraction of the world's premier base metal exchange. LME has recently announced some fundamental and far-reaching changes to its SELECT electronic trading system, and LCH will be working closely with the exchange to ensure that its clearing services move seamlessly in support of the new trading structure.

Perhaps the biggest event for the Futures & Options stream was the launch of LCH EnClear, established to enable a bespoke service for energy derivatives, traded both on exchange and OTC. EnClear provides clearing services to IPE and commenced clearing services for IntercontinentalExchange, IPE's parent company, during the summer, starting with the OTC-traded WTI Crude oil and Henry Hub natural gas contracts. This new service has bedded down well, and we are looking forward to expanding its scope over the coming period. EnClear has recently established a new service for Endex, the Amsterdam-based power exchange, providing clearing services for, at the outset, Dutch electricity contracts. We expect EnClear to expand its range of clearing services to OTC energy markets generally.

LCH EquityClear

The EquityClear business stream has enjoyed an excellent year. The clearing service to the London Stock Exchange SETS electronic order book has gone from strength to strength. Volumes have increased strongly, and the service is now routinely handling well over 100,000 bargains a day - hitting a peak on 19 September of over 190,000. The introduction of optional netting has also proved highly successful, with this service extension now covering over 50% of SETS total volume. From its outset, the netting service has reduced daily eligible settlement instructions by over 98%.

...Business streams report

EquityClear will also be providing a clearing service to the new EDX equity option trading platform being established by London Stock Exchange, which is expected to commence trading later in 2003.

The new clearing service to virt-x is scheduled to go live in May 2003. Working with x-clear, the newly established Swiss central counterparty, this complex model, with its ability to settle into Crest, Euroclear and SIS SegaIntersettle, represents a radical new structure in the clearing and settlement of pan-European cross border trades, and may well represent an industry working model for the future.

EquityClear has recently announced reductions in its tariff, which will come into effect during 2003.

LCH RepoClear

The fixed income clearing service achieved some notable successes during the year. Now with 50 participants, RepoClear has been vigorously expanding its product range. General collateral baskets joined the service in the Spring, Finnish, Irish and Portuguese government repo and cash bonds were added in the early Summer, and in August, RepoClear started a service for UK gilts. These product extensions, along with the addition of third-party clearing facilities, have been well received by the market, and re-confirm RepoClear as the leading pan-European central counterparty in this class of business.

Netting is a key benefit of any clearing service, and in the cleared fixed income sector, daily netting efficiency averages are in the order of 65%. During the financial year, RepoClear netted a total of €24.5 trillion down to €8.3 trillion - meaning that €16.2 trillion in cash and bonds required no settlement and incurred no operational risk. There could perhaps be no clearer example of the key role played by CCPs in delivering operational efficiency.

LCH SwapClear

LCH is unique in providing a central counterparty service to the wholesale interbank interest rate swaps market. SwapClear, operating now for three years, has moved beyond the achievement of critical mass within its service sector to being a key element in the infrastructure of the international swaps market. The 19 members of LCH SwapClear are the major market makers in the sector. Backloading of existing member portfolios continued apace during the year, and, together with new trades, the notional value of outstanding trades registered with LCH is more than US$7 trillion.

During the year, the Swiss Franc was added as an eligible cleared currency, for swaps with tenors out to ten years, whilst the maximum tenor for trades denominated in US Dollars, Euro, Yen and Sterling was extended to 30 years. We intend to add further currencies and service functionality during the course of this year.

Risk and regulation

Risk management, at the heart of our services, continued its on-going programme of development. Core risk management techniques and procedures have been extended and adapted to reflect the expansion in both LCH's existing and developing business profile. During the course of the year a number of key risk policies have been reviewed and endorsed by the Board. As the range and scope of LCH services has expanded over the past year, design of new approaches to multi-product margining has been taken to an advanced stage. We will work closely with members to ensure that any future proposals for full portfolio margining are both realistic and will add strength and security to both their business operations and to LCH's. The new stress testing model, introduced last year to assess the adequacy of the Default Fund has been extended to cover a further range of possible price movements. Work on IDRiS, the intra-day margining process for futures and options contracts, has been completed and will be fully operational shortly. IDRiS data are combined with intra-day risk measures for all the other product types cleared to show a comprehensive picture of LCH's intra-day exposures at member level.

LCH does all it can to reduce its legal risk to an absolute minimum. Potential challenges to our arrangements in the event of financial failure of a member firm are the focus of that legal risk. LCH has enjoyed extensive protection since the introduction of Part VII of the UK Companies Act 1989, and that protection has been increased with our recognition as a Designated System under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999.

Default backing

At the end of October 2002, the Default Fund stood at £344 million, within a maximum of £400 million. There were two successful member ballots within the course of the year to extend the scope of the Fund to cover the clearing of ICE and Endex business.

...Default backing

During the Summer, our £100 million insurance policy with Lexington Insurance Company expired, and was replaced with a new £200 million facility from AAA-rated Financial Security Assurance (UK) Ltd. The doubling in size of this back-up to the Default Fund is appropriate in the light of the increase in the size and scope of LCH's business, and, as its predecessor, the facility serves as a valuable contingent recourse in case of need.

IT strategy

It is a key element of the service which we deliver that our systems should be reliable, resilient, secure and safe; our members are entitled to expect no less. At the moment, as a legacy of rapid growth across a broad spectrum of products, LCH works in a complex, but ageing, systems environment. This environment needs to be streamlined and made more efficient in order that we can help maintain downward pressure on members' operating costs.

It is therefore our intention to rationalise our clearing services with a new technical architecture deliverable across a wider range of products and using as many common components as possible. This will not be delivered overnight; we expect full implementation to take several years. We are confident, however, that the results will be worth the wait. We are equally confident that the considerable investment required can be achieved without fee increases.

Staff

The Company's staff are of course crucial to the business, and it was with this in mind that we embarked on our first ever full staff survey. Entitled Viewpoint 2002, it enabled us to establish true grass root views, delivered with proper confidentiality, to help evaluate the effectiveness of our existing policies and to establish areas where we can enhance our most important asset. The findings have been extremely valuable, and changes arising from it are being implemented during 2003.

LCH takes seriously its new corporate responsibility programme. As part of the programme, in Autumn 2002, we established links with Wellington Primary School in Bow. Since the beginning of this year, some 45 members of LCH staff have, in their spare time, become literacy and numeracy partners for pupils at the school. It is of course too early to expect the school to have reaped great benefit from our efforts, but I am deeply indebted to those members of staff who are prepared very tangibly to give their time and help to teachers and young children in a deprived area to provide just a little of what so many of us are simply able to take for granted.

Conclusion

This has been a year of solid progress. All our business streams are thriving, clearly focussing on the needs of members and trading platforms. Last year, I said that we were at last in a position that we could meet the needs of our members' business, wherever that need might be. We have been doing exactly that. Be it across Europe in futures and options, cash equities or cash and repo trading, or globally in interbank interest rate derivatives or OTC energy trading, LCH has been adding value and helping to make our members' businesses better - truly a central counterparty of choice.

Finally and most importantly of all, I offer my deepest thanks and appreciation to all those that make it work - management and staff colleagues, those in the governance structure, members and exchange shareholders - without whose commitment and dedication LCH would not be where it is today.

David Hardy
Chief Executive

Board of Directors

Chairman	Sir Michael Jenkins
Directors	G J Anderson (appointed 31 October 2002)
	R N Barton (appointed 26 November 2001)
	R D A Berliand
	J Chenevix-Trench
	R M Eynon (resigned 28 March 2002)
	C F FitzMaurice (resigned 31 October 2002)
	M Fox-Andrews
	J L Foyle
	D M Hardy
	S J N Heale
	W G Higgins (appointed 31 October 2002)
	J R Morgan
	D P Pritchard (appointed 26 November 2001)
	D A Robins (appointed 26 November 2001)
	J Rogers-Coltman (appointed 31 October 2002) (resigned 22 January 2003)
	L J Scott (resigned 31 October 2002)
	T Spanner (appointed 31 October 2002)
	R Ward
	M Zamkow (resigned 30 November 2001)
Secretary	E A John

The Chairman and all other directors, with the exception of D M Hardy, are non-executive directors.

The Chairman, Sir Michael Jenkins, D P Pritchard and D A Robins are independent non-executive directors.

Directors serving on the Audit, Remuneration and Risk Committees are identified in the Corporate Governance section of this Report and Accounts.

Registered Office:
Aldgate House, 33 Aldgate High Street, London EC3N 1EA
Telephone: +44 (0)20 7426 7000   Facsimile: +44 (0)20 7426 7001
Registered in England   Number: 25932
Established in 1888 as The London Produce Clearing House, Limited.

Report of the Directors

The directors present their report and the audited financial statements for the year ended 31 October 2002.

Results and dividend

The profit for the year, after taxation, amounted to £15.6m (2001: £4.4m, as restated) and turnover has increased by 8% to £188m during the year. The directors do not recommend the payment of a dividend (2001 - £nil).

As detailed in Note 1 the company has adopted FRS 19 'Deferred Tax' and the transitional arrangements of FRS 17 'Retirement Benefits' in the current year.

The adoption of FRS 19 has resulted in a change in accounting policy for deferred tax. Deferred tax is recognised on a full provision basis in accordance with the accounting policy described in Note 1. Previously, deferred tax was provided for on a partial provision basis, whereby provision was made on all timing differences to the extent that they were expected to reverse in the future without replacement.

This change in accounting policy has resulted in a prior year adjustment. Shareholders' funds at 1 November 2001 have been increased by £2.1m and the tax charge for the year ended 31 October 2001 has been decreased by £0.8m. Profit for the current year has been increased by £0.7m as a result of the change in accounting policy.

The transitional arrangements under FRS 17 require additional disclosure in the notes only.

Principal activity and review of the business

The company's principal activity during the year continued to be providing clearing, central counterparty and other services to clearing members, trade matching organisations and exchanges. The company was in a sound financial position at the year-end and is well placed to take advantage of any opportunities which may arise in the future.

...Principal activity and review of the business

The company continues to meet its requirements as a Recognised Clearing House under The Financial Services and Markets Act 2000 and as a Derivatives Clearing Organization in the USA.

Share buy back

On 23 May 2002 12 'A' shares with a nominal value of £2,400,000 were redeemed from outgoing members at original subscription price of £297,619 each. Net assets were reduced by £3,571,429 as a result of the buy back.

Future developments

The directors aim to maintain the management policies that have resulted in the company's substantial growth in recent years.

The company will continue to provide clearing and central counterparty facilities for members on exchanges and for over-the-counter (OTC) markets, maintain and extend services to its clearing members and seek opportunities to broaden the range of markets served. The company will continue to co-operate with, and assist new developments for, the markets and members that it currently serves.

The company is continually developing its systems to enable more efficient and cost effective services to be provided and anticipates carrying out a major development of its core CCP systems over the next two to three years. This will lead to reduced costs and increased flexibility and efficiency.

LCH, x-clear (the Swiss central counterparty) and virt-x plc (the operator of the virt-x pan-European cross border exchange), will launch the first pan-European central counterparty structure by the summer of 2003.

LCH, together with the London Stock Exchange, will be developing an OTC clearing service for the new EDX equity derivatives trading platform being set up by the LSE in 2003.

Market risk

As a central counterparty the company has a balanced position in all cleared contracts and runs no market risk unless a member defaults. To protect itself against the market risk contingent on member default, LCH narrows the scope of market risk by collecting in losses on marked-to-market positions each day, establishing initial margin requirements for each member and replenishing such requirements intra-day, maintaining a Default Fund for use should the initial margin of a defaulter not fully cover close-out costs, and by having a supplementary default financial facility.

Interest rate risk

The company is exposed to interest rate risk where there are mismatches of the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature.

The next contractual interest rate re-pricing date and maturity date for all financial assets and liabilities of the company, except balances with members, falls within the next six months.

Currency risk

There are no material currency risk exposures.

Directors

The directors of the company, shown on page 14, were directors throughout the year unless otherwise indicated.

Directors' interests

None of the directors of the company during the years ended 31 October 2002 and 31 October 2001 had any interests in the shares of the company at any time during the year.

Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Charitable donations

The company made charitable donations during the year of £32,315 (2001: £5,533).

Auditors

The auditors, Ernst & Young LLP, have indicated their willingness to be re-appointed under the provisions of the Companies Act 1985.

By order of the Board

Elizabeth John
Secretary
24 February 2003

Corporate Governance

The Board policy is that The London Clearing House Limited ("LCH") should have strong and effective internal controls as also required by the regulatory bodies. In the current year the company has undertaken a thorough and detailed review of its internal policies, procedures and controls in order to implement the relevant core principles of the Turnbull Committee guidance that are applicable to its constitution and structure. As of 31 October 2002, the company has put in place the framework to comply with the core principles of the Turnbull Committee which are applicable to LCH, and expects to become fully compliant during the 2003 financial year.

The company is committed to applying the highest principles of governance commensurate with its size, constitution and systemic importance.

Workings of the Board and its Committees

The Board

The Board focuses on strategic issues and key operational issues including financial performance. It determines how the company operates within a framework of authorities delegated to the executive and to committees.

In the context of the Combined Code (the principles of good governance and code of best practice derived by the Committee on Corporate Governance, 'Turnbull', and from the Cadbury and Greenbury Reports), the principal difference between LCH and listed companies relates to the composition of the Board. The Articles of Association of LCH prescribe the composition of the Board and the procedures for appointment to it. The Chief Executive is the only member of the Board who is a member of the management of the company. The maximum number of directors is sixteen. Not more than nine 'A' Directors are elected by the clearing members, following a nomination process conducted by the Nominating Committee, and not more than three 'B' Directors are appointed by each of Euronext.liffe, LME and IPE. The remaining four directors consist of the Chairman, the Chief Executive and two independent non-executive directors appointed by the Board.

Directors

The company supports the concept of an effective Board leading and controlling the company. The Board is responsible for approving company policy and strategy and meets on a monthly basis. Management supply the Board with appropriate and timely information and the directors are free to seek any further information they consider necessary. All directors have access to advice from the company secretary and independent professionals at the company's expense.

...Workings of the Board and its Committees

The Board includes one executive director, the Chief Executive, who holds the key operational position in the company, and fourteen non-executive directors (as at February 2003), of whom three are independent of management and any business or other relationship which could interfere with the exercise of their independent judgement. This provides a balance whereby the Board's decision-making cannot be dominated by an individual or small group. The Chairman of the Board is Sir Michael Jenkins and the Chief Executive of LCH is David Hardy. The names of the Board members are set out on page 14.

One-third of the 'A' directors are subject to re-election at the company's annual general meeting ("AGM"). An 'A' director appointed during the year holds office until the next AGM unless re-appointed at the AGM. The Nomination Committee meets as required to select and recommend to the Board suitable candidates for both 'A' directors and non-executive appointments to the Board. It comprises Sir Michael Jenkins (Chair), Chairman of the Board, Richard Berliand and Mark Fox-Andrews, both non-executive directors, Nicholas Durlacher, Roy Leighton and Richard Seaman, all of whom are independent of the company.

The Board believes that its current structure provides a fair representation to the various participants of the different markets cleared by LCH.

The following committees deal with specific aspects of the company's affairs:

Executive Committee

The Executive Committee comprises the senior executive management of LCH, including the Chief Executive. The Executive Committee meets weekly and is responsible for the day-to-day management of the company within the framework and authority as outlined and delegated by the Board.

The members of the Executive Committee are as follows:

David Hardy - Chief Executive
Andrew Lamb - Managing Director, Risk and Deputy Chief Executive
Arun Aggarwal - Managing Director, Business Management
Jackie Alexander - Managing Director, Human Resources (appointed 28 October 2002)
Guy Ruddock - Managing Director, Information Technology (appointed 28 October 2002)
Ian Scott - Managing Director, Finance
Paul Swann - Managing Director, Service Delivery

Audit Committee

The Audit Committee comprises David Pritchard (Chair), Simon Heale, Mark Fox-Andrews and David Robins, replacing Lawrence Scott who resigned on 31 October 2002. Since its reconstitution in September 2001, the terms of reference of the Committee have included keeping under review the scope and results of the internal and external audits and their cost effectiveness. The Committee is also responsible for recommending approval of the financial statements to the Board. The Committee ensures the independence of the internal auditors within the company and reviews the independence and objectivity of the external auditors. This includes reviewing the nature and extent of non-audit services supplied by the external auditors to the company, seeking to balance objectivity and value for money.

Risk Committee

The Risk Committee is chaired by Roger Barton (who succeeded Mark Eynon in February 2002) and considers membership applications, risk management policies and other developments affecting the company's risk profile including the introduction of new markets. The Committee reviews the adequacy of LCH's Default Fund on a quarterly basis and advises the Board on the continued adequacy of the Fund. It has the authority, delegated from the Board, to approve membership applications and the clearing of new contracts or products.

Remuneration Committee

The Remuneration Committee comprises Sir Michael Jenkins (Chair), Chairman of the Board, Richard Berliand, Ronald Morgan and David Robins, replacing Catherine FitzMaurice who resigned on 31 October 2002, and is responsible for making recommendations to the Board, within agreed terms of reference, on the company's framework of remuneration and its cost. The Committee determines the contract terms, remuneration and other benefits for senior management. The Board itself determines the remuneration of the Chairman of the Board.

Relations with shareholders

The company values the views of its shareholders and recognises their interest in the company's strategy and performance, Board membership and quality of management. The company holds meetings with its shareholders to discuss the company's objectives and any relevant, major current issues.

Internal control

The Board is responsible for the company's system of internal control which aims to safeguard the company's assets, ensure that proper accounting records are maintained, that the financial information used within the business for publication is reliable and that LCH continues to meet its legal requirements, including those flowing from its status as a Recognised Clearing House in the UK and as a Derivatives Clearing Organization in the USA.

The directors are responsible for the company's system of internal financial control and reviewing its effectiveness. The system of internal financial control is designed to provide reasonable, but not absolute, assurance against material misstatement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives.

The Audit Committee will review the operation and effectiveness of the company's system of internal financial, operational, compliance and risk management for the financial year and the period up to the date of approval of the current financial statements.

Key features of the system of internal financial control are currently as follows:

- **Organisation and culture**

  The Board seeks to emphasise a culture of integrity, competence, fairness and responsibility. The Board has established Executive, Audit and Risk committees to assist with this requirement.

- **Financial reporting**

  There is a comprehensive planning system with an annual business plan and annual budget approved by the Board. Results are reported monthly to the Board and compared to the budget and forecasts.

- **Identification of business risks**

  The Board is responsible for identifying the major business risks faced by the company and for determining the appropriate course of action to manage those risks.

- **Internal Audit function**

  The company operates within a laid down control framework which is monitored by the Internal Audit function which reports to the Audit Committee.

Going concern

After making enquiries, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

The responsibilities of Auditors

The responsibilities of the company's independent auditors are established by statute, the Auditing Practices Board, and the accountancy profession's ethical guidance. Their responsibilities in relation to the Annual Report are set out below.

They report to the shareholders their opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. They also report to the shareholders if, in their opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if they have not received all the information and explanations they require for their audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

They read the other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. They consider the implications for their report to shareholders if they become aware of any apparent misstatements or material inconsistencies with the financial statements.

Auditors' Report

Auditors' report to the members of The London Clearing House Limited

We have audited the company's financial statements for the year ended 31 October 2002 which comprise the Profit and Loss Account, Statement of Total Recognised Gains and Losses, Balance Sheet, Cash Flow Statement, and the related notes 1 to 22. The financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprised of the Directors' Report, Chairman's Statement and Chief Executive's Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company as at 31 October 2002 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered Auditor
London
24 February 2003

Profit and Loss

Profit and loss account
for the year ended 31 October 2002

	Note	2002 £'000	2001 £'000 As restated
Turnover	2	188,287	174,165
Interest paid to clearing members	2	(105,659)	(117,497)
		82,628	56,668
Administrative expenditure	3	(59,008)	(50,295)
Profit on ordinary activities before tax		23,620	6,373
Tax on profit on ordinary activities	4	(8,006)	(1,945)
Profit for the financial year transferred to reserves		15,614	4,428

The 2001 comparatives have been restated following a change in accounting policy on the adoption of FRS 19 Deferred Tax. Further details can be found within the Accounting Policies in Note 1.

The notes on pages 30 to 52 form part of these financial statements.

Balance Sheet

As at 31 October 2002

	Note	2002 £'000	2001 £'000 As restated
Fixed Assets			
Tangible assets	7	13,228	13,827
Current Assets			
Debtors and other amounts receivable	8/9	42,520,888	38,550,289
Cash at bank and in hand	10	3,755,032	3,970,413
		46,275,920	42,520,702
Creditors: amounts falling due within one year	11	(40,323,881)	(38,918,399)
Net current assets		5,952,039	3,602,303
Total assets less current liabilities		5,965,267	3,616,130
Creditors: amounts falling due after more than one year	12	(5,895,366)	(3,558,272)
Net Assets		69,901	57,858
Capital and Reserves:	17		
Called up share capital			
Ordinary shares	15	36,700	39,100
Share premium account	16	11,812	12,984
Capital redemption reserve	16	3,571	-
Retained earnings	16	17,818	5,774
		69,901	57,858

The 2001 comparatives have been restated following a change in accounting policy on the adoption of FRS 19 Deferred Tax. Further details can be found under Accounting Policies in Note 1.

The Capital and Reserves includes £1 of non-equity share capital.

The financial statements were approved by the Board on 24 February 2003.

Sir Michael Jenkins, Chairman

The notes on pages 30 to 52 form part of these financial statements.

Cashflows

Statement of cashflows for the year ended 31 October 2002

	Note	2002 £'000	2001 £'000
Net cash Inflow from operating activities before movement in margins held	19	17,844	2,505
Margin monies net cash (outflow)/inflow	22	(250,801)	1,983,804
Increase in the Default Fund		10,183	140,369
Net cash (outflow)/inflow from operating activities		(222,774)	2,126,678
Taxation	20	(5,384)	-
Capital expenditure	20	(6,576)	(7,262)
Net Cash (outflow)/inflow before management of liquid resources and financing		(234,734)	2,119,416
Management of liquid resources		253,390	-
Financing	20	(3,571)	-
Increase in cash		15,085	2,119,416

Analysis of changes in net funds

		1 November 2001 £'000	Cashflow £'000	31 October 2002 £'000
Cash		2,007,614	15,085	2,022,699
Liquid resources - Short-term deposits		1,962,621	(253,390)	1,709,231
Net funds	Note 21	3,970,235	(238,305)	3,731,930

The notes on pages 30 to 52 form part of these financial statements.

Gains and Losses

Statement of total recognised gains and losses for the year ended 31 October 2002

	Note	2002 £'000	2001 £'000
Profit for the financial year		15,614	4,428
Redemption of Share Capital	16	(3,571)	-
Total recognised gains and losses relating to the year		12,043	4,428
Prior year adjustment	1(a)	2,121	-
Total gains and losses recognised since last annual report		14,164	4,428

The notes on pages 30 to 52 form part of these financial statements.

Notes

Notes to the financial statements 31 October 2002

1 Accounting policies

a) Basis of preparation and change in accounting policy

The financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards.

In preparing the financial statements for the current year, the company has adopted FRS 19 'Deferred Tax' and the transitional arrangements of FRS 17 'Retirement Benefits'. The adoption of FRS 19 has resulted in a change in accounting policy for deferred tax. Deferred tax is recognised on a full provision basis in accordance with the accounting policy described below. Previously, deferred tax was provided for on a partial provision basis, whereby provision was made on all timing differences to the extent that they were expected to reverse in the future without replacement.

This change in accounting policy has resulted in a prior year adjustment. Shareholders' funds at 1 November 2001 have been increased by £2.1m and the tax charge for the year ended 31 October 2001 has been decreased by £0.8m. Profit for the current year has been increased by £0.7m as a result of the change in accounting policy.

The transitional arrangements under FRS 17 require additional disclosure in the notes only.

b) Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date.

All differences are taken to the profit and loss account.

c) Tangible fixed assets and depreciation

Tangible fixed assets are capitalised and depreciated at rates calculated to write off their cost over their estimated useful lives as follows:

Office refurbishment costs	-	Straight line basis over the term of the lease
Computer equipment, office equipment, software and other fixed assets	-	Straight line basis between 3 and 5 years

Project costs are capitalised and depreciated on a straight line basis over three years commencing from the application of the developed product, service, process or system.

d) Financial instruments

All transactions are recorded in the balance sheet within 'Balances with Members' on a trade date basis.

Derivative financial instruments, including exchange traded futures and options and swaps, are recorded at fair value based on market prices or calculated by reference to quoted market prices.

Repurchase Agreements ("Repos") are recorded at their net present value. The underlying securities relating to such contracts are not recorded in the balance sheet.

Equity contracts are recorded at contractual value.

Debtors and creditors representing the recorded values of financial instruments are off-set in the balance sheet where they are entered into with the same member and LCH has a legally enforceable right to insist on net settlement in the event of insolvency or default of the member.

e) Taxation

Corporation tax payable is provided on taxable profits at the current rate.

The directors have implemented FRS 19 Deferred Tax for the year ended 31 October 2002. This represents a change of accounting policy. The main impact of this change is that, whereas previously deferred tax assets were not recognised where they were expected to be recoverable with replacement by equivalent assets, now assets are recognised if it is considered more likely than not that there will be suitable profits from which the future reversal of the underlying timing differences can be deducted.

...Accounting policies

The comparatives have been restated and the impact of this change in accounting policy is set out in note 14. The new accounting policy for deferred tax is set out in the next paragraphs.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. This is subject to deferred tax assets only being recognised if it is considered more likely than not that there will be suitable profits from which the future reversal of the underlying timing differences can be deducted. Timing differences are differences between the company's taxable profits and its results as stated in the financial statements, which are capable of reversal in one or more subsequent periods.

Deferred tax is measured on a non-discounted basis at the tax rates that are expected to apply in the periods that the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

f) Leases

Assets held under finance leases, which are leases where substantially all the risks and rewards of ownership of the asset have been passed to the company, and hire purchase contracts are capitalised in the balance sheet. The interest elements of the rental obligations are charged in the profit and loss account over the periods of the leases and hire purchase contracts and represent a constant proportion of the balance of capital repayments outstanding.

Rentals payable under operating leases are charged in the profit and loss account on a straight-line basis over the lease term.

g) Pensions and post-retirement benefits

The company operates a defined benefit pension scheme which requires contributions to be made into a separately administered fund.

Contributions to the LCH Pension Scheme are assessed by a qualified actuary and are charged to the profit and loss account so as to spread the cost over the service lives of the employees. The regular cost is attributed to individual years using the projected unit method. Variations in pension cost, which are identified as a result of actuarial valuations, are amortised over the average expected remaining working lives of employees in proportion to their expected payroll costs. The company has adopted the transitional arrangements as set out under FRS 17 Retirement Benefits. A full actuarial valuation was carried out at 30 June 2002 and updated to 31 October 2002 by a qualified independent actuary. Major assumptions used by the actuary are included within Note 18.

h) Capital instruments

Shares are included in Shareholders' funds. Other instruments are classified as liabilities if they contain an obligation to transfer economic benefits and if not they are included in shareholders' funds. The finance cost recognised in the profit and loss account in respect of capital instruments other than equity shares is allocated to periods over the term of the instrument at a constant rate on the carrying amount.

2 Turnover and interest paid to clearing members

Turnover and operating profits are derived from the provision of services to clearing members and exchanges, including interest received on deposits and accommodation charges.

Turnover analysis	2002 £'000	2001 £'000
Interest on shareholders' funds	2,501	2,803
Interest on default fund	13,437	14,356
Treasury earnings	103,167	110,452
	119,105	127,611
Clearing fees	63,162	43,961
Other income	6,020	2,593
	69,182	46,554
	188,287	174,165

Interest paid to clearing members analysis	2002 £'000	2001 £'000
Treasury	88,588	100,056
Default Fund	17,071	17,441
	105,659	117,497

3 Administrative expenditure

Administrative expenditure includes:	2002 £'000	2001 £'000
Staff costs (Note 6)	23,428	16,567
Depreciation of assets owned by the company (Note 7)	7,090	6,026
Hire of plant and machinery under operating leases	84	76
Property lease rentals	1,841	1,546
Auditors' remuneration	80	70
Interest on bank overdrafts and loans repayable within 5 years	153	81
Loss/(Profit) on disposal of fixed assets	85	(65)

Fees payable to Ernst & Young LLP for non-audit services in 2002 were £366,219 (2001 - £271,378) of which £258,950 relates to accounting and tax advice provided in connection with the ongoing corporate discussions with the Euronext group.

4 Tax on profit on ordinary activities

The tax charge is made up as follows:	2002 £'000	2001 £'000
Current tax:		
United Kingdom corporation tax		
- current year (charge)	(8,580)	(2,719)
- prior year under-provision	(87)	-
Total current tax charge	(8,667)	(2,719)
Deferred tax: (Note 14)	661	774
Tax on profit on ordinary activities	(8,006)	(1,945)

Factors affecting current tax charge

The tax assessed on the profit on ordinary activities for the year is higher than the standard rate of corporation tax in the UK of 30% (2001 - 30%). The differences are reconciled below:

	2002 £'000	2001 £'000
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2001 - 30%)	7,086	1,912
Permanent differences - expenses not deductible for tax purposes	1,494	807
Tax under-provided in previous years	87	-
Total current tax charge	8,667	2,719

5 Directors' emoluments and transactions

The emoluments of directors of the company were:	2002 £'000	2001 £'000
Aggregate emoluments	623	448

Remuneration was paid to the Chairman, Chief Executive and two independent non-executive directors. Remuneration is determined by the Board based on the recommendations of the Remuneration Committee. There is one director in the defined benefit pension scheme. The remuneration of the Chairman, Chief Executive and two independent non-executive directors is as follows:

	Basic salary and fees £	Benefits £	Performance related bonuses £	Total 2002 £	Total 2001 £
Sir Michael Jenkins	50,000	-	-	50,000	50,000
David Hardy	295,833	12,535	150,000	458,368	384,871
David Pritchard	35,000	-	-	35,000	-
David Robbins	35,000	-	-	35,000	-
	415,833	12,535	150,000	578,368	434,871

The value of the accrued pension for the highest paid director was £97,132 per annum at 31 October 2002 (2001: £84,929).

6 Employees

The average number of staff employed during the year was:	2002	2001
	324	276

The aggregate staff costs were:	£'000	£'000
Wages and salaries	19,458	14,487
Social security costs	1,895	1,553
Other pension costs	2,075	527
	23,428	16,567

7 Tangible assets

	Leasehold refurbishment	Computer and office equipment, software and other fixed assets	Total
	£'000	£'000	£'000
Cost:			
Balance at 1 November 2001	2,301	26,085	28,386
Additions	637	5,994	6,631
Disposals	(613)	(1,634)	(2,247)
Balance at 31 October 2002	2,325	30,445	32,770
Depreciation:			
Balance at 1 November 2001	1,017	13,542	14,559
Charge for the year	332	6,758	7,090
Disposals	(519)	(1,588)	(2,107)
Balance at 31 October 2002	830	18,712	19,542
Net book value 31 October 2002	1,495	11,733	13,228
Net book value 31 October 2001	1,284	12,543	13,827

8 Balances with members

Included within balances with members are the following fair value balances at 31 October 2002

	Assets £'000	Liabilities £'000
RepoClear transactions	37,152,626	(37,152,626)
SwapClear transactions	3,615,141	(3,615,141)
London Metal Exchange transactions	170,814	(170,814)
EquityClear transactions	604,157	(604,157)
LIFFE Traded Options transactions	544,405	(544,405)
Initial margin	413,705	(3,742,485)
	42,500,848	(45,829,628)

The net balances due from members recorded in the balance sheet of £42,501 million (2001: £38,538 million) are fully secured by non-cash collateral or guarantees held by the company. At 31 October 2002, the total net amount of non-cash collateral held, including in respect of initial margin, was £43,942 million (2001: £39,611 million) and the total amount of guarantees held was £1,465 million (2001: £1,245 million). Included within the non-cash collateral is the net amount of debt securities received as collateral for the company's assets in respect of RepoClear transactions, which has in turn been passed on to RepoClear counterparties to secure the company's liabilities in respect of Repoclear contracts. All gross fair value balances due to and from members mature within one year, except for £5,551 million (2001: £3,224 million) in respect of the fair value of contracts. Balances due to members have been reanalysed in the current year between those due within one year and those due in more than one year. This has resulted in a restatement of the prior year comparative in the Balance sheet.

9 Debtors and other amounts receivable

	2002 £'000	2001 £'000
Balances with members (Note 8)	42,500,848	38,538,439
Other debtors	13,399	7,603
Deferred tax (Note 14)	2,782	2,121
Prepayments and accrued income	3,859	2,126
	42,520,888	38,550,289
Of the above, the following amounts are due after one year:		
Balances with members	5,551,042	3,224,131
Deferred tax	2,782	2,121
	5,553,824	3,226,252

10 Cash at bank and in hand

	2002 £'000	2001 £'000
Cash and balances with banks, money on deposit and at call (Note 21)	3,755,032	3,970,413

11 Creditors: amounts falling due within one year

	2002 £'000	2001 £'000
Bank overdrafts and loans (Note 21)	23,102	178
Balances with members	40,278,586	38,893,889
Trade creditors	5,447	15,124
Other creditors including taxation and social security	7,282	2,720
Accruals	9,464	6,488
	40,323,881	38,918,399

The £23 million borrowing in 2002 was in respect of short-term Yen funding requirements. The entire £23 million borrowing reversed on 1 November 2002.

12 Creditors: amounts falling due after more than one year

	2002 £'000	2001 £'000
Balances with members (Note 8)	5,551,042	3,224,131
Default Fund	344,324	334,141
	5,895,366	3,558,272

The Default Fund's purpose is to fund losses incurred by the company in the event of member default where margin monies are insufficient to cover the management and close out of the positions of the defaulting clearing member. Monies are placed on deposit by LCH and interest has been paid to clearing members at a rate of not less than three-month LIBOR (or equivalent) plus one per cent on their contributions to the Fund, which is included within interest paid to clearing members in these financial statements (see Note 2). Members' contributions are adjusted on a quarterly basis and are refundable on resignation subject to the rules and regulations of the company.

13 Other financial commitments

At 31 October 2002 the company had annual commitments under non-cancellable operating leases as set out below:

	Land and Buildings		Other	
	2002 £'000	2001 £'000	2002 £'000	2001 £'000
Operating leases which expire:				
Within one year	274	-	22	-
In two to five years	-	246	15	33
In over five years	2,387	1,695	-	-
	2,661	1,941	37	33

14 Deferred taxation

The deferred tax included within the balance sheet is as follows:

	2002 £'000	2001 £'000
Accelerated capital allowances	9,271	7,073
Deferred tax asset at 30%	2,782	2,121

	2002 £'000	2001 £'000
At 1 November	2,121	1,347
Movement in the year	661	774
At 31 October	2,782	2,121

The adoption of FRS 19 has resulted in a prior year adjustment being made to recognise a deferred tax asset. The cumulative adjustment of £2.121 million is reflected in the Statement of Total Recognised Gains and Losses.

The deferred tax asset arises due to the tax written down value of assets qualifying for capital allowances exceeding the net book value of qualifying assets. The overall profit and loss account impact has been to decrease the tax charge (and increase the profit for the year) in 2001 by £774,000, with a similar decrease in the tax charge in 2002 of £661,000.

15 Called up share capital (including non-equity interests)

	2002 £	2001 £
Authorised		
'A' redeemable ordinary (equity) shares of £200,000 each	50,000,000	50,000,000
'B' redeemable ordinary (equity) shares of £12,500 each	12,500,000	12,500,000
'C' ordinary (non-equity) share of £1	1	1
	62,500,001	62,500,001
Issued and fully paid		
'A' redeemable ordinary (equity) shares of £200,000 each	24,200,000	26,600,000
'B' redeemable ordinary (equity) shares of £12,500 each	12,500,000	12,500,000
'C' ordinary (non-equity) share of £1	1	1
	36,700,001	39,100,001

The 'A' shares carry one vote per share, the 'B' shares carry in total one third of the number of votes to which 'A' shareholders are entitled. The 'C' share is non-voting and carries no right to participate in the profits of the company.

The company may, at its sole discretion (subject as permitted by law), redeem an outgoing member's 'A' share at the original subscription price, although it is not the company's policy routinely to build up reserves with a view to effecting such redemption.

On 23 May 2002 12 'A' shares with a nominal value of £2,400,000 were redeemed from outgoing members at original subscription price of £297,619 each.

16 Reserves

	2002 £'000	2001 £'000
Share premium account		
At beginning of year	12,984	12,984
Redemption of share capital	(1,172)	-
At end of year	11,812	12,984
Capital Redemption reserve		
At beginning of year	-	-
Arising on redemption of share capital	3,571	-
At end of year	3,571	-
Profit and loss reserve		
At beginning of year (as previously reported)	3,654	-
Prior year adjustment for deferred tax	2,121	1,347
At beginning of year (as re-stated)	5,775	1,347
Retained profit for the year	15,614	4,428
Transfer to Capital Redemption reserve	(3,571)	-
At end of year	17,818	5,775

The effect of the change in accounting policy (see Note 1 - under the heading 'Taxation') on the profit for the year ended 31 October 2002 is to reduce the tax charge and therefore increase the retained profit for the year by £661,000 (2001 - to reduce the tax charge and therefore increase the retained profit by £774,000).

17 Reconciliation of movements in shareholders' funds

	2002 £'000	2001 £'000
Retained profit for the year	15,614	4,428
Share buy back	(3,571)	-
Net addition to shareholders' equity	12,043	4,428
Opening shareholders' equity (as previously reported)	55,737	52,083
Prior year adjustment - note 1(a)	2,121	1,347
Opening shareholders' equity (as restated)	57,858	53,430
Closing shareholders' equity	69,901	57,858

18 Pension commitments

SSAP 24 disclosure

The company participates in the LCH Pension Scheme. This scheme is of the defined benefit type providing benefits to employees of LCH and the assets are held in a separate trustee administered fund. The total pension cost for the company relating to the scheme in the year to 31 October 2002 was £2.075 million (2001 - £526,000). As at 31 October 2002 accrued contributions payable by the company amounted to £182,635. These were paid into the pension scheme in November 2002.

The pension cost relating to the scheme is assessed in accordance with the advice of a qualified actuary using the projected unit method. A full actuarial assessment of the scheme was carried out as at 30 June 2001 and subsequently updated to 31 October 2002 by a qualified independent actuary.

The major assumptions used by the actuary were:

	At 31 October 2002	At 31 October 2001
Rate of increase in salaries*	4.50%	4.50%
Rate of increase of pensions in payment	2.50%	2.50%
Discount rate	7.50%	7.50%
Inflation assumption	2.50%	2.50%
Level of funding being the actuarial value of assets expressed as a percentage of the benefits accrued to members, after allowing for future salary increases	91%	116%

**plus a promotional salary scale*

Contributions increased from 5% to 15% of pensionable earnings in order to eliminate the deficiency in the scheme. The deficit in the scheme will be recognised as variations from regular cost over 15 years, which is the average expected remaining service lives of the employees.

...Pension commitments

FRS 17 disclosure

The valuation used for FRS 17 disclosures has been based on the most recent actuarial valuation at 30 June 2001 and updated by a qualified independent actuary to take account of the requirements of FRS 17 in order to assess the liabilities of the scheme at 31 October 2002 and 31 October 2001. Scheme assets are stated at their market values at the respective balance sheet dates.

	At 31 October 2002	At 31 October 2001
Rate of increase in salaries*	4.30%	4.25%
Rate of increase of pensions in payment	2.30%	2.25%
Discount rate	5.60%	5.60%
Inflation assumption	2.30%	2.25%

**plus a promotional salary scale*

The assets in the scheme and the expected rate of return were:

	At 31 Oct 2002 Projected returns	At 31 Oct 2002 £'000	At 31 Oct 2001 Projected returns	At 31 Oct 2001 £'000
Equities	7.10%	21,881	6.90%	22,205
Bonds	4.60%	4,492	4.50%	5,414
Property and 'other'	4.00%	2,408	4.00%	3,741
Total market value of assets		28,781		31,360
Actuarial value of liability		(38,774)		(35,350)
Deficit in the scheme		(9,993)		(3,990)
Related deferred tax asset		2,998		1,596
Net pension liability		(6,995)		(2,394)

Under the arrangements of FRS 17, an additional £2.763m would have to be charged to the profit and loss account in the current year as a service cost if the standard was implemented in full. The net return, being the difference between the expected return on the pension scheme assets and the interest on pension liabilities on the pension scheme if FRS 17 was adopted in full, would be a favourable return of £5,000.

Analysis of amount that would be recognised in the balance sheet under FRS 17

	As at 31 Oct 2002 £'000	As at 31 Oct 2001 £'000
Net assets excluding pension liability	69,901	57,858
Pension liability	(9,993)	(3,990)
Deferred tax	2,998	1,596
Net assets including pension liability	62,906	55,464

Analysis of amount that would be recognised in the reserves note under FRS 17

	Year to 31 Oct 2002 £'000	Year to 31 Oct 2001 £'000
Profit and loss reserve excluding pension reserve	17,818	5,775
Pension reserve	(9,993)	(3,990)
Deferred tax	2,998	1,596
Profit and loss reserve under FRS 17	10,823	3,381

...Pension commitments

Analysis of amount that would be recognised in the statement of total recognised gains and losses under FRS 17

	Year to 31 Oct 2002 £'000
Actual return less expected return on assets	(6,077)
Experience gains and losses on liabilities	1,374
Changes in assumptions	(492)
Actuarial loss recognised in the statement of total recognised gains and losses	(5,195)

Movement in deficit during the year

	Year to 31 Oct 2002 £'000
Deficit in scheme at beginning of year	(3,990)
Movement in year:	
Current service cost	(2,763)
Contributions	1,950
Net return on assets	5
Actuarial loss	(5,195)
Deficit in scheme at end of year	(9,993)

19 Reconciliation of operating profit to net cashflows from operating activities before movements in margin monies held

	2002 £'000	2001 £'000
Operating profit	23,620	6,373
Depreciation charges	7,090	6,026
Loss/ (profit) on disposal of fixed assets	85	(65)
(Increase)/ decrease in debtors	(7,532)	7,171
Decrease in creditors	(5,419)	(17,000)
Net cash inflow from operating activities before movement in margin monies held	17,844	2,505

20 Analysis of cashflows

		2002 £'000	2001 £'000
Taxation			
UK Corporation tax	- paid	(5,388)	-
	- received	4	-
		(5,384)	-
Capital expenditure			
Payments to acquire tangible fixed assets		(6,631)	(7,375)
Receipts from sale of tangible fixed assets		55	113
		(6,576)	(7,262)
Financing			
Payment for redemption of share capital		(3,571)	-

21 Analysis of changes in net funds

The analysis of net funds is made up as follows in the balance sheet:

	At 1 November 2001 £'000	Cashflow £'000	At 31 October 2002 £'000
Cash at bank and in hand (Note 10)	3,970,413	(215,381)	3,755,032
Borrowings and Overdraft (Note 11)	(178)	(22,924)	(23,102)
	3,970,235	(238,305)	3,731,930

FRS1 defines cash as only including cash-in-hand and deposits that can be withdrawn at any time without notice and without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed. The Statement of Cashflows for 2002 has been prepared so as to differentiate between those movements in cash as defined by FRS1 and those in other liquid resources.

22 Analysis of movement in margin monies

	At 1 November 2001 £'000	Cashflow £'000	At 31 October 2002 £'000
Balances due to members	42,118,020	3,711,608	45,829,628
Balances due from members	(38,538,439)	(3,962,409)	(42,500,848)
	3,579,581	(250,801)	3,328,780