

CDS CLEAR ARRANGEMENTS

Introduction

In order to develop a compelling and viable offering, LCH.Clearnet SA has harnessed the expertise and the financial resources of certain banks (the **CDS Clear Banks**¹) to develop a credit default swap (**CDS**) clearing service (the **CDS Clear Business**).

LCH.Clearnet SA has developed arrangements for the CDS Clear Business with the CDS Clear Banks, under which part of the cost of developing and operating the CDS Clear Business is borne by the CDS Clear Banks. Accordingly, governance and financial returns from the CDS Clear Business are shared by LCH.Clearnet SA with the CDS Clear Banks.

The CDS Clear Agreement

In order to give effect to the commercial agreement between LCH.Clearnet SA and the CDS Clear Banks, an agreement (the **CDS Clear Agreement**) was entered into in 2012 between LCH.Clearnet SA and the CDS Clear Banks. It has recently been amended to reflect (i) requirements under Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (**EMIR**), and (ii) amended commercial arrangements related to funding and sharing in returns of the CDS Clear Business. The terms of the CDS Clear Agreement currently provide that:

- (a) the CDS Clear Banks, through a company established by those banks, have the right to be consulted with respect to the development and operation of the CDS Clear Business and, as a part of this right, are able to make proposals in respect of certain areas of the CDS Clear Business with no obligation for LCH.Clearnet SA to implement such proposals;
- (b) the CDS Clear Business has established a consultative committee, the majority of the members of which are nominated by the CDS Clear Banks. This consultative committee has consultation rights and can make proposals regarding the CDS Clear Business. LCH.Clearnet SA maintains ultimate authority for directing the CDS Clear Business and, therefore, such consultation and proposal rights are subject to the discretion of LCH.Clearnet SA not to take into account the representations made by the CDS Clear Banks and/or not to implement such proposals;
- (c) LCH.Clearnet SA has established a separate business unit for the CDS Clear Business (the **CDS Clear Business Unit**), with its own Global Head and core staffing team, supported by certain central services shared across the LCH.Clearnet businesses (including Risk, Legal and Compliance). All of the non-central teams report to the Global Head of CDS Clear for the CDS Clear Business;

¹ The CDS Clear Banks are as follows: Banc of America Merrill Lynch International Limited, Barclays Bank Plc, BNP Paribas, Citigroup Global Markets Limited, Credit Suisse Finance (Guernsey) Limited, DB UK Holdings Limited, Goldman Sachs International, HSBC Bank Plc, J.P Morgan Financial Investments Limited, Morgan Stanley Strategic Investment Limited and Société Générale acting through its London Branch.

- (d) the CDSClear Banks and LCH.Clearnet SA have each provided substantial funding to meet the establishment and development costs of the CDSClear Business. Notwithstanding the foregoing, LCH.Clearnet SA has overall control over the operation of the CDSClear Business, including the ongoing funding, and will be responsible for meeting losses arising from the operation of the service;
- (e) the annual surpluses earned by LCH.Clearnet SA in respect of the CDSClear Business will be shared between LCH.Clearnet SA and the CDSClear Banks in accordance with the CDSClear Agreement pro rata their respective funding commitments, where it is expected that such surpluses will be split equally by the financial year 2014; and
- (f) there are customary rights of termination for material breach on the part of both parties. In addition, LCH.Clearnet SA is entitled to terminate the CDSClear Agreement in the situation where the CDSClear service has generated a loss of a certain amount for two consecutive accounting periods, such loss triggering the decision to close the service. Where the CDSClear Agreement is terminated, the CDSClear Banks are entitled to a duplicate licence of the software systems used by LCH.Clearnet SA in favour of another provider. In addition, the CDSClear Agreement contains provisions entitling each party to terminate the CDSClear Agreement in the event of a change in control of the other party. If the CDSClear Banks exercise their right to terminate the relevant agreement with immediate effect on a change of control of LCH.Clearnet SA, LCH.Clearnet SA will be required to reimburse the relevant counterparties for their capital investment incurred (to the extent not previously recovered under the terms of the CDSClear Agreement).