

onExchange™
Clearing Procedures

Introduction

onExchange, Inc. is seeking regulatory approval to operate a futures exchange, the onExchange Board of Trade (ONXBOT or the Exchange). Trades executed on the Exchange will be settled and cleared through onExchange Clearing Corp (ONXCC or the Clearinghouse). Both ONXBOT and ONXCC are wholly owned subsidiaries of onExchange, Inc. Collectively the Exchange and Clearinghouse are referred to as onExchange.

onExchange is a futures market in which market participants, called Subscribers, execute trades directly without an intermediary. Subscriber clearing occurs through a margin system that relates assets on deposit with custody banks to trading accounts maintained at onExchange. The relationship between these accounts and the ONXCC clearinghouse is described below:

Definitions

Subcustody Account: The Subcustody Account is a sub-account of ONXCC's account at the Custody Bank. Each Subscriber has at least one Subcustody Account, which is established by ONXCC uniquely for the Subscriber. The Subcustody Account is used to deposit Margin Eligible Assets for Original Margin, Delivery Margin, and Variation Margin. It is also used to pay and receive all amounts to and from ONXCC. A Subscriber may have multiple Subcustody Accounts at one or more Custody Banks.

Trading Account: A Trading Account is maintained by ONXCC to track open positions, margin requirements, and gains or losses of the Subscriber. The Trading Account also notes the assets (cash, government securities, and foreign currency) held in a Subscribers' Subcustody Account and any letters of credit for the Subscriber's benefit. ONXCC may establish multiple Trading Accounts for a Subscriber at its request.

Settlement Account: The Settlement Account is used to aggregate and net variation margin payments and collections at each Custody Bank. Each Settlement Account will have a net balance of zero at the end of each complete pay/collect cycle as differences are settled against the ONXCC Master Settlement Account. ONXCC will maintain one Settlement Account at each Custody Bank.

Master Settlement Account: An ONXCC account that is used to aggregate and net variation margin flows among ONXCC's Settlement Accounts at each Custody Bank. The Master Settlement Account will have a net balance of zero at the end of the trading day.

Custody Bank: An onExchange-approved Bank, (as described in the Federal Deposit Insurance Act) whose long-term unsecured, unsubordinated debt carries an investment-grade credit rating.

Approved Financial Institution (AFI): An onExchange-approved bank, trust company or other entity that is eligible to issue letters of credit (LCs) for the benefit of Subscribers. A Custody Bank may apply to be an AFI, but Custody Bank status is not required to become an AFI.

Account Structure and Margin Eligible Assets

Before a Subscriber can trade on the Exchange, the Subscriber must deposit Margin Eligible Assets equal to or greater than the original margin requirement of the contemplated transaction. These assets must be deposited in the Subcustody Account that is associated with the Subscriber's Trading Account. ONXCC associates individual assets in each Subcustody Account uniquely with a specific Subscriber Trading Account. In the case of a LC, which is held by ONXCC, the Trading Account will also reflect the AFI issuing the LC and the relevant terms and conditions of the LC.

As described above, all margin eligible assets deposited by Subscribers to margin their positions will be held in a Subcustody Account at an ONXCC Custody Bank. The Account is governed by an agreement between ONXCC and the Custody Bank. Assets in the Subcustody Account belong to ONXCC subject to the rules requiring segregation of Subscriber assets by a clearing organization.

A Subscriber's rights and responsibilities with respect to the account are defined in the Subscriber Agreement with the Exchange (Appendix A). Further, the Custody Bank acknowledges in its agreement with the Exchange that no funds in the account may be used to offset any liability that OnExchange, the Subscriber, or any other third party may owe to the Bank.

Subscribers may meet their Original margin obligations in one or a combination of margin eligible assets: cash; U.S. Treasury securities; foreign currency or a letter of credit drawn on an AFI (ONXCC Rule 5.04). Sufficient margin assets must be posted to a Subscriber's Trading Account before a trade can be matched for the Account.

A. Cash

Cash deposited by Subscribers for use as Original Margin will be held in an onExchange Subcustody Account. All Variation Margin Payments will be made in cash.

B. Securities

All U.S. Treasury securities deposited by subscribers to margin their positions will be held in an onExchange Subcustody Account. These securities will be subject to capital charges set forth below:

- i. A five per cent haircut will apply to all such securities;
- ii. an additional five per cent haircut will be applied if more than nine months has elapsed since the security's issue date;

- iii. an additional five per cent haircut will apply if the security will mature or is capable of being called in more than five years.

C. Approved Foreign Currencies

All Approved Foreign Currencies deposited by subscribers to margin their positions will be held in an onExchange Subcustody Account. These currencies will be marked to market daily and subject to a capital charge of five per cent.

D. Letters of Credit

Letters of Credit (LCs) provided by AFIs will be accepted as margin eligible assets. The Exchange is developing eligibility standards for AFIs in collaboration with leading commercial banks.

The Exchange will limit its concentration risk to individual AFIs by capping the percentage of credit that an AFI can provide to the onExchange marketplace. The concentration risk threshold will be measured on a market share and absolute dollar amount.

Trade Execution

As described in greater detail in ONXBOT Rule 4.05 the following order types may be entered for execution on the Exchange: (1) market orders; (2) limit orders; and (3) certain contingency orders.

A Subscriber may designate one or more Authorized Traders to execute trades on its behalf. A Subscriber may place limits on the amount of market risk taken by its Authorized Trader(s).

Authorized Traders may execute futures transactions during the hours that a contract market is open for trading as prescribed by the Exchange. onExchange will set trading hours as part of its contract rules.

The Exchange's trading and clearing systems are designed to operate 24 hours daily, seven days weekly. It is contemplated that the systems will be taken off line once weekly for two to three hours to accommodate maintenance and upgrade.

Upon entering an order for execution, the trader will be prompted to confirm the specific elements of the transaction. Following this step, the order is entered into the trading system.

When the order is matched, the system will check that the Trading Account has sufficient assets to meet the required Original Margin. If the account has insufficient assets, the order will be

placed on system hold and the initiating trader and Subscriber will be notified of the deficiency. The trade will not be cleared. Exchange Compliance Staff also is notified of this condition.

If the account has sufficient assets, the trade is matched and accepted for clearing, which occurs instantly. Confirmation notices will be sent to both counterparties by electronic means.

Members may modify cancel orders at any time prior to match, although alterations will cause orders to lose time priority under certain circumstances (ONXBOT Rule 4.05 (d)).

Margin Requirements and Procedures

Original Margin

Original Margin levels are established in the contract rules and may be amended as necessary by the Exchange. The appropriate level will be based on an analysis of market volatility and other conditions. In no case will Original Margin levels will be less than three times the Daily Price Limit of the contract market (ONXBOT 3.01).

Original Margin levels must be maintained in a Trading Account at all times. Original Margin deficiencies may be remedied by posting of additional Margin Eligible Assets.

Open and Closed Contract Equity Amounts

A Subscriber's Trading Account will be revalued continually based on general market conditions or conditions unique to the Subscriber. For example, routine revaluations will coincide with the end of day settlement run and every time an open contract position is offset. Additionally, limit price moves, low or deficient margin assets in a particular Subscriber's Trading Account(s), or other conditions specified in Contract rules may also prompt revaluations.

Revaluations will correspond to scheduled pay/collect or variation margin cycles only coincidentally. When a revaluation occurs, Trading Account gains and losses will be credited or debited to a Subscriber's Trading Account and treated according to ONXCC Rule 5.06 and Rule 5.07 as appropriate. Specifically, gains in a Subscriber's Trading Account may be applied to Original Margin requirements for new positions, while net losses will reduce the Subscriber's capacity to support Original Margin obligations.

Variation Margin

As specified in the rules of each contract, ONXCC will assess Variation Margin and make Variation Margin calls (ONXCC Rule 5.08) to convert the open contract equity amounts described above to cash. In effect, a Variation Margin call initiates the pay and collect cycle for gains and losses carried as open equity amounts in the Subscriber's Trading Account.

Subscribers must pay all required amounts upon a variation margin call in U.S. dollars.

A variation margin call is made by notifying the Subscriber of the amount of the call and the affected accounts. Simultaneously, the Clearinghouse will instruct Custody Banks to move the required amount of margin assets from the Subcustody Account(s) of the Subscriber who owes the margin to the ONXCC Settlement Account at the Bank. ONXCC will maintain an electronic record of time that margin call notifications are sent. Subscribers will be responsible for receiving these notifications

Variation margin will be netted at the Custody Bank level. Variation margin collected from Subcustody accounts within a Bank will be transferred to Subcustody accounts within the Bank that are due to receive variation margin. Net balances in the Settlement Account will be wired to the ONXCC Master Settlement Account and redistributed so that all Trading Accounts are reconciled to the current settlement mark.

ONXCC reserves the right to make intra-day variation margin calls at its sole discretion.

Payment and Collections

ONXCC will maintain a separate Settlement Account at each Custody Bank. These accounts will be used to aggregate funds from subscribers' Subcustody Accounts to facilitate pay/collects. When pay/collects occur, cash is collected from market losers and paid to market winners with the payments flowing through ONXCC's Settlement Account.

At 8:00 a.m. daily ONXCC will instruct Custody Banks to move any Variation Margin due of payable. to and from individual Subcustody accounts. When the aggregate net balance of the Subcustody accounts within an individual custody bank is a surplus, the surplus amount will be transferred to the ONXCC's settlement account at the Custody Bank and forwarded to a Master Settlement Account.

The surplus funds will be sent to Custody Banks with net negative balances in the settlement account and redistributed to the appropriate Subcustody accounts. ONXCC will reconcile account balances daily to ensure agreement among its Master Settlement Account, Custody Accounts, Subcustody Accounts and Trading Accounts.

ONXCC's Custody Banks will have no information with respect to the futures positions held by each Subscriber. Custody Banks will be required to confirm the amount of cash, government securities and foreign currency held in each Subcustody Account and fulfill their responsibilities under the Custody Bank Agreement.

Delivery Margin

Delivery Margin will be in the trading accounts of open long and short position holders of contracts that are in the delivery period. Delivery Margin will be released upon completion of the delivery of the commodity or instrument underlying the contract.

Subscriber Defaults

In the event a Subscriber defaults by not meeting a margin call, the Exchange will take control of all Subscriber's open positions and in its discretion take further steps to endeavor to ensure minimum market disruption as specified in ONXCC Rule 7.02. If in liquidating the defaulting Subscriber's positions the proceeds raised are insufficient to cover the shortfall created by the default, ONXCC will make payments owed to the other side of the trade(s) from its own funds. Such payments will be made as provided by ONXCC Rule 7.03.