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April 26, 2004

Re: **Linked Clearing of Instruments  
Traded on the Eurex Exchanges**

**BY ELECTRONIC MAIL AND AIR COURIER**

James L. Carley  
Director  
Division of Clearing and Intermediary Oversight  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

J. Michael Gorham  
Director  
Division of Market Oversight  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

Dear Messrs. Carley and Gorham:

**Introduction.**

The Clearing Corporation and Eurex Clearing Frankfurt, AG (“Eurex Clearing”) (together, the “Clearing Houses) have agreed to link clearing services for transactions executed on Eurex AG (“Eurex”) and U.S. Futures Exchange, L.L.C. (“USFE”). This submission to the Commodity Futures Trading Commission (the “Commission”) requests that the Commission take those regulatory actions required for the Clearing Houses to provide linked clearing of transactions executed on Eurex. As explained in greater detail below, the Clearing Houses envision additional linked operations under the rubric of “The Global Clearing Link.” These linked clearing arrangements are separate and segregable. This submission seeks approval for implementation of a linked clearing arrangement only with respect to the clearing

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of Euro-denominated futures contracts and options on futures contracts executed on Eurex (the "Euro Link"). It does not involve any products or transactions executed on USFE. This submission nonetheless includes an overview of the Global Clearing Link to provide context for this request.

## **The Parties.**

### ***The Clearing Corporation.***

The Clearing Corporation is a Delaware corporation owned by 50 stockholders, many of whom represent market-makers and other worldwide derivatives market participants, and is the only active independent futures clearinghouse in the world.

Membership. As noted above, The Clearing Corporation has 50 stockholders. Clearing Corporation participants are not required to own stock in The Clearing Corporation but are required to pledge assets (which may take the form of Clearing Corporation stock) to the applicable Clearing Corporation Guaranty Fund.

Risk Management. All trades submitted to The Clearing Corporation from the USFE trading platform are matched by the time they are received by The Clearing Corporation. The Clearing Corporation is, with limited exceptions, substituted as the counterparty at the time the trade is matched. The Clearing Corporation, therefore, acts as the buyer to every clearing participant seller and the seller to every clearing participant buyer, and in this way guarantees performance of those trades in accordance with its Rules, policies and procedures.

The Clearing Corporation uses a sophisticated risk management system. Key components of this risk management system include: at least once daily collection of original margin; at least twice daily marking-to-market of all open positions and payment and collection of related gains and losses; and monitoring of clearing participants' net mark-to-market obligations throughout the trading day.

This process of risk management allows The Clearing Corporation to analyze participants' net open trading positions and determine market exposure. In addition, the continuous flow of information to and from The Clearing Corporation and clearing participants allows both The Clearing Corporation and its participants actively to monitor trading positions and any associated financial risks. This continuous exchange of information also permits active communication with other self-regulatory organizations and, where appropriate, regulatory authorities to ensure coordination of risk management activities.

Since The Clearing Corporation's formation in 1925, no customer has lost money as a result of a default by a clearing participant to The Clearing Corporation.

Guaranty Fund. Throughout its more than 75-year history, The Clearing Corporation has developed and maintained some of the most sophisticated credit and guarantee systems in the world. Upon its inception in 1925, The Clearing Corporation had an initial capitalization of \$2,500,000. Due to the

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size of the markets at that time, this amount was more than adequate to ensure that The Clearing Corporation could properly fulfill its role as guarantor of the marketplace. As the scale of business handled by The Clearing Corporation has grown, so too has its balance sheet and its default resources – as at February 29, 2004, The Clearing Corporation had stockholder equity in excess of \$100 million, while its Guaranty Fund totaled more than \$125 million, an amount that The Clearing Corporation believes is more than sufficient protection against the risk of loss caused by a participant default.

### ***Eurex Clearing.***

Eurex Clearing was formed in 1998 to function as the clearinghouse for the Eurex exchanges, which are described in greater detail below. Eurex Clearing acts as the central counterparty for all Eurex transactions and guarantees the fulfillment of all transactions in futures and options on futures traded on Eurex. Eurex Clearing also acts as the central counterparty for and guarantees Eurex Bonds (a cash market for bonds), Eurex Repo (repurchase agreements) and for equities. Eurex Clearing is directly connected with various national and international central securities depositories, thereby simplifying the settlement processes for its clearing members. When a trade is executed in these markets, Eurex Clearing stands between the buyer and seller as clearinghouse for, and counterparty of, both contractual partners. Cleared transactions on Eurex are made between Eurex Clearing and the member firm that holds a clearing license. Each clearing member must provide collateral as required, in cash or securities, and must effect any daily settlement payments on the trading day following the final settlement day. In turn, clearing members must require collateral and daily settlement payments from their customers in an amount at least equal to the amount determined by Eurex Clearing. Eurex Clearing retains the authority to require a clearing member to deposit supplemental margin as a condition of maintaining its clearing status.

The Clearing House enables the parties to the transaction to make further decisions fully independently of each other and limit counterparty risk to a single contractual partner. Eurex Clearing's clearing system, with its integrated safety and control mechanisms, thus guarantees fulfillment of every contract executed on Eurex.

Margin. The mainstay of this security system is margin – *i.e.*, the funds or securities that must be deposited by clearing members as collateral for their positions. Throughout this process, losses calculated on the basis of current market prices and any potential future price risks must be covered to help ensure that a collateral shortfall does not arise prior to the next calculation of margin requirements.

Membership. The requirements for clearing membership establish clearly defined conditions with respect to the creditworthiness of Exchange members participating in the clearing process. This is a key component of the protection provided by the Eurex system.

The approximately 90 members of Eurex Clearing are categorized as either Direct clearing members (“DCMs”) or General clearing members (“GCMs”). DCMs are permitted to clear transactions only on their own behalf and on behalf of affiliated non-clearing members (“NCMs”). GCMs are the

only clearing members who may clear transactions on behalf of nonaffiliated NCMs. Credit institutions, banks, and other financial institutions that are regulated by a member country of the European Union or Switzerland may become clearing members (as can the branch offices of those entities if the branch office is comprehensively regulated by a European Union member state or Switzerland). Eurex Clearing may revoke or suspend a firm's clearing status if such firm fails to satisfy the qualifications necessary for clearing membership.

DCMs are required to have at least €12.5 million (approximately \$13.5 million) in regulatory equity capital, calculated in accordance with the laws and regulations applicable to the relevant branch of the institution acting as a clearing member. GCMs must have at least €125 million (approximately \$135 million) in regulatory equity capital, as similarly calculated. Eurex Clearing may demand from its clearing members such information and evidence as may be necessary for it to verify the net equity of any clearing member. In addition to the above, issuance of the appropriate license as a DCM or a GCM requires that the member: (i) satisfy the Guarantee Fund requirements described below; (ii) maintain current accounts with (A) the Swiss central bank, and (B) the German central bank (Deutsche Bundesbank) or an institution that has a correspondent relationship with a member of Deutsche Bundesbank; and (iii) maintain the technical installations and personnel necessary for back-office clearing operations.

Clearing Guarantee Fund. Additionally, each clearing member must provide collateral – in the form of cash, securities or a guarantee from a third-party bank – to the Clearing Guarantee Fund. Each GCM must provide collateral in the amount of €5 million (approximately \$5.4 million); each DCM must provide collateral in the amount of €1 million (approximately \$1.08 million). Any collateral that is drawn by Eurex Clearing must be restored to its original amount by the GCM or DCM within ten trading days. In its discretion, Eurex Clearing may use funds from its annual surplus to set aside reserves to contribute to the performance of the commitments of any defaulting clearing member. The Clearing Guarantee Fund is currently funded at a level of approximately €530 million.

Default Provisions. If a clearing member defaults, any resulting losses are covered by the following sources in the following order of priority: (i) margin funds of the defaulting clearing member; (ii) the clearing guarantee of the defaulting clearing member; (iii) the discretionary reserve fund created by Eurex Clearing; and (iv) the clearing guarantees of the other clearing members of Eurex Clearing.

Regulatory Oversight. Eurex Clearing is supervised by the Exchange Supervisory Authority of Hesse. Eurex Clearing, in turn, permits clearing licenses to be issued only to licensed banks or financial services institutions domiciled in the European Union or Switzerland, thereby ensuring that clearing members are additionally subject to oversight by the bank supervisory authorities in their country of origin.

### ***Eurex.***

The Eurex exchanges, Eurex Deutschland and Eurex Zürich (collectively, “Eurex”), were formed in 1998 as the result of the merger of Deutsche Terminbörse and the Swiss Options and Financial Futures Exchange. Both exchanges trade the same products, on the same system, and a member of

one exchange is automatically deemed to be a member of the other. During the merger, Eurex Clearing was formed to function as the clearinghouse for Eurex.

Eurex Deutschland is a securities exchange within the meaning of § 1 Para. 5 of the German Exchange Act. As such, it is licensed and supervised by the Exchange Supervisory Authority of Hesse, the competent supreme state authority in the State of Hesse. Eurex Zurich is an options and futures exchange approved under the Swiss Law on Stock Exchange and Securities Trading and supervised by the Swiss Banking Commission (Eidgenössische Bankenkommision).

Eurex is thus supervised in both Germany and Switzerland, in each case to the extent of the respective jurisdiction of the Exchange Supervisory Authority of Hesse and the Swiss Banking Commission. Where the Exchange Supervisory Authority of Hesse and the Swiss Banking Commission deem it appropriate to take supervisory measures abroad, such measures are implemented by means of administrative or legal cooperation established under agreements with the authorities in other countries. Thus, Exchange Supervisory Authority of Hesse acts through the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, or "BaFin") if it needs to obtain information from a foreign government.

Admission to Trading. Applicants to Eurex must meet the conditions of membership to participate directly in exchange trading as a member. These conditions include, among others: regulation by the regulatory authorities in the country where the applicant is organized or does business; participation in the clearing process either directly, as a clearing member of Eurex Clearing, or indirectly, through a GCM-NCM Agreement with a clearing member; and fulfillment of the technical requirements including maintenance of specified hardware and software, as well as observance of prescribed network requirements.

### ***USFE.***

Eurex formed USFE, a U.S.-based futures exchange, in 2003. USFE was designated by the Commission as a contract market on February 4, 2004. USFE currently lists for trading futures contracts on U.S. Dollar-denominated interest rate products. Products traded on USFE are not included in the Euro Link.

Both USFE and Eurex are fully electronic exchanges. Members of Eurex and USFE must apply separately to each of the exchanges. Members of USFE must be a clearing participant of The Clearing Corporation or have a relationship with a clearing participant that has agreed to accept the member's trades for clearing.

The Clearing Corporation serves as the derivatives clearing organization for USFE. Thus, for all transactions executed on USFE, The Clearing Corporation becomes the central counterparty.

### **The Global Clearing Link.**

When fully implemented, the Global Clearing Link will permit a trader executing transactions on either Eurex or USFE to have its positions cleared either by a clearing participant at The Clearing Corporation, the designated Clearing House for USFE, or a clearing member of Eurex Clearing, the designated Clearing House for Eurex. In addition, certain Euro-denominated products would be cross-listed on both Eurex and USFE during Phase II of the Global Clearing Link. Thus, when the Global Clearing Link is fully implemented, traders will be able to establish or offset in Euro-denominated products interchangeably, on Eurex or USFE, and clear their trades and maintain their positions at either The Clearing Corporation or Eurex Clearing. Dollar-denominated products, which will continue to be listed only on USFE, will not be traded on Eurex but would be able to be cleared through either Clearing Corporation participants or members of Eurex Clearing. It is expected that this flexibility has the potential to result in significant savings for market participants, reduce systemic risk by facilitating portfolio margining and reducing unnecessary movements of capital, and provide traders and other market users with greater liquidity.

### ***Primary, Destination and Home Country Clearing Houses.***

The key concepts underlying the Global Clearing Link are embodied in the definitions that describe the relationships between and among the two markets (USFE and Eurex) and their Clearing Houses. These relationships are defined as the Primary Clearing House, Destination Clearing House and Home Country Clearing House for the contracts traded on each of the Exchanges.

The Clearing Corporation is the “Primary Clearing House” for trades executed at USFE; Eurex Clearing is the “Primary Clearing House” for trades executed at Eurex. Each of the Primary Clearing Houses has a contractual relationship with the relevant exchange – The Clearing Corporation has a Clearing Services Agreement with USFE and Eurex Clearing has a Clearing Services Agreement with Eurex Frankfurt AG, the operating company of Eurex Frankfurt.

The “Destination Clearing House” is the Clearing House where a clearing member is admitted for clearing. Thus, The Clearing Corporation is the Destination Clearing House for all Clearing Corporation participants; Eurex Clearing is the Destination Clearing House for all members of Eurex Clearing. (As a result, a market user can indirectly choose its Destination Clearing House by choosing to maintain its account with either a Clearing Corporation participant, in which case The Clearing Corporation will be the Destination Clearing House for all of the trades made by that market user, or with a member of Eurex Clearing, in which case Eurex Clearing will be the Destination Clearing House for all of the trades made by that market user.) The “Home Country Clearing House” is The Clearing Corporation with respect to all U.S. Dollar-denominated products and is Eurex Clearing with respect to all Euro-denominated products, regardless of the exchange on which such trades were executed.

Finally, each Clearing House will be a Special Clearing Member of the other, establishing an omnibus account (as further described below) at the other Clearing House” to hold trades in connection with the Link.

Primary Clearing House Principle. Under the Primary Clearing House principle, the Primary Clearing House for all trades made on one of the exchanges – The Clearing Corporation for trades made on USFE, Eurex Clearing for trades made on Eurex – becomes the central counterparty to those trades. The Primary Clearing House becomes central counterparty for those trades in accordance with its rules, regardless of the parties' choice of Destination Clearing House. Each exchange has revised its Rules accordingly and will require its non-clearing members to enter into an agreement with a clearing member.

Destination Clearing House Principle. Under the Destination Clearing House principle, the Destination Clearing House is responsible for all clearing functions for its participants or members. Thus, the Destination Clearing House is responsible for all obligations of its clearing members to the other Clearing House, irrespective of whether its clearing members perform. The Destination Clearing House also is responsible for all obligations to its clearing members, regardless of whether the other Clearing House performs. The resulting inter-Clearing House risk position is collateralized by credit support provided by each Clearing House to the other, as provided in the Link Clearing Agreement (the "Link Agreement").

The Destination Clearing House has a contractual relationship with, and manages the risks relating to, its participants or members. In cases where the Destination Clearing House is not also the Home Country Clearing House, it will outsource all trade and position management functions (except for processes related to the collection and custody of original margin) to the Home Country Clearing House.

Home Country Clearing House Principle. Conformity of certain rules and procedures is a prerequisite of fungibility of positions. Thus, under the Home Country Clearing House principle, the Home Country Clearing House controls the processing of positions in its Home Country contracts and sets the rules for those products in several areas, as described below. If the Primary Clearing House or the Destination Clearing House is not also the Home Country Clearing House, it will outsource trade and position management functions (except for processes related to collection and custody of original margin) to the Home Country Clearing House as service provider. In this regard, the Primary Clearing House or Destination Clearing House, as applicable, remains legally responsible for all trades and positions as described above, but uses the infrastructure of the Home Country Clearing House to implement related functions and processes. The Clearing Houses intend to enter into a Clearing Link Services Agreement, which will set forth the scope and the relevant service levels for the outsourcing of services from one Clearing House to the other.

## **The Euro Link.**

Functional Description. Under the Euro Link, positions executed on Eurex will be capable of being cleared by Clearing Corporation participants, as well as by members of Eurex Clearing. However,

only those contracts that are permitted to be traded on Eurex terminals in the United States pursuant to Commission no-action letters will be eligible for clearing through the Euro Link.<sup>1</sup>

Omnibus Accounts and Technical Clearing IDs. Each Clearing House will establish an omnibus account at the other Clearing House to hold Link-related positions. Thus, Eurex Clearing will become a Special Clearing Member of, and establish an omnibus account with, The Clearing Corporation to hold Euro Link positions, and *vice versa*. In addition, Eurex Clearing, acting as the Home Country Clearing House for Euro Link contracts, will set up an account (“Technical Clearing ID Account”) for each Clearing Corporation participant. The Technical Clearing ID Accounts will be used by Eurex Clearing – the Home Country Clearing House – as service provider to support the activities of The Clearing Corporation with respect to Euro contracts.

The omnibus account represents the sum of the obligations of the Technical Clearing ID Accounts. The Clearing Corporation will be liable for the obligations of its clearing participants, and Clearing Corporation participants do not have any legal rights against Eurex Clearing with respect to Euro Link contracts.

Linked Transactions. The relationship between Eurex Clearing and The Clearing Corporation will be governed by a Link Agreement, a Clearing Link Services Agreement, and the Rules of the Clearing Houses.<sup>2</sup> Consistent with the Home Country Principle, The Clearing Corporation has conformed its rules to those of Eurex Clearing with respect to the Euro Link contracts. Accordingly, The Clearing Corporation’s rules conform to Eurex Clearing’s rules with respect to: settlement prices; calculation of variation margin; cash management (except original margin) and banking facilities; end of clearing day (accounting cut-off); delivery notification and allocation procedure; option exercise and assignment; trade and position management; give-up and take-up processing; position transfer; deliveries; system access; trade data reporting; timelines, holiday calendars, time schedules and deadlines.

In addition, Eurex Clearing will act as service provider to The Clearing Corporation for Euro Link contracts with respect to the notification and allocation process for physically settled futures contracts; the exercise and assignment process for options; and the variation margin calculation and collection process with respect to its own members and, with respect to the Technical Clearing IDs,

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<sup>1</sup> Specifically, they are: Euro Schatz Futures and Options on Euro Schatz Future; Euro Bobl Futures and Options on Euro Bobl Future; Euro Bund Futures and Options on Euro Bund Future; Euro Buxl Futures; One-Month EONIA Futures; Three-Month EURIBOR Futures; Options on Three-Month EURIBOR Futures; Dow Jones Euro STOXX<sup>SM</sup> 50 Futures; Dow Jones STOXX<sup>SM</sup> 50 Futures; DAX<sup>®</sup> Futures; Dow Jones Global Titans 50<sup>SM</sup> Futures; Dow Jones STOXX<sup>SM</sup> 600-Banks Future; and Dow Jones Euro STOXX<sup>SM</sup> Banks Futures (“Euro Link contracts”).

<sup>2</sup> The Rules of The Clearing Corporation are being submitted in the form in which they are proposed to be amended. (For the convenience of the Commission, we also have included an additional copy that has been marked to show all changes from the Rules of The Clearing Corporation as presently in effect.) Corresponding amendments to the Rules of Eurex Clearing also are enclosed. The implementation of those Rules has been delayed pending authorization of the Global Clearing Link by the Commission.

on behalf of (and for the account and risk of) The Clearing Corporation. Each of the Clearing Houses applies its own rules, however, with regard to collection of original margin; custody and use of margin; membership rules and conditions; and default penalties and procedures.

Becoming Central Counterparty. Pursuant to the Primary Clearing House principle, Eurex Clearing will interpose itself as the central counterparty to each trade made in a Euro Link contract, either directly with its members, or with The Clearing Corporation as a Special Clearing Member. Under the Euro Link, The Clearing Corporation, as the Destination Clearing House for its clearing participants, becomes the central counterparty to its clearing participants simultaneously, and in parallel, to Eurex Clearing. Thus, The Clearing Corporation will never accept or be required to accept a trade in a Euro Link contract in its capacity as Special Clearing Member unless Eurex Clearing, the Primary Clearing House for all Euro Link contracts, also does so.

Trade Execution and Confirmation. Trades in Euro Link contracts will be captured by Eurex and transmitted directly to Eurex Clearing, the Primary (and Home Country) Clearing House, and The Clearing Corporation as Destination Clearing House. The Eurex trade execution platform will generate trade confirmations. The Eurex platform will also be used for post-trade management (such as give-ups and take-ups), which will be confirmed by both of the Clearing Houses.

Data Exchange and Reconciliation. The Clearing Corporation and Eurex Clearing will exchange data with each other during the hours when they are both fully operational, as well as at the end of their respective business days. The data to be reconciled will be both static (product, market and participant or clearing member) and dynamic (risk management, trade- and position-related). The Clearing Houses have agreed to reconcile with each other on at least a daily basis and have further agreed to reconcile the following information: transactions and positions; cash balances, variation margin, and credit support coverage; delivery obligations and fulfillment; and master reference data. Any differences identified during the reconciliation process will be resolved immediately between the Clearing Houses.

Trading Hours. The Bund, Bobl, Schatz, Buxl, and one month Eonia contracts currently trade from 8:00 a.m. until 7:00 p.m. The three month Euribor trades from 8:30 a.m. until 7:00 p.m.; the Dow Jones Global Titans<sup>SM</sup>, Dow Jones STOXX<sup>SM</sup>, Dow Jones Euro STOXX<sup>SM</sup> 50, Dow Jones STOXX<sup>SM</sup> 600-Banks and Dow Jones Euro STOXX<sup>SM</sup> 600 Banks trade from 9:00 a.m. until 8:00 p.m.; and the DAX<sup>®</sup> contract trades from 8:50 a.m. until 8:00 p.m. (all times Frankfurt time). It is not anticipated that any of these times will be changed as a result of the introduction of the Euro Link.

Holidays. Eurex will set the trading calendar for Euro Link contracts. The Clearing Corporation will be available for clearing (even if it is a Clearing Corporation holiday) on each day that there is trading in Euro Link contracts, although certain operational functions (such as the collection of original margin on days when banks in Chicago and New York are closed) may be delayed until the next business day at the relevant Clearing House.

Position Keeping. Eurex Clearing maintains records by account type for its clearing members (and NCM trading members) and will also do so for positions held in the accounts of Clearing Corporation participants (including any NCMs who clear through such participants). An account indicator is used by the Eurex trading member at the time of order entry to specify the account that is to be used by the Clearing House.<sup>3</sup>

Original Margin. The Clearing Corporation will collect and hold original margin collateral from all Clearing Corporation participants. Consequently, and subject to regulatory approval, Clearing Corporation participants will be able to maintain house and customer margin accounts at The Clearing Corporation for both Dollar-denominated contracts traded on USFE and Euro-denominated contracts executed on Eurex. In this regard, and as explained in further detail in a separate letter from our counsel, we are requesting that the Commission take steps to permit funds that are subject to customer segregation requirements for USFE transactions to be commingled at The Clearing Corporation and by futures commission merchants with the “secured amount” that is required to be set aside by futures commission merchants in respect of Euro Link contracts.

Original margin will not be transferred between the Clearing Houses. Eurex Clearing, as the Home Country Clearinghouse, will provide The Clearing Corporation with the necessary open position information to enable The Clearing Corporation to perform original margin calculations and other risk management functions. The Clearing Corporation’s Rules already specify the acceptable forms of original margin collateral, and The Clearing Corporation will establish original margin requirements for Euro Link contracts under its own Rules and using its own methodology.<sup>4</sup> USFE has advised The Clearing Corporation that it will, in turn, permit its members to use the same inter-market offsets used by The Clearing Corporation when calculating the amount of initial margin required from their customers. A copy of the draft USFE bulletin is attached.

Variation Margin. Variation margin for Euro Link contracts will be denominated and due in Euros. Eurex Clearing as a service provider will calculate the variation margin for Euro Link contracts and transmit such information to The Clearing Corporation.

Under the Link, Eurex Clearing will exchange (through collections and deposits) variation margin for Euro Link contracts with (i) its own clearing members, (ii) on behalf of The Clearing

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<sup>3</sup> The Eurex Clearing system records all trades and positions in one of five account types. So-called A1, P1 and P2 accounts are maintained on a gross basis; M1 and M2 (market-maker) accounts are maintained on a net basis.

<sup>4</sup> The Clearing Corporation calculates the original margin requirements using SPAN®. SPAN® is a registered trademark of Chicago Mercantile Exchange Inc. and is used herein under license. Chicago Mercantile Exchange Inc. assumes no liability in connection with the use of SPAN® by any person or entity. In contrast, Eurex Clearing uses a different risk-based original margin calculation method based on the TIMS™ methodology. (TIMS™, or Theoretical Intermarket Margining System, was first developed and continues to be used, in somewhat modified form, by The Options Clearing Corporation.) Both calculation methods are “state of the art,” and the Clearing Houses have agreed to coordinate the relevant input parameters to ensure that their respective margin systems will yield comparable results for the same positions and portfolios.

Corporation, with Clearing Corporation participants (the Technical Clearing IDs), and (iii) if necessary due to a default by a Clearing Corporation participant, The Clearing Corporation itself. Thus, Eurex Clearing will exchange variation margin directly with its own members and also, as an agent of The Clearing Corporation, with Clearing Corporation participants, transferring funds to and from the accounts of Clearing Corporation participants on a net basis.

The Clearing Corporation will require its participants to open an account with Deutsche Bundesbank (if eligible) or a correspondent bank that holds an account at Deutsche Bundesbank and to grant Eurex Clearing a power of attorney enabling Eurex Clearing directly to debit and credit on behalf of The Clearing Corporation variation margin from and to each participant's variation margin settlement account.<sup>5</sup>

Although the variation margin obligations of The Clearing Corporation as a Special Clearing Member to Eurex Clearing will ordinarily be fulfilled by Clearing Corporation participants, The Clearing Corporation is actually the contractual counterparty to Eurex Clearing, and thus is liable to Eurex Clearing for any portion of the variation margin that is not provided by one or more participants. Accordingly, The Clearing Corporation, as a Special Clearing Member of Eurex Clearing, will also open a variation margin settlement account and grant a power of attorney to Eurex Clearing over that account. The Clearing Corporation's account will be assessed by Eurex Clearing only in the event that variation margin is not received by Eurex Clearing from a Clearing Corporation participant. (In such circumstances, The Clearing Corporation will seek recourse directly from its own defaulting participant.) The Clearing Corporation would remain liable to its clearing participants in the unlikely event that Eurex Clearing were to fail to pay variation margin that is owed to participants.

The Clearing Corporation calculates and calls for original margin once each day and variation margin two times each day for contracts traded on USFE. Specifically, The Clearing Corporation calculates original margin (using SPAN and intraday position information) and variation margin (using intraday prices and positions) in the middle of each trading day, at approximately 2:00 p.m. Chicago time, makes a corresponding routine settlement call at 2:15 p.m. Chicago time, and requires payment confirmation from its clearing participants' settlement banks by 3:15 p.m. Chicago time. In the evening, after the completion of post-trade processing (at approximately 9:00 p.m. Chicago time), The Clearing Corporation calculates original margin (using SPAN and end-of-day positions) and variation margin (using end-of-day settlement prices and positions) and makes a corresponding routine settlement call in the morning on the next trading day, at 5:40 a.m. Chicago time, with settlement bank payment confirmation required by 6:40 a.m. Chicago time.

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<sup>5</sup> The Link Clearing Agreement between The Clearing Corporation and Eurex Clearing permits The Clearing Corporation to act for its participants in effecting variation margin settlements. In other words, The Clearing Corporation would in such circumstances establish the necessary banking relationships for its clearing participants, thereby making it unnecessary for them to do so themselves. It is not known at this time if The Clearing Corporation will ultimately offer such a service and, if so, to what extent Clearing Corporation participants will choose to avail themselves of this service or choose instead to establish and maintain their own banking arrangements.

For Euro Link contracts, The Clearing Corporation will continue to calculate and call for original margin. However, The Clearing Corporation will outsource to Eurex Clearing all variation margin calculations and calls. Eurex Clearing calculates original and variation margin once a day during its end-of-day batch processing and issues a routine settlement call in the morning on the next trading day.

The Clearing Corporation's risk management systems continuously calculate the risk position of each of its clearing members, however, and The Clearing Corporation can issue a special call for intra-day margins (additional original margin for Euro Link contracts) from one or more clearing participants based on the risk associated with their positions. Eurex Clearing also can calculate and call for additional variation margin on a non-routine basis at any time during the day.

Segregation. In order for The Clearing Corporation to know which trades (and the related margin and profits) of a clearing participant are customer origin trades that must be segregated from the trades made for the participant's house account, an account type code is used at order entry by the Eurex trading member to indicate whether the clearing participant is clearing on behalf of a customer and therefore, whether segregation is required for the trade and any associated margin deposits. (The responsibility to identify the correct account type lies with the Exchange member that is making the trade. This is consistent both with industry practice in the United States and Commission Regulations.) Based on this account information, The Clearing Corporation will collect and hold original margin collateral from its clearing members in either a segregated or "house" (non-segregated) account.

Settlement Prices. Settlement prices are used for valuing positions, calculating variation margin, and realized and unrealized profits and losses. Eurex Clearing will calculate the settlement prices for all Euro Link contracts at approximately 8:00 p.m. Frankfurt time, before batch processing starts. The Clearing Corporation may set its own settlement prices for Euro Link contracts if necessary for risk management – *i.e.*, for purposes relating to the calculation of original margin, but it cannot use such prices for purposes of calculating daily variation margin requirements. The Clearing Corporation retains the authority to set its own settlement prices at any time to recalculate the obligations of its clearing participants and to collect those sums through the original margin process. In addition, in case of an emergency, The Clearing Corporation can direct Eurex Clearing to collect additional margin intra-day through a manual pay/collect process executed by Eurex Clearing.

Cash Settlement and Other Cash Transactions. The stock index, Euribor and EONIA futures contracts traded on Eurex are cash-settled. Eurex Clearing will manage the cash settlement of all such Euro Link contracts as a final variation margin payment. Eurex Clearing will also administer premiums, fees, and fines related to the Euro Link contracts. Although these cash obligations are fulfilled by Clearing Corporation participants in the first instance, The Clearing Corporation remains liable to pay those amount in the event of a failure to pay or other default by one or more of its participants.

Delivery. The Euro-denominated bonds and notes traded on Eurex (*i.e.*, the Euro Bund, Euro Bobl and Euro Schatz) provide for physical settlement and The Clearing Corporation has conformed its

delivery rules to those of Eurex Clearing for those contracts. The Clearing Corporation will authorize Eurex Clearing to administer the delivery process with respect to its clearing participants (and upon a failure to deliver or pay or other default by a clearing participant, with respect to The Clearing Corporation itself). Thus, Eurex Clearing will establish and carry out delivery procedures for its German bond and note futures with respect to its own members, Clearing Corporation participants, and The Clearing Corporation, as Special Clearing Member.

Clearing Corporation participants, therefore, will be required by the rules of The Clearing Corporation to satisfy their delivery obligations in the home (European) market for the underlying bonds and notes. This requires the establishment and maintenance of a Settlement account at Clearstream Banking Frankfurt AG (“Clearstream”) or at a custodian bank that has an account at, and granting a power of attorney authorizing Eurex Clearing to directly debit or credit that settlement account. Because all deliveries are effected directly between Eurex clearing member accounts (including for this purpose, the Technical Clearing ID accounts that will be established for Clearing Corporation participants), The Clearing Corporation does not need to open an account at Clearstream (or at a custodian bank that holds an account at Clearstream). The Clearing Corporation nonetheless remains liable to Eurex Clearing for any loss resulting from a delivery default by its clearing participants. The Clearing Corporation will amend its rules to apply to its clearing participants the same default procedures that Eurex Clearing applies to its clearing members.

Delivery Process. For European bond and note futures, the delivery notification process will follow Eurex Clearing processes, and The Clearing Corporation will conform its rules to so provide. Under those procedures, the short on a European bond or note future must make delivery on the one day identified in the Clearing Houses’ rules as the “delivery day” for such products (ordinarily, the tenth calendar day of the delivery month). Clearing members with open short positions in European bond or note futures must notify Eurex Clearing which debt securities they will deliver on the delivery day. Such notice must be given during the period between the close of trading and the end of the Post Trading Full Period (as defined in the Rules of Eurex Clearing) two Exchange days before the delivery day. Although The Clearing Corporation, as Special Clearing Member, is ultimately responsible for deliveries to be made to and by its clearing participants, Clearing Corporation participants will be required to submit their delivery notifications to Eurex Clearing, as Home Country Clearing House and service provider to The Clearing Corporation. After the end of the Post-Trading Period on the notice day, Eurex Clearing will allocate to both its members and Clearing Corporation participants with open long positions the debt securities notified for delivery, using a procedure that ensures the neutrality of the allocation process.

Eurex Clearing will inform The Clearing Corporation and each clearing participant of the rights or obligations of each such participant to receive or make a particular delivery. On the delivery day, Eurex Clearing as attorney-in-fact will effectuate the deliveries by issuing settlement instructions for the appropriate settlement accounts. The impact of this arrangement is to expose those market participants clearing through The Clearing Corporation to the entire available deliverable supply for

such instruments in their normal cash marketing channels, consistent with the standard set for designated contract markets by Commission Guideline No. 1 (17 C.F.R. Part 40, Appendix A(a)(3)).

Option Exercise. The Clearing Corporation will, for Euro Link option contracts, adopt rules relating to the exercise and assignment that conform to those of Eurex Clearing. A Clearing Corporation participant using the Euro Link will submit an option exercise instruction directly to Eurex Clearing, although The Clearing Corporation is ultimately responsible for such instructions and the performance of the resulting obligations. Once it receives the exercise instructions, Eurex Clearing will make the option exercise assignments, using its own system, to members of Eurex Clearing and/or Clearing Corporation participants. Once the assignment process is completed, Eurex Clearing will notify affected Clearing Corporation participants and The Clearing Corporation of any such assignments.

Information Sharing. The Clearing Houses consider it to be vitally important that there be satisfactory arrangements in place for the sharing of information relating to financial risk. In addition to the information-sharing arrangements envisioned by the Link Agreement, The Clearing Corporation and Eurex Clearing are both signatories to international arrangements for the sharing of financial information relating to their members. The Commission and BaFin also have arrangements in place for the sharing of information and cooperation.<sup>6</sup>

***Public Interest Considerations.***

The Euro Link will provide market participants with a number of benefits. First, the Euro Link permits those market users who already trade on Eurex the opportunity to clear their positions through Clearing Corporation participants, using their existing arrangements with The Clearing Corporation and The Clearing Corporation's electronic infrastructure and banking relationships. By clearing their Eurex positions through Clearing Corporation clearing participants, market participants also have an opportunity to reduce their clearing costs and to use their capital more efficiently through the margining of their entire risk portfolio. Moreover, to the extent that market participants may be required to maintain their funds on deposit in the United States, the Euro Link enables them to do so. Finally, the ability to use portfolio margining makes the over-all system for funds transfer more efficient by reducing unnecessary, offsetting payments and by substituting appropriately correlated positions in related contracts for other forms of collateral.

The public interest in permitting Clearing Houses to link operations has long been recognized and encouraged by the Commission. The Commission has almost twenty years experience with

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<sup>6</sup> These include an October 17, 1997 Memorandum of Understanding between the Commission and Bundesaufsichtsamt für den Wertpapierhandel ("BaWe"), the predecessor to BaFin; the March 15, 1996 Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations (the "Boca Declaration"), to which BaWe and the Commission are parties; and a Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information of the International Organization of Securities Commissions dated October 16, 2003.

James L. Carley  
J. Michael Gorham  
April 26, 2004  
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overseeing link arrangements, none of which has had any adverse effect on the public, market users or the financial system generally. The Euro Link can be expected to offer the public and market users the benefit of greater market efficiencies, while posing no greater or different regulatory or financial risk than existing Clearing House link arrangements.

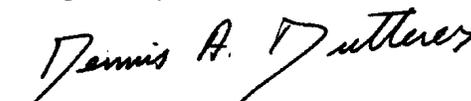
**Action Requested.**

The Clearing Corporation has previously undertaken not to establish a linked clearing arrangement with Eurex Clearing without prior Commission approval or permission. Although few formal regulatory actions are required by the Commission or its staff to make the Euro Link effective, Commission action to permit the commingling of customer segregated funds and the foreign futures or foreign options secured amount will be required before the Euro Link can be made fully effective. In support of that request, we are also providing supporting documentation which includes: proposed amendments to the Rules of The Clearing Corporation that, if acceptable to the Commission, will at a later date be self-certified pursuant to Commission Rule 40.6; drafts of the Link Clearing and Link Clearing Services Agreements between The Clearing Corporation and Eurex Clearing; and a draft USFE Bulletin relating to the margin treatment of customer positions in Euro Link contracts. Amendments to the Rules of Eurex Clearing will be submitted shortly.

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We appreciate the Divisions' consideration of this matter. Please feel free to call Kenneth Rosenzweig at 312-701-8354, Nancy Brooks at 312-786-5711, Daniel Waldman at 202-942-5804, or Ekkerhard Jaskulla at 011-49-69-2101-5133, if you have questions or if you would otherwise like to discuss these matters further.

Respectfully submitted,

  
Dennis A. Dutterer

Enclosures

cc: John C. Lawton  
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