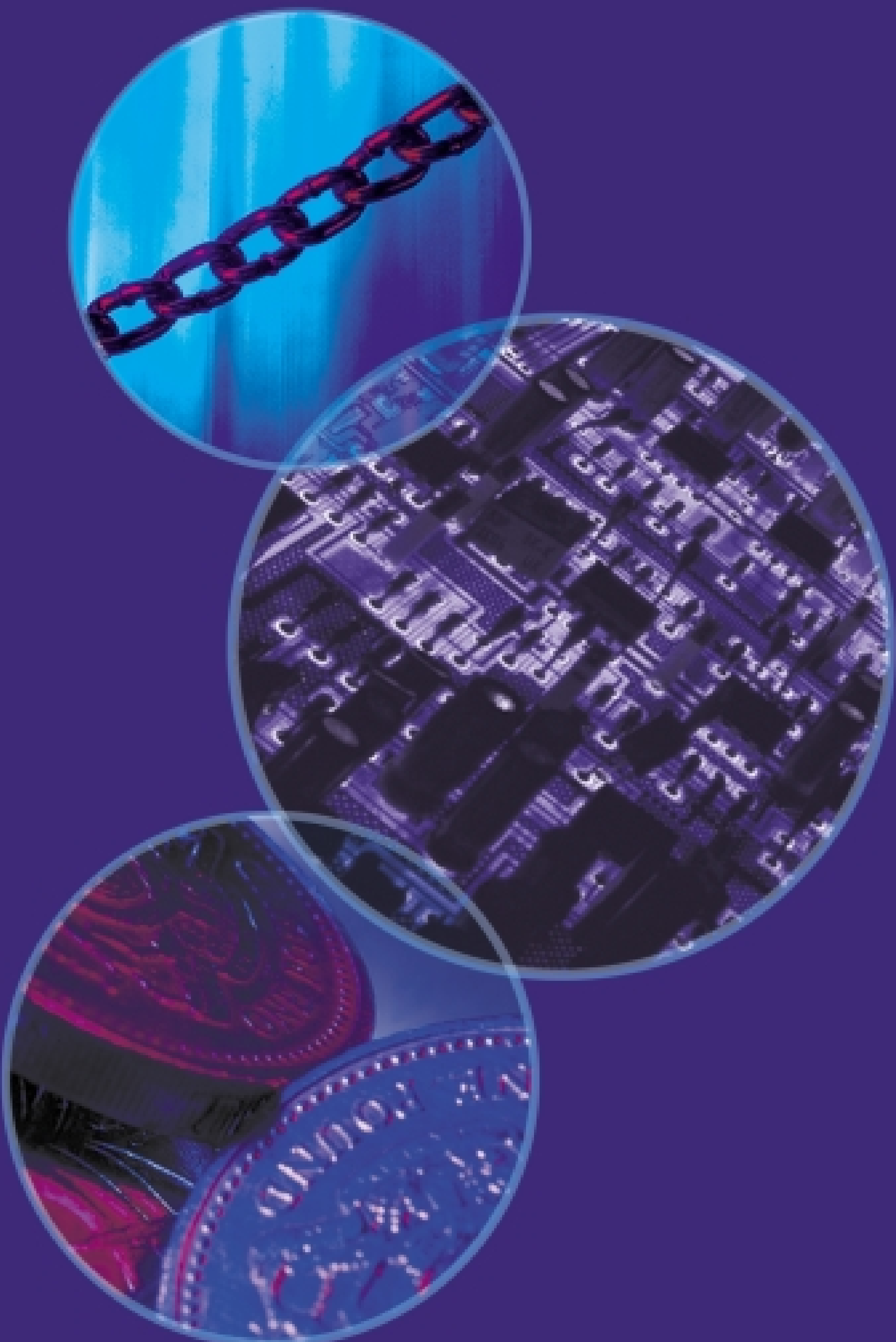
LCH



LONDON CLEARING HOUSE

Report and Financial Statements 2001

Contents

report and financial statements 2001

Chairman's Statement

Trends do not fit neatly into calendar years, but over the past year or so clearing and settlement have been influenced by two trends. The first has been for exchanges to become public companies owned in part by shareholders who are not customers of the exchange. The second has seen a growing body of opinion arguing that consolidation of clearing and settlement services is a pre-requisite to reducing the costs of cross-border business. The fragmented structure of the industry in Europe is contrasted - unfavourably but also unrealistically - with consolidated, albeit segmented, clearing in the US. The first of these trends makes the objective of the second more difficult to achieve.

The views and actions of the industry in Europe on this issue of consolidation have been inconsistent. On the one hand, its preference, as expressed through the European Securities Forum, is for a consolidated central counterparty that is a mutually-owned, non-profit making entity. But, on the other hand, this frequently expressed preference has not been supported by effective attempts to prevent the establishment of so-called vertical silos where clearing is an integral part of an exchange's operations, often contributing significantly to its profits. If consolidation is the aim, vertical silos make it more difficult to bring about.

LCH is predominantly owned by its users and has been non-profit making to the extent that it has paid its surpluses as rebates to users rather than as dividends to shareholders. However, in reality it behaves as a commercial entity. Over the past five years the company has made substantial investments in new services with the result that it now offers a wider range than any other clearing house in the world. At the same time its fees are low by industry standards and appear to be acceptable to users. Our core philosophy is that LCH should be able to act as the central counterparty to any trading platform that has support from shareholders and where there is a clear business case for its doing so. The Board believes that this philosophy should be preserved in any steps that it takes towards consolidation in the industry.

As the Chief Executive reports, 2001 was a successful year for the company. It now operates four thriving businesses, marking the diversification that the Board set out to achieve five years ago. This is reflected in the 41% increase in the volume of contracts cleared. The Company has only been able to make this sizeable investment with the forbearance of shareholders and the Board is very grateful for the continuing support that they have shown.

Once again I am indebted to members of the Board and to those serving on LCH committees for their advice and for the time that they have been willing to devote to the company - always a scarce commodity. During the year we took steps to augment the Board by the appointment of two independent directors and are delighted to have secured David Pritchard and David Robins, two City heavyweights. They joined the Board in October 2001. We were delighted that Roger Barton has returned to the Board and also welcomed Ronald Morgan and Simon Heale, who became a Board member having succeeded David King as Chief Executive of LME. Steven Patriarco retired after a short spell on the Board to return to New York, as did Michael Zamkow on his retirement from Goldman Sachs at the end of the year. I would like to thank them all for the contribution they made to the Board.

It has been another busy year for LCH staff and David Hardy's report gives a flavour of the range of initiatives with which he and his team have successfully grappled. The Company's success rests, however, on the bedrock of sound risk management and reliable service, for which all staff can take credit.

Sir Michael Jenkins
Chairman

r e p o r t   a n d   f i n a n c i a l   s t a t e m e n t s   2 0 0 1

2001 was a watershed year for LCH in which it saw the development of its services through four distinct business streams successfully come of age. Each business stream - futures and options, cash equities, fixed income, and interest rate derivatives - now has its own identity and is firmly established within its segment of the clearing and settlement infrastructure. The expansion of our equities, fixed income and interest rate derivatives businesses has been remarkable, and LCH is able to report a 41% increase in the number of contracts cleared, from 224 million to a record 315 million, primarily from its traditional futures and options business stream, and with an underlying notional value of 168 trillion. These are startling numbers, and whilst they do not position LCH as the largest clearing house in the world in terms of the statistics, it is certainly close. What is beyond question however is that LCH is unrivalled in the range of services it provides and I would like to make some comment on each of those service areas.

Futures and Options

Our services to London International Financial Futures and Options Exchange (LIFFE), London Metal Exchange (LME) and International Petroleum Exchange (IPE) continue to be key. 2001 has been a year of considerable change for them all, consolidating their positions as shareholder-owned institutions. So far as LIFFE and IPE are concerned, the changes have been even more far-reaching. Euronext, the exchanges grouping comprising the Amsterdam, Brussels, Paris and now Lisbon derivatives and equity exchanges, has just completed its acquisition of LIFFE, giving what LIFFE sees as a vibrant opportunity to expand and develop its business base. Clearing of LIFFE contracts will of course continue to be handled by LCH, and we look forward to supporting their developing business model. Quite apart from the very substantial increase in volumes generally, LCH started to clear LIFFE's new weather contracts and saw the introduction of a broad range of new Universal Stock Futures contracts, of which there are now more than 100 being cleared. During the year, LCH launched enhancements to the GATS tendering system, enabling LIFFE to publish certified stock figures for a range of soft commodities on its website, whilst the launch of the latest version of the SPAN margining system, SPAN 4, has enabled improved and refined margining for all products, resulting in more accurate assessment overall, especially for lower risk spreads and strategies.

2001 saw the acquisition of IPE by IntercontinentalExchange (ICE), based in Atlanta. IPE, already the dominant European energy trading exchange, has seen its range of business opportunity expand greatly with the synergies inherent in this new relationship, whilst LCH is delighted to have agreed with ICE that it will provide clearing services for, at the outset, two globally traded OTC energy contracts. To do so required LCH to obtain Derivatives Clearing Organisation recognition by the US regulatory authorities, with LCH the first and only non-US clearing house to be awarded such recognition. IPE continues towards a fully electronic trading process, and LCH looks forward to providing robust and effective clearing services in this challenging environment.

LME has also had a busy year. Much of our work with the world's premier base metals exchange has related to the implementation of the second phase of its highly successful electronic trading platform, LME SELECT, including the introduction of an automated link to LCH. This is now in place, and together with the coming year's new release of SWORD, the electronic warrants management system, LCH will further enhance the quality of service it provides. Together with LME, we are currently developing clearing services for a new North American aluminium contract, and look forward to seeing this launched in the coming months.

LCH EquityClear ®

This business stream launched its first product, Central Counterparty for Equities, for the London Stock Exchange SETS electronic order book at the end of February. This has been outstandingly successful. The daily volume traded on SETS has practically doubled in less than a year to a daily average of some 75,000 contracts, partly as a result of a greater proportion of LSE business being transacted on SETS. Whilst LCH would not claim sole responsibility for the increase in activity, there can be no doubt that the advantages of trading anonymity and improved risk management provided by a central counterparty have had a very significant impact. The service to the London Stock Exchange will be further improved in the middle of 2002 by the introduction of optional netting, again with the co-operation of our colleagues at CRESTCo, which will deliver substantial operational efficiencies to those members for whom such a service extension is appropriate. LCH EquityClear will launch similar clearing services for virt-x, the pan-European stock exchange formed by the merger of Tradepoint Stock Exchange and SWX Swiss Exchange.

LCH RepoClear ®

It has been a year of records for LCH RepoClear, our fixed income clearing service. When the service started in late 1999, we were delighted when daily volumes hit 5 billion. Daily volumes now average some 100 billion, and membership has grown from eight members to 40, with more expected to join during the first months of 2002. Feeds come from BrokerTec, e-Speed, EuroMTS and ETCMS, with RepoClear providing repo and cash bond clearing services in German, Belgian, Dutch and Austrian government bonds, Jumbo Pfandbriefe and International issues. The service will shortly be extended to include baskets of General Collateral, and it expects to introduce Italian government bonds and Gilts during the coming year. LCH RepoClear currently handles some 90% of the cleared market in European fixed income trading, and we are hopeful that its continuing expansion and acceptance will reinforce its key role.

LCH SwapClear ®

The wholesale interbank interest rate swaps business stream has seen a period of acceptance, improvement and expansion. Following the formation of OTC DerivNet in November 2000, the original eight members have now become 12, taking overall LCH SwapClear membership to 17. Well over 20,000 swap transactions have now been loaded into the system, with a face value in the order of $1.25 trillion, more trade loading is taking place and members, following their implementation of the necessary messaging systems, are beginning to carry out intraday clearing. It is now clear that the service has not only achieved critical mass, but has also been accepted as an integral element of the industry's trading infrastructure. We are looking forward to more members joining the service in 2002 and to fresh functionality being delivered, including maturities extended from 10 years to 30 years, more currencies and further types of interest rate instruments

Risk and Regulation

Risk management, at the core of our services, continued its programme of development throughout the year. Existing margining systems were expanded, adapted and modified to cover new areas and LCH ERA, a new portfolio based margining system for equity contracts, was devised and implemented in support of LCH EquityClear. The year also saw the introduction of a new stress testing model to ensure the continued adequacy of the Default Fund. Work to deliver IDRiS, a full intra-day revaluation and remargining tool for futures and options contracts, is nearing completion. This will enhance the already significant capability for futures and options contracts and full capability for equities, fixed income and interest rate derivatives into a full "across the board" capability. The Financial Services Authority satisfactorily reviewed LCH arrangements in the light of the requirements of the Financial Services and Markets Act (2000) which came into effect at the end of the year. This "grandfathering" process was a valuable opportunity for LCH to re-evaluate the robustness of its systems, and to implement a number of useful improvements.

Default Fund

The Default Fund currently stands at £334 million, within a maximum of £400 million. The maximum level was increased by £100 million from £300 million in the early part of the year to allow for the inclusion of LCH EquityClear business. Our work with ICE has necessitated a fresh member ballot to permit its inclusion with the futures and options element of the Fund. There are no current plans to increase the aggregate value of the Fund. Our insurance policy, providing a further £100 million of cover, continues to stand as a valuable contingent recourse in case of need. The current cover is in the course of replacement by an improved facility later in 2002.

International Developments

This has been an eventful year for the industry's infrastructure. I reported last year on the forthcoming IPOs for both Deutsche Börse and Euronext. Both of these took place during the first half of 2001, and each raised very substantial sums. It was both interesting and disappointing to note that, despite an apparent determination on the part of market users to require fundamental changes to the way the industry functions, each IPO was greeted with considerable enthusiasm, essentially ensuring that, at least so far as equity markets are concerned, exchanges continue to dominate the strategic agenda.

This is contrary to the apparent wishes of the majority of the larger users, and a source of considerable frustration to those who recognise the need for consolidation of the clearing and settlement segments of the infrastructure in order to achieve a competitive European capital market. If anything, we are presently seeing the reverse trend with a number of new central counterparties in course of formation. For our part, we remain convinced that a commercially minded, member-facing structure, which is, organisationally rather than operationally, independent of trade-capture and settlement bodies, is the optimum model for this key segment of the capital market infrastructure and we will continue to pursue the goal of consolidation for as long as this remains in the interests of our shareholders.

Management Structure

LCH staffing has stabilised at some 350 in number, and is expected to remain at around this level. This headcount reflects both the key role that LCH plays both in the City of London and globally and the growth in size and complexity of our markets, but remains at a comparatively low level as a result of ever improving technology.

With the commensurate increase in management workload, the role of the Executive Committee has become the focus of the day-to-day management of the company, releasing the Board to operate on a higher strategic level. The Executive Committee comprises myself, Andrew Lamb (Deputy Chief Executive and Managing Director, Risk), Arun Aggarwal (Managing Director, Business Management), Ian Scott (Managing Director, Finance) and Paul Swann (Managing Director, Service Delivery).

Business Continuity

It would be inappropriate for me not to refer to the terrible events of 11 September last year. Although just about everything that can be expressed has already been said, all of us at LCH, even some months later, still look back with shock and sorrow at the dreadful cost in lives, injury and property. We all knew someone personally involved, which made handling the business aftermath, to the extent that it affected LCH, all the harder.

There are, however, clear lessons to be learned, and we saw our own drive to have effective and tested plans in place to ensure ongoing business effectiveness brought into sharp relief; our arrangements had in fact been enhanced and our internal resources in this area strengthened prior to 11 September. But the world saw a new level of terrorist extremism on that day; no major centre can feel immune to a horrific repetition and one can no longer claim that the arrangements in place can withstand any shock. We are confident that, in the hopefully unlikely event that we find those plans tested, we are taking sensible steps to ensure that our service to members continues with minimum disruption.

L to r: Arun Aggarwal, Ian Scott, David Hardy, Andrew Lamb and Paul Swann

Financial Performance

The results for the year show a strong performance: turnover for the year of £174.2 million, itself an increase of over 30% over last year and with significant contributions from all four business streams, resulted in profit before tax of £6.4 million. The Board has decided that the after tax profit of £3.7 million should be taken to reserves to help finance the future expansion of the company. An increase in administrative expenses to £50.3 million reflects the final stages of the expansion of capability required to service and extend our rapidly growing business. It is expected that further expansion can be achieved without a commensurate increase in the current cost base, so that the bottom line will benefit from the anticipated growth in revenues.

This has been an important year for LCH. Our confidence that the four business streams, the cornerstones of our service, would see both market acceptance and impressive growth has been fully justified. We now are in the position that we can meet the needs of our members' businesses, on a local, European or global basis. Our challenge for the future is to enhance those services still further so that, whatever and wherever the business, LCH remains the central counterparty of choice.

I am more than fortunate that all those who work to make LCH what it is - members, management and staff colleagues, and all those in the governance structure - are so dedicated and committed. The company is the sum of its talent, and I offer my deepest thanks to all those who have contributed.

David Hardy
Chief Executive

Board of Directors

Chairman	Sir Michael Jenkins**◆
Directors	R N Barton* (appointed 26 November 2001)
	R D A Berliand*◆
	J Chenevix-Trench*
	R M Eynon*●
	C F Fitzmaurice*◆
	M Fox-Andrews*
	J L Foyle*
	D M Hardy
	S J N Heale*■ (appointed 2 July 2001)
	D E King* (resigned 29 June 2001)
	J R Morgan* (appointed 31 July 2001)
	S Patriarco* (resigned 30 July 2001)
	D P Pritchard**■ (appointed 26 November 2001)
	D A Robins** (appointed 26 November 2001)
	L J Scott*■ (appointed 29 January 2001)
	R Ward*
	M Zamkow* (resigned 30 November 2001)
Secretary	E A John

* Non Executive
** Independent Non Executive

● Member of Risk Committee
■ Member of Audit Committee
◆ Member of Remuneration Committee

Board of Directors


L to r: Sir Michael Jenkins and David Hardy

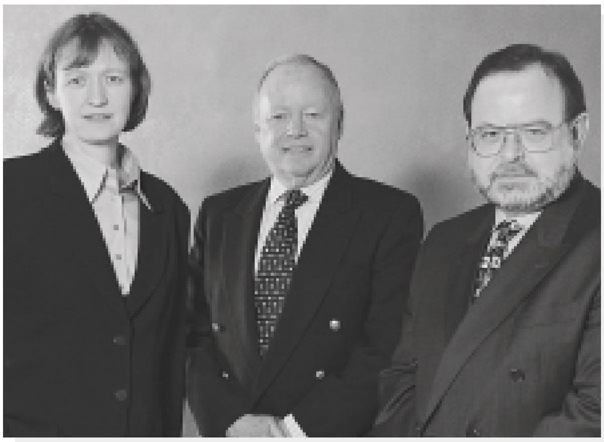

L to r: Richard Ward and David Pritchard


Lawrence Scott


L to r: David Robins and
Jonathan Chenevix-Trench


Richard Berliand


Mark Fox-Andrews


L to r: Catherine Fitzmaurice, Ronald Morgan and John Foyle


L to r: Simon Heale and Roger Barton

report and financial statements 2001

Report of the Directors

The directors present their report and the audited financial statements for the financial year ended 31 October 2001.

Review of the business

During the financial year the company provided clearing, central counterparty and other services to clearing members and exchanges in London. The company was in a sound financial position at the year end.

Profit and dividend

There was a profit for the year after taxation amounting to £3.653m (2000: £nil). The directors do not recommend the payment of a dividend (2000: £nil).

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 repricing date and maturity date for all financial assets and liabilities of the company, except balances with members, falls within the next three months.

Currency risk

There are no currency risk mismatches except for immaterial amounts in respect of margins earned on members' foreign currency balances.

Future developments

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 continuously developing its systems to enable more efficient and cost effective services to be provided.

The company is currently undergoing a review of internal policies and procedures to ensure that they fully meet the relevant core principles of the Turnbull Committee guidance on Corporate Governance applicable to the constitution and structure of the company. It is also reviewing the adequacy of its business continuity and recovery arrangements in the light of the events of 11 September 2001. The company has an on-going obligation to meet its requirements as a Recognised Clearing House under The Financial Services and Markets Act 2000 and as a Designated Clearing Organisation in the USA.

Directors

The directors of the company, shown on page 10, were directors throughout the year unless otherwise indicated.

Directors' interests

None of the directors of the company during the years ended 31 October 2001 and 31 October 2000 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 which 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;
- 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 £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
29 January 2001

The London Clearing House Limited ("LCH") has complied with earlier versions of the Combined Code throughout the year and is currently in the process of implementing the relevant core principles of the Turnbull Committee guidance that are applicable to its constitution and structure and intends to put in place the necessary additional procedures to comply with that guidance by 31 October 2002. The company is committed to applying the highest principles of governance commensurate with its size and constitution.

The 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 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 LCH. 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 LIFFE, LME and IPE. The remaining four directors consist of the Chairman, the Chief Executive and two other 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.

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 January 2002), 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 10.

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
Ian Scott	-	Managing Director, Finance
Arun Aggarwal	-	Managing Director, Business Management
Paul Swann	-	Managing Director, Service Delivery

Risk Committee

The Risk Committee is chaired by Mark Eynon (to be succeeded in February 2002 by Roger Barton) 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.

Audit Committee

The Audit Committee comprises David Pritchard (Chair), Simon Heale and Lawrence Scott. 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.

Remuneration Committee

The Remuneration Committee comprises Sir Michael Jenkins (Chair), Chairman of the Board, Richard Berliand and Catherine Fitzmaurice 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 therefore holds regular meetings with its shareholders to discuss the company's objectives and any relevant current issues.

The AGM is also used to communicate with shareholders and they are encouraged to participate.

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; that LCH continues to meet its legal requirements, including those flowing from its status as a Recognised Clearing House.

The directors are responsible for the company's system of internal financial control and reviewing its effectiveness. This system is designed to provide reasonable, but not absolute, assurance against material misstatement or loss, and 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 controls in conjunction with the Executive Audit Committee 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

to the members of The London Clearing House Limited

We have audited the company's financial statements for the year ended 31 October 2001 which comprise the Profit and Loss Account, Balance Sheet, Cash Flow Statement, and the related notes 1 to 20. The financial statements have been prepared under the accounting policies set out therein.

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 are 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 comprises 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 2001 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 Auditors
Rolls House
7 Rolls Buildings
Fetter Lane
London EC4A 1NH

Consolidated Profit and Loss Account

For the year ended 31 October 2001

	Note	2001 £'000	2000 £'000
Turnover	2	174,165	131,802
Interest paid to members		(117,497)	(94,962)
		56,668	36,840
Administrative expenditure	3	(50,296)	(37,601)
Profit/ (loss) before taxation		6,372	(761)
Tax (charge)/credit on profit on ordinary activities	4	(2,719)	761
Profit for the financial year transferred to reserves		3,653	0

All gains and losses have been recognised in the profit and loss account for the financial year.

The notes on pages 23 to 34 form part of these financial statements.

Balance Sheet

As at 31 October 2001

LCH

	Note	2001 £'000	2000 £'000
Fixed Assets			
Tangible assets	7	13,827	12,527
Current Assets			
Debtors and other amounts receivable	9	38,548,167	12,214,658
Cash at bank and in hand	10	3,970,413	1,850,936
		42,518,580	14,065,594
Creditors			
amounts falling due within one year	11	(42,142,529)	(13,832,265)
Net current assets		376,051	233,329
Total assets less current liabilities		389,878	245,856
Creditors			
amounts falling due after more than one year	12	(334,141)	(193,772)
		55,737	52,084
Capital and Reserves			
Called up share capital			
(including non-equity interests)			
Ordinary shares	15	39,100	39,100
Share premium		12,984	12,984
Profit and loss account		3,653	-
		55,737	52,084

The financial statements were approved by the Board on 29 January 2002.

The notes on pages 23 to 34 form part of these financial statements

Sir Michael Jenkins, Chairman

Cash Flow Statement

For the year ended 31 October 2001

	Note	2001 £'000	2000 £'000
Net cash flow from operating activites before movement in margins held	18	2,505	75,902
Margin monies net cash inflow		1,983,804	31,040
Increase in the Default Fund		140,369	23,528
Net cash inflow from operating activities		2,126,678	130,470
Taxation	19	-	(12)
Capital expenditure	19	(7,262)	(5,702)
Increase in cash		2,119,416	124,756

The notes on pages 23 to 34 form part of these financial statements.

1 Accounting policies

a) Basis of preparation

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

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 instrument contracts

Derivative financial instruments, including exchange traded futures and options, and swaps, are recorded in the balance sheet date from trade date at fair value. Fair values are calculated based on quoted market prices.

Equity Contracts

Equity contracts are recorded at contractual value on a trade date basis and are recorded within 'Balances with Members'.

e) Financial Instruments

In its role as central counterparty, members enter into RepoClear contracts with the company. RepoClear transactions consist of agreements to repurchase securities which have already been sold and agreements to resell securities which have already been purchased. As the central counterparty to these transactions, for each RepoClear contract the company has an equal and opposite contract with another member.

Accounting policies...

The present value of amounts payable in respect of agreements to repurchase securities previously sold are recorded in the balance sheet as liabilities to members under 'Balances with members'. The present value of amounts receivable in respect of agreements to resell securities previously purchased are recorded in the balance sheet as an asset of the company owed by members and shown under 'Balances with members'. Securities acquired under such contracts are not recorded in the balance sheet.

f) Balances with members

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.

g) Deferred taxation

Deferred taxation is provided using the liability method on all timing differences, including those relating to pensions, which are expected to reverse in the future without being replaced, calculated at the rate at which it is anticipated the timing differences will reverse.

Deferred tax assets are only recognised if recovery without replacement by equivalent debit balances is reasonably certain.

h) Leases

Operating lease rentals are charged to the profit and loss account in the period to which they relate.

i) Pension costs

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. Actuarial surpluses and deficits are spread forward over the average remaining service lives of the employees. 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 2001 and updated to 31 October 2001 by a qualified independent actuary. Major assumptions used by the actuary are included within note 17.

2 Turnover

Turnover and operating profits are wholly derived from the provision of services to members and exchanges, including interest received on deposits and accommodation charges, and relate to activities in London. Interest receivable for the 12 months to 31 October 2001 amounted to £126m.

3 Administrative expenditure

Administrative expenditure includes:	2001 £'000	2000 £'000
Staff costs (Note 6)	16,567	11,740
Depreciation of assets owned by the company	6,026	4,517
Office equipment	925	739
Hire of plant and machinery under operating leases	76	50
Property lease rentals	1,546	955
Auditors' remuneration	70	60
Interest on bank overdrafts and loans repayable within 5 years	81	55
(Profit)/Loss on disposal of fixed assets	(65)	303

Fees payable to Ernst & Young LLP for non-audit services in 2001 were £271,378 (2000 - £67,200).

4 Tax on profit on ordinary activities

	2001 £'000	2000 £'000
United Kingdom corporation tax		
- current year charge	(2,719)	(259)
- prior year overprovision	-	1,020
	(2,719)	761

The charge for UK taxation has been provided at a rate of 30% for the year ended 31 October 2001 (31 October 2000: 31% in respect of the prior year over provision and 20.4%, being the average small companies rate, for the year ended 31 October 2000).

5 Directors' emoluments and transactions

The emoluments of directors of the company were:	2001 £'000	2000 £'000
Aggregate emoluments	448	417

Remuneration was only paid to the Chairman and Chief Executive. 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 is as follows:

	Basic salary and fees £	Benefits £	Performance related bonuses £	Total 2001 £	Total 2000 £
Sir Michael Jenkins	50,000	-	-	50,000	40,000
David Hardy	272,500	12,371	100,000	384,871	364,625
	322,500	12,371	100,000	434,871	404,625

The value of the accrued pension for the highest paid director was £84,325 per annum at 31 October 2001 (2000 - £71,245).

During the year an interest free loan of £3,052 for the purchase of a season ticket was made available to D M Hardy. An amount of £nil was outstanding at 31 October 2001.

6 Employees

The average number of staff employed during the year was:	2001	2000
London	276	180

The aggregate staff costs were:	£'000	£'000
Wages and salaries	14,487	10,373
Social security costs	1,553	1,028
Other pension costs	527	339
	16,567	11,740

7 Tangible assets

	Leasehold refurbishments £'000	Computer and office equipment, software and other fixed assets £'000	Total £'000
Cost:			
Balance at 1 November 2000	1,957	19,818	21,775
Additions	344	7,031	7,375
Disposals	-	(764)	(764)
Balance at 31 October 2001	2,301	26,085	28,386
Depreciation:			
Balance at 1 November 2000	749	8,499	9,248
Charge for the year	268	5,757	6,025
Disposals	-	(714)	(714)
Balance at 31 October 2001	1,017	13,542	14,559
Net book value 31 October 2001	1,284	12,543	13,827
Net book value 31 October 2000	1,208	11,319	12,527

8 Balances with members

Balances with members at 31 October 2001	Assets £'000	Liabilities £'000
RepoClear transactions	36,553,974	(36,553,974)
SwapClear transactions	2,216,525	(2,216,525)
London Metal Exchange transactions	364,570	(364,570)
EquityClear transactions	2,167,054	(2,167,054)
LIFFE Traded Options transactions	312,863	(312,863)
Initial margin, restricted members' assets and effect of permissible netting	(3,076,547)	(503,034)
Total balances with members included in the balance sheet	38,538,439	(42,118,020)

Balances with members at 31 October 2000	Assets £'000	Liabilities £'000
RepoClear transactions	12,023,029	(12,023,029)
SwapClear transactions	11,642	(11,642)
London Metal Exchange transactions	227,716	(227,716)
LIFFE Traded Options transactions	151,619	(151,619)
Initial margin, restricted members' assets and effect of permissible netting	(216,247)	(1,379,530)
Total balances with members included in the balance sheet	12,197,759	(13,793,536)

The net balances due from members recorded in the balance sheet of £38,538 million are fully secured by non-cash collateral or guarantees held by the company. At 31 October 2001, the total net amount of non-cash collateral held was £39,611 million and the total amount of guarantees held was £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 £94 million in respect of the fair value of contracts.

9 Debtors and other amounts receivable

	Note	2001 £'000	2000 £'000
Amounts falling due within one year:			
Balances with members	8	38,538,439	12,197,759
Other debtors		7,603	1,205
Prepayments and accrued income		2,125	15,694
		38,548,167	12,214,658

10 Cash at bank and in hand

	2001 £'000	2000 £'000
Cash and balances with banks, money on deposit and at call	3,970,413	1,850,936

11 Creditors: amounts falling due within one year

	Note	2001 £'000	2000 £'000
Bank overdrafts and loans		178	117
Balances with members	8	42,118,020	13,793,536
Trade creditors		15,124	31,739
Other creditors including taxation and social security		2,720	985
Accruals		6,487	5,888
		42,142,529	13,832,265

12 Creditors: amounts falling due after more than one year

	2001 £'000	2000 £'000
Default Fund	334,141	193,772

The 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 member. Monies are placed on deposit by LCH and interest has been paid to 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. Members' contributions are adjusted on a quarterly basis and are refundable on resignation subject to the rules and regulations of the company.

13 Commitments under operating leases

	2001 £'000	2000 £'000
Operating lease commitments		
The total annual commitments in respect of non-cancellable operating leases are analysed by year of expiry as follows:		
Land and buildings		
Lease expiry date:		
Within one year	-	-
In the second to fifth years inclusive	246	209
Over five years	1,695	746
	1,941	955
Other operating leases		
Lease expiry date:		
Within one year	-	25
In the second to fifth years inclusive	33	33
	33	58
Total operating lease commitments	1,974	1,013

14 Deferred taxation

Group and company

The potential amounts of deferred tax asset, none of which are recognised in the financial statements, amount to £2,134,700 (2000: £1,350,000) relating to accumulated depreciation in excess of capital allowances.

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

	2001 £'000	2000 £'000
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	26,600,000	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
	39,100,001	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.

16 Reconciliation of movements in shareholders' funds

	2001 £'000	2000 £'000
Profit for the year	3,653	0
Net increase in shareholders' funds	3,653	0
Shareholders' funds at 1 November	52,084	52,084
Shareholders' funds at 31 October	55,737	52,084

17 Pension commitments

The company participates in the LCH Pension Scheme. This scheme is of the defined benefit type providing benefits to certain 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 2001 was £526,511 (2000 - £338,721).

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 2001 by a qualified independent actuary. The major assumptions for the calculation under SSAP 24 of the profit and loss account charge used by the actuary were:

	At 31 October 2001
Discount rate	5.60%
Inflation assumptions	2.25%
Rate of increase in salaries	4.25%
Rate of increase in pensions in payment	2.25%

The assets in the scheme and expected rate of return are set out in the FRS 17 disclosure below:	Long term rate of return expected at 31 October 2001	Value at 31 October 2001 £'000
Equities	6.90%	22,205
Bonds	4.5%	5,414
Other	4.0%	3,741
Total market value of assets		31,360
Present value of scheme liabilities		(35,350)
Deficit in the scheme		(3,990)

18 Reconciliation of operating profit to net cash flow from operating activities

	2001 £'000	2000 £'000
Operating profit/(loss)	6,372	(761)
Depreciation charges	6,026	4,517
(Profit)/Loss on disposal of fixed assets	(65)	303
Write-down of investments	0	9
Decrease/(Increase) in debtors	7,172	(4,343)
(Decrease)/Increase in creditors	(17,000)	76,177
Net cash inflow from operating activities	2,505	75,902

19 Gross cash flows

		2001 £'000	2000 £'000
Taxation			
UK Corporation tax	- paid	-	(12)
	- received	-	-
		-	(12)
Capital expenditure			
Purchase of tangible fixed assets		(7,375)	(5,702)
Sale of tangible fixed assets		113	-
		(7,262)	(5,702)

20 Analysis of changes in net funds

	At 31 October 2001 £'000	At 1 November 2000 £'000
Cash at bank and in hand	3,970,413	1,850,936
Overdraft	(178)	(116)
Total	3,970,235	1,850,820

report and financial statements 2001

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