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Loss-Sharing Overview

There are three points where payment obligations may be created between the participating clearing organizations. Each is designed to accomplish a specific objective.

1) The primary evaluation of the loss-sharing obligation is based on the liquidation of the contracts that were actually used to form inter-exchange spreads under the agreement. This evaluation establishes the initial loss-sharing payment and isolates the cross-margining losses from other profits or losses either clearing organization may experience on the liquidation of its other positions or due to its participation in other loss-sharing arrangements.

   This "product level" loss-sharing payment could ultimately create or worsen a clearing organization's overall deficit. Because these payments could ultimately create or worsen a clearing organization's overall deficit, product level loss-sharing payments are sometimes capped at an amount that is fair and reasonable but is less than the maximum payment that could occur.

2) The second type of payment that may pass between clearing organizations is referred to as "payment forgiveness." Under payment forgiveness, each clearing organization determines its total profit or loss given the liquidation of all positions and collateral for the defaulting clearing member origin and given any other loss-sharing payments it makes or receives under other cross-margining arrangements.

   If a clearing organization that was the beneficiary of an initial loss-sharing payment liquidates the entire clearing member portfolio to a surplus, the loss-sharing payment will be forgiven. Depending on the size of the surplus and the participation of multiple clearing organizations, a payment may also be partially forgiven. Payment forgiveness will not create or worsen a clearing house's overall deficit.

3) The third type of payment that may pass between clearing organizations is referred to as "payment maximization." The maximum loss-sharing payment that may pass between two clearing organizations is the sum of the beneficiary's foregone margin (the Cross-Margin Reduction) and the payer's Net Surplus on the liquidation of the Offsetting Contracts. Because product level loss-sharing obligations are established prior to the time when either clearing organization will know the overall surplus or deficit on the entire clearing member origin, product level loss-sharing payments will not always result in the maximum payment being made.

   If, after determining the Proprietary Account Surplus and performing payment forgiveness, one clearing house has a remaining Proprietary Account Surplus while another has a deficit, an additional payment will be made that is the lesser of a) the payer's remaining surplus, b) the beneficiary's remaining deficit, or c) an amount that would achieve a total payment by the payer equal to the maximum payment.

Payment maximization is designed to minimize systemic risk by reducing the possibility and potential size of a clearing house deficit while ensuring that the payments between clearing houses are still directly traceable to the Offsetting Contracts.

Detailed Description – For Use in Interpreting the Examples

This section summarizes both the basic and the specific loss-sharing characteristics that are described in the agreement and shown in the examples included as Exhibit H.

1) Loss-sharing obligations will be created based on the liquidating profits and losses (Net Loss and Net Surplus) on the Offsetting Contracts. This "product trigger" is the primary trigger for loss-sharing, although it may not result in the absolute maximum loss-sharing payment allowed under the agreement. For simplicity, the loss-sharing based on the Offsetting Contracts will be referred to here as "product level loss-sharing."

2) The Net Loss or Net Surplus on the Offsetting Contracts includes the proceeds from the liquidation of the Offsetting Contract positions and the performance bond collateral supporting those positions.

3) In the case where neither party has a liquidating deficit on the offsetting contracts, no product level loss-sharing payment will be made regardless of the relative size of the Cross-Margin Reductions. See Example 1.

4) In the case where the Net Surplus from the liquidation of the Offsetting Contracts on one side exceeds **both** the losses associated with the liquidation of the Offsetting Contracts on the other side and the Cross-Margin Reduction guaranteed to the other (losing) side, the product level loss-sharing obligation will equal the Cross-Margining Reduction (which was "collateralized" by anticipated profits on the other side of the trade) plus any Net Surplus in excess of the Cross-Margining Reduction. See Example 2a.

5) In the case where the Net Loss from the liquidation of the Offsetting Contracts on one side exceeds the Net Surplus from the liquidation of the Offsetting Contracts on the other side, the Cross-Margin Reduction or the principal of elimination of losses will serve as a maximum on the product level loss-sharing payment. The maximum product level loss-sharing payment will be the lesser of the two. See Examples 2b and 2c.

6) In the case where both sides experience a Net Loss on the liquidation of the offsetting contracts, the Cross-Margin Reduction guarantee obligations between the two clearing organizations will be netted. In addition, the clearing house with the smaller Net Loss will make a payment to the other clearing house that will

equalize the distribution of the liquidating profit or loss on the Offsetting Contracts. Except as stipulated in assumption 7. See Example 3a.

7) In the case where the payment described in assumption 6 would result in one clearing organization achieving a surplus position in the Offsetting Contracts, the payment described in assumption 6 will be capped at the amount of the beneficiary's Net Loss on the Offsetting Contracts. See Example 3b.

8) The determination of the Net Surplus/Net Loss for the Offsetting Contracts will be independent of either organization's other cross-margining arrangements since, by definition, a given position can only be spread with a single outside clearing organization.

9) Loss-sharing obligations, or portions thereof, between the two clearing organizations may be forgiven following the liquidation of the entire defaulting portfolio. See Examples 1-3b.

10) Loss-sharing obligations on the Offsetting Contracts will be forgiven if, after liquidating the entire defaulting portfolio and settling any loss-sharing obligations to other clearing organizations, the clearing organization that is the beneficiary of a loss-sharing payment based on the liquidation of the Offsetting Contracts has an overall Proprietary Account Surplus after accounting for all other loss-sharing obligations.

11) Loss-sharing obligations will be forgiven on a pro rata basis based on Cross Margin Reduction (guarantee) amounts if a clearing organization's overall Proprietary Account Surplus is insufficient to forgive all loss-sharing payments it received.

12) Forgiving loss-sharing payments based on overall Proprietary Account Surplus will never take a clearing organization from a surplus to a deficit position. At worst, forgiving loss-sharing payments will reduce a clearing organization's overall Proprietary Account Surplus to zero.

13) Following payment forgiveness, if applicable, an additional payment will pass between clearing organizations if there is an opportunity for payment maximization to occur. See examples 1-3b.

14) Payment maximization will occur if one clearing organization has a remaining Proprietary Account Surplus and the other has a remaining Proprietary Account Deficit, and the clearing organization with a surplus has not yet made the maximum allowable payment to the beneficiary (the maximum allowable payment is equal to the sum of the beneficiary's Cross-Margin Reduction and the payer's Net Surplus on the Offsetting Contracts).

15) Payment maximization will occur on a pro rata basis based on each beneficiary's Cross-Margin Reduction (guarantee) amounts if a clearing organization's overall Proprietary Account Surplus is insufficient to make the maximum payment to all other clearing organizations with deficits.

16) Payment maximization will result in a payment that is the lesser of a) the payer's remaining surplus, b) the beneficiary's remaining deficit, or c) an amount that would achieve a total payment by the payer equal to the maximum payment.

17) Payment maximization may result in a payment passing from a clearing organization that was the original beneficiary of a product level loss-sharing payment to the party that originally made a product level loss-sharing payment.

18) Payment maximization will neither create nor worsen a clearing organization's overall Proprietary Account Deficit.

19) If the clearing organizations cross-margin multiple products, each product will be evaluated separately for purposes of determining the Net Loss or Net Surplus on the Offsetting Contracts and the associated product level loss-sharing obligation.

20) Offsetting loss-sharing obligations between the two clearing organizations (e.g. for different products) will be netted.

The examples referred to in this document are not intended to represent every potential loss-sharing situation that could occur. The examples are illustrative of the types of scenarios, which could occur, and of the application of the loss-sharing principles to these scenarios.