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THE COMPETITIVE ADVANTAGES OF PRODUCT FUNGIBILITY

It is difficult to have a conversation about "common clearing" without discussing the concept of "product fungibility" at the same time. Many believe that the two are naturally linked, having one without the other contradicts the desired result.

1. Fungibility helps to foster standardization of contracts.

   This has been, and continues to be, a cornerstone concept in our industry. It provides customers a level of certainty as to what they are trading.

2. Fungibility creates an enhanced, single liquidity pool.

   The deeper the liquidity pool, the more efficient a market will be.

3. Fungibility helps promote "best execution".

   This is achieved by allowing customers and intermediaries the opportunity to seek the best price when establishing or liquidating a trade. This will also aid in promoting truer price transparency.

4. Fungibility helps spur competition.

   Exchanges and intermediaries will now compete on price and technology, clearly benefiting the customers involved.

5. Fungibility will help reduce overall operational processing costs.

   As stated earlier, fungibility and common clearing need to be thought of as one concept. With that, processing costs are reduced as intermediaries would be afforded the opportunity to streamline back office processing and pass much of those savings onto their customers. The savings would be in the area of reduced technology maintenance costs and reduced staffing needs to perform

the many reconciliation processes. Compliance issues would also be streamlined, since there would only be one set of rules to comply with.

6. Fungibility, again coupled with common clearing, lowers the cost of collateral to member firms and their customers.

   This is achieved by more cross margining and a single margin requirement to all participants. It reduces costs in having to move collateral around, and the maintenance of numerous settlement bank accounts.

7. Fungibility reduces the amount of margin required by customers.

   In a non-fungible world, customers with economically offsetting positions bear additional costs by being required to a) post additional capital to maintain offsetting positions until final settlement, and b) bear the additional execution costs if they want to liquidate the non-offsetting positions prior to final settlement.