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December 24, 2008

Ms. Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Request for Exemptive Relief

Dear Ms. Harmon:

The market for credit derivatives, and in particular, credit default swaps (“CDSs”) has grown exponentially over the past decade.¹ As this market has grown, the need for operational improvements in the clearing and settlement process has also grown, including the need for a strong central counterparty clearinghouse for these products.² LIFFE Administration and Management (“LIFFE A&M”) has developed and makes available to its members an over-the-counter (“OTC”) derivatives processing service, called Bclear (referred to herein as “Bclear” or the “Bclear Service”), that will provide a mechanism for the processing and centralized clearing of CDSs based on credit default swap indices (“Index CDSs”).³

The Bclear Service processes OTC transactions and submits them for clearance to LCH.Clearnet Ltd. (“LCH.Clearnet”), which stands as the central counterparty to all transactions processed through Bclear.⁴ LIFFE A&M began processing Index CDSs through Bclear on

¹ The Bank for International Settlements estimated that the notional amount of outstanding CDSs in 1998 was approximately \$108 billion. By 2007, that number had grown to approximately \$58 trillion. Bank for International Settlements, Press Release, *The Global Derivatives Market at End-June 2001*, December 20, 2001, and Bank for International Settlements Monetary and Economic Department, *OTC Derivatives Market Activity in the Second Half of 2007*, May 2008.

² The President’s Working Group on Financial Markets included in its recommendations the need to enhance the operational infrastructure for the OTC derivatives markets. *Policy Statement on Financial Market Developments*, The President’s Working Group on Financial Markets, March 2008.

³ LIFFE A&M initially intends to offer the Bclear Service with respect to CDSs on the iTraxx Europe indices and has entered into a license agreement with International Index Company Ltd./Markit Group Ltd. to use the iTraxx Europe indices.

⁴ On October 31, 2008, LIFFE announced changes to its clearing arrangements which, subject to regulatory approval, will be implemented in the first quarter of 2009. These will involve LIFFE A&M becoming the central counterparty to all transactions entered into on the LIFFE market and all transactions which are

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December 22, 2008 for non-U.S. persons and would like to make such service available to certain market participants in the United States on the terms described herein.⁵

We note that the question of whether a particular CDS is a security is a facts and circumstances analysis. In the interest of moving forward with the development of a central clearinghouse for CDSs for US market participants, we have assumed, solely for purposes of this request and without prejudice to any resolution of the issue, that these products are securities. Given this assumption, the offering of the Bclear Service with respect to CDSs to market participants in the United States may raise certain issues under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the rules and regulations promulgated thereunder.

I. Request for Exemptive Relief

We request that the Securities and Exchange Commission (the "Commission") grant the following exemptive relief: (i) on behalf of LIFFE A&M and any of its members, exemptive relief from Section 15 of the Exchange Act by reason of LIFFE A&M or its members not registering under the Exchange Act as broker-dealers; and (ii) on behalf of LCH.Clearnet and any of its members, exemptive relief from Section 17A of the Exchange Act by reason of LCH.Clearnet not registering under the Exchange Act as a clearing agency, in each case, if LIFFE A&M, LCH.Clearnet and any of their respective members make the Index CDS processing and clearance services described herein available to certain market participants in the United States. As explained in more detail below, we believe that the regulatory regime that governs the activities of LIFFE A&M and LCH.Clearnet and their respective members and LCH.Clearnet's risk management controls are sufficiently robust to provide an appropriate level of protection to market participants using the Bclear Service to process and clear Index CDSs. Accordingly, we believe that the granting of the requested exemptive relief is appropriate.

II. The CDS Market

CDSs represent contractual agreements between counterparties, pursuant to which one party (the buyer) pays a premium to the other party (the seller) for protection against the happening of certain credit events. Each CDS contract incorporates the following features: (i) a reference entity (the underlying entity with respect to which the buyer is seeking protection) or in the case

accepted by LIFFE A&M through Bclear, including CDS transactions. Under these arrangements, LIFFE A&M will outsource certain functions to LCH.Clearnet, including those concerning the management of clearing member defaults. At this time, we are not seeking exemptive relief for LIFFE A&M to act as the central counterparty to CDS transactions.

⁵ If, in the future, LIFFE A&M offers the Bclear Service with respect to CDSs on single names, rather than indices, LIFFE A&M and LCH.Clearnet will seek additional exemptive relief before offering such service to market participants in the United States.

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of an index, a group of reference entities; (ii) a reference obligation (upon the occurrence of a credit event, this identifies the lowest seniority of bond that can be delivered); (iii) a term; (iv) a notional amount; and (v) specified credit events that trigger the obligation of the seller to pay the buyer.

As noted above, the CDS market represented approximately 10% of the OTC derivatives market as at December 31, 2007, with notional value outstanding of \$58 trillion out of a total \$596 trillion.⁶ Single name CDS contracts represented 55% of this total with \$32 trillion notional value outstanding; index contracts represent the remaining \$26 trillion. Rapid year on year growth in CDS transactions initially led to trade processing inefficiencies with a significant number of trades being processed manually. Industry participants have since taken significant steps to automate transactions with an overall strategic ambition to ensure the majority of transactions are confirmed and processed in a T+0 timeframe.

Although progress has been made in trade processing, the concentration of the majority of CDS transactions among a relatively small group of major dealers has led to concerns from regulators, including the Commission and the New York Federal Reserve Bank, that the collapse of a major dealer and the potential systemic risk may add significant strain to financial markets. This has prompted calls for a clearing house environment to be set up to act as a central counterparty for CDS transactions.

III. Description of LIFFE A&M and LCH.Clearnet

A. Regulation of LIFFE A&M and LCH.Clearnet

LIFFE A&M is a Recognised Investment Exchange (“RIE”) under the UK Financial Services and Markets Act 2000 (“FSMA”). Recognition as an RIE has been granted to LIFFE A&M by the UK Financial Services Authority (the “FSA”), the designated agency under FSMA. The regulatory obligations of RIEs are set out in Regulations made under FSMA (the “Recognition Requirements”).⁷ In summary, these stipulate that an RIE:

1. must have financial resources sufficient for the proper performance of its functions as an RIE;
2. must be a fit and proper person to perform the functions of an RIE;

⁶ Bank for International Settlements semi-annual OTC derivatives statistics at end-December 2007.

⁷ The Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001.

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3. must ensure that the systems and controls used in the performance of its functions are adequate and appropriate for the scale and nature of its business;
4. must ensure that business conducted by means of its facilities is conducted in an orderly manner and so as to afford proper protection to investors;
5. must ensure that access to its facilities is subject to criteria designed to protect the orderly functioning of the market and the interests of investors;
6. must ensure that satisfactory arrangements are made for the timely discharge of the rights and liabilities of the parties to transactions effected on the RIE;
7. must be able and willing to promote and maintain high standards of integrity and fair dealing in the carrying on of regulated activities by persons in the course of using the facilities provided by the RIE;
8. must ensure that appropriate procedures are adopted for it to make rules, for keeping its rules under review and for amending them;
9. must ensure that appropriate measures are adopted to reduce the extent to which the RIE's facilities can be used for a purpose connected with market abuse or financial crime, and to facilitate their detection and monitor their incidence;
10. must have effective arrangements for monitoring and enforcing compliance with its rules; and
11. must have effective arrangements for the investigation and resolution of complaints arising in connection with the performance of, or failure to perform, any of its regulatory functions.

LIFFE A&M operates a central order book⁸ and wholesale trading facilities through the LIFFE CONNECT® electronic trading platform as “trading services,” subject to the oversight of the FSA. The Bclear Service is also subject to FSA oversight.

LCH.Clearnet is a Recognised Clearing House (“RCH”) under FSMA. Regulation and oversight of LCH.Clearnet in the U.K. is carried out by the FSA and the Bank of England. The FSA is the main regulator of LCH.Clearnet as an RCH, while the Bank of England’s oversight is confined to LCH.Clearnet’s payment system. In addition, LCH.Clearnet has been approved as a

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LIFFE A&M will not operate a central order book for Index CDSs.

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Derivatives Clearing Organization by the Commodity Futures Trading Commission. The regulatory obligations of RCHs are set out in the Recognition Requirements. In summary, these stipulate that an RCH:

1. must have financial resources sufficient for the proper performance of its functions as an RCH;
2. must be a fit and proper person to perform the functions of an RCH;
3. must ensure that the systems and controls used in the performance of its functions are adequate and appropriate for the scale and nature of its business, including the assessment and management of risks to the performance of the RCH's relevant functions, and (where relevant) the safeguarding and administration of assets belonging to users of the RCH's facilities;
4. must ensure that access to its facilities is subject to criteria designed to protect the orderly functioning of those facilities and the interests of investors;
5. must be able and willing to promote and maintain high standards of integrity and fair dealing in the carrying on of regulated activities by persons in the course of using the facilities provided by the RCH;
6. must ensure that appropriate procedures are adopted for it to make rules, for keeping its rules under review and for amending them;
7. must ensure that appropriate measures are adopted to reduce the extent to which the RCH's facilities can be used for a purpose connected with market abuse or financial crime, and to facilitate their detection and monitor their incidence;
8. must have effective arrangements for monitoring and enforcing compliance with its rules; and
9. must have effective arrangements for the investigation and resolution of complaints arising in connection with the performance of, or failure to perform, any of its regulatory functions.

LCH.Clearnet provides clearing services through the use of various proprietary and third party supplied applications.

The FSA and each of LIFFE A&M and LCH.Clearnet together carry on a "close and continuous" regulatory supervision relationship, through a number of formal and ad hoc meetings and other communications at many levels and of many frequencies. Additionally, on an annual basis, the

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FSA undertakes a risk assessment of LIFFE A&M and LCH.Clearnet, pursuant to which the FSA determines whether relevant regulatory obligations continue to be met and whether activities of either LIFFE A&M or LCH.Clearnet pose any risks to the FSA's statutory objectives, including maintaining market confidence and providing customer protection.

Both LIFFE A&M and LCH.Clearnet have in place robust business continuity plans that set forth procedures to be followed in the event of short, medium and long-term technical and premises interruptions. These plans have been approved by the FSA.

The FSA and the Commission have entered into a Memorandum of Understanding⁹ pursuant to which the FSA and the Commission have agreed to cooperate and share information in connection with the oversight of financial services firms. This agreement provides a means by which the Commission may access information regarding the transactions processed by the Bclear Service and cleared by LCH.Clearnet to address any potential issues, such as insider trading, manipulation and similar matters.

B. Services Provided by LCH.Clearnet

LCH.Clearnet provides central counterparty clearing house services to the following markets and services:

- London Stock Exchange (LSE)
- SWX Europe Ltd.
- LIFFE
- EDX London
- London Metal Exchange (LME)
- Other European Multilateral Trading Facilities ("MTF")
- RepoClear and SwapClear

As legal counterparty to each clearing member in respect of registered business, LCH.Clearnet bears any loss arising from the default of a clearing member, beyond the margin deposits held as security in respect of the defaulting member's liabilities. LCH.Clearnet's supplementary resources for use in default cases, should those margin deposits be insufficient, comprise a Default Fund,¹⁰ totaling approximately £600 million, which is provided by members and held in cash by LCH.Clearnet. Each member's Default Fund contribution is assessed every three

⁹ *Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information related to Market Oversight and the Supervision of Financial Services Firms*, between the United States Securities and Exchange Commission and the United Kingdom Financial Services Authority, 2006.

¹⁰ This fund is a single fund used in respect of the markets and services described above.

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months on the basis of that member's initial margin and (in the case of exchange traded derivatives) trading volumes over the preceding three months. The Default Fund is mutual in nature, in the sense that any loss faced by LCH.Clearnet as a result of a default which cannot be met from the defaulter's margin cover at LCH.Clearnet or from its contribution to the Default Fund will be met by the Default Fund generally. Customers of a defaulting clearing member have no contractual relationship with LCH.Clearnet, but are protected to the extent of their client agreement and any segregation arrangements in place with that member. LCH.Clearnet uses a stress testing model to ensure that its post-default financial backing is of appropriate size. The stress testing model assesses the adequacy of initial margin requirements and the Default Fund on the basis of extreme price movement scenarios in all contracts cleared by LCH.Clearnet.

The sequence of protections to be applied in the event of a default is as follows:

1. Defaulter's Initial Margin (including excess collateral posted)
2. Defaulter's Default Fund contribution
3. Up to £20 million of LCH.Clearnet's capital and reserves
4. Remainder of Default Fund
5. Remainder of LCH.Clearnet's capital and reserves

The sequence outlined above does not take into account the anticipated replenishment of the Default Fund by market members and/or national governments between stages 4 and 5.

As the counterparty to every clearing member, LCH.Clearnet reduces the scope for counterparty risk between clearing members. LCH.Clearnet is legally responsible for the financial performance of the contracts that it has registered and any resulting delivery contracts. All clearing members deposit margin with LCH.Clearnet to cover the risk on their net positions.

LCH.Clearnet is not counterparty to contracts with customers. Behind contracts between LCH.Clearnet and a clearing member there may exist further "back-to-back" contracts; for example, if a customer enters into an Index CDS, the clearing member is the counterparty to the customer and the counterparty to LCH.Clearnet (once the transaction has been registered). These customer contracts are subject to LIFFE Rules, but LCH.Clearnet is not a party to them.

C. LIFFE A&M and LCH.Clearnet Participants

LIFFE A&M has two categories of members, clearing members and non-clearing members, and two types of clearing members: Individual Clearing Members who clear and settle business for their own account or, in the case of dealers, on behalf of their customers; and General Clearing

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Members who, in addition, clear and settle business on behalf of other LIFFE A&M members. All transactions of non-clearing members must be cleared through a specific clearing member.

As elements in a range of clearing membership criteria, all clearing members must also be members of LCH.Clearnet and all are subject to standards of capital adequacy.¹¹ Clearing members must also satisfy LIFFE A&M and LCH.Clearnet that they have adequate systems and controls to clear and settle transactions.

All LIFFE members undertaking business for clients are subject to UK client money rules and client asset rules or, if they are authorized outside the UK, similar rules of the relevant regulator. In the European Union, those rules are governed by the Markets in Financial Instruments Directive (“MIFID”), although the UK client money rules and client asset rules prescribe some extended conditions in certain cases. The majority of LIFFE members are based in either European member states or in the United States.¹² In terms of other locations, there are LIFFE members in Switzerland (5 at present) and Singapore (1 at present) plus a dormant member in each of Japan and Canada.

European members are subject to the relevant provisions of MIFID and the Capital Adequacy Directive in respect of financial resources and conduct of business obligations (including those in respect of record-keeping).

MIFID sets out requirements (which each member state is required to implement in national legislation) covering, inter alia, obligations of investment firms in respect of record keeping and the treatment of client assets and client money. In particular, Article 13 of MIFID (“Organisational requirements”) requires an investment firm to keep records “which shall be sufficient to enable the competent authority to . . . ascertain that the investment firm has complied with all obligations with respect to clients or potential clients.” Commission Regulation 1287/2006/EC provides more detailed obligations in respect of record-keeping.

Article 13 of MIFID also requires each investment firm, when holding funds or financial instruments belonging to clients, to make adequate arrangements so as to safeguard clients’ rights and to limit the extent to which such funds and instruments can be used by the firm for its own account. These high level standards are implemented at the national level by more detailed

¹¹ Standards of capital adequacy for membership purposes are set by LCH.Clearnet rather than by LIFFE A&M. Clearing members will, however, also be subject to capital adequacy requirements set by their regulators.

¹² Any LIFFE member that is based in the United States and undertakes a customer business is either a broker-dealer registered with the Commission or registered with the Commodity Futures Trading Commission as a futures commission merchant.

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regulations (e.g., the UK client money and client asset requirements are set out in the “Client Assets” section of the FSA Handbook¹³).

In addition, Article 12 of MIFID (“Initial capital endowment”) obliges member states to ensure that competent authorities do not grant authorization unless the investment firm has sufficient initial capital, having regard to the nature of the investment service or activity in question. The recast Capital Adequacy Directive sets out in detail such requirements, including which assets may be used for initial capital purposes.

Although Switzerland is not a member of the European Union, it has tended to implement equivalent legislation in relation to financial markets to maintain its equivalence with EU member states, and requirements comparable to those set out above can be found in Swiss legislation. Similarly, when LIFFE A&M conducted due diligence in respect of Singapore, it concluded that firms there were subject to a well-developed regulatory regime equivalent to European and US standards, incorporating capital requirements and organizational rules.

¹³ As an illustration of how such requirements work, the FSA’s Client Asset Rules (covering client assets and client money) require all client money received to be deposited immediately with a banking institution in an account clearly labeled as a client account. The Rules create a statutory trust, with the investment firm receiving and holding client money as trustee, and the bank in which the money is deposited has to acknowledge that all money standing to the credit of the account is held by the firm as trustee. (NB: where the investment firm is itself a bank and the money is held in an account with itself, it must inform the client that such money will be held by the firm as banker and not as trustee.) The Rules allows the investment firm to transfer client money to a clearing member or to a clearing house for the purposes of a transaction for a client through that entity or to meet a client’s obligation to provide margin for such transaction; such transfer does not alter the firm’s fiduciary duty to the client in respect of such money. These provisions are important because where a client has a customer relationship with a broker who is an exchange member but not a clearing member, money (and, potentially, assets) for margin purposes will need to flow from client to broker to clearing member and then to the clearing house. Both the non-clearing member and the clearing member will be subject to the Client Asset Rules.

The Rules make clear, following the language of MIFID, that a firm “must, when holding client money, make adequate arrangements to safeguard the client’s rights and prevent the use of client money for its own account.”

The section of the FSA’s Client Asset Rules dealing with assets that the firm receives or holds in connection with an arrangement to secure the obligation of a client in connection with investment business recognizes that the firm will need to be able to treat the asset as if legal title and associated rights to that asset had been transferred to the firm. Nonetheless, the Rules require that the firm “maintains adequate records to enable it to meet any future obligations including the return of equivalent assets to the client.”

Finally, it should be noted that client money and client asset rules fall under the responsibility of the home member state under MIFID, so the FSA Client Asset Rules apply only to firms authorized by the FSA and not firms from other member states operating in the UK under their passport rights. However, firms from other members states would be required to comply with equivalent provisions, given that all member states are required to have implemented MIFID.

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It should be noted that LIFFE A&M relies on the relevant home state regulator to ensure compliance with all such requirements. In the extreme case, where authorization is curtailed or removed, LIFFE A&M would expect to hear from both the regulator and the member concerned, and LIFFE A&M Rules require each member to notify LIFFE A&M immediately of any material change “in respect of the Member’s authorization, license or permission to conduct Investment Services.”

D. Risk Management

Each clearing member may have two accounts with LCH.Clearnet: one for segregated customer business (the “Client margin account”), and one for all house and non-segregated client business (the “House margin account”).¹⁴ The offset of liabilities and credits between the House margin account and the Client margin account is not permitted.

LCH.Clearnet requires the posting of initial margin and maintenance (“variation”) margin for all clearing accounts. The majority of initial margin and maintenance margin is determined utilizing the London SPAN (Standard Portfolio Analysis of Risk) method. London SPAN was adapted from the Chicago Mercantile Exchange’s margining system, which is designed to match margin to risk. London SPAN does this by simulating how a portfolio would react to changing market conditions. The initial margin requirement for the portfolio is the largest loss identified under these various market conditions that might reasonably occur, taking into account risk offsets within the portfolio. Initial margin is refunded when the position is closed. This risk management methodology is designed to protect LCH.Clearnet against the worst likely loss from one or two day’s move in the market. Net Liquidation Value (“NLV”) is the value of the portfolio at closing market prices. It represents the income or expenditure which would be associated with closing out an Index CDS position. This figure is added to initial margin to give the total margin requirement. LCH.Clearnet revalues the margin position on at least a daily basis to take account of changes or volatility in the market price of the underlying index and in LCH.Clearnet’s valuation of margin collateral provided in the form of securities. During the day LCH.Clearnet monitors market prices and clearing members’ positions and may call for additional margin payments. LCH.Clearnet then revalues the margin requirements each night.

LCH.Clearnet’s margin requirements are only applicable to clearing members. All clearing members must provide LCH.Clearnet with margin cover to cover the risk on their total net positions for each account. Clearing members and/or non-clearing members in turn set the margin requirements applicable to their customers and may hold funds and assets posted by customers to meet such margin requirements.

¹⁴ Clearing members are required to segregate customer funds except in instances where the investor, if permitted to do so by applicable client money rules, contracts out of the segregation requirement.

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While LCH.Clearnet's margin requirements are central to its risk management, LCH.Clearnet also has other measures at its disposal, including:

1. additional financial resource requirements (buffers);
2. additional initial margin requirements;
3. imposition of position limits;
4. trading for liquidation only;
5. prior authorization of trades above a certain size; and
6. issuing instructions to reduce positions.

LCH.Clearnet also monitors large cumulative profits or losses. If large and unusual trading activity is detected (relative to previous exposures) LCH.Clearnet will contact compliance officers and seek assurances from the senior executives or boards of a member firm or parent company.

LCH.Clearnet was assessed by the FSA and the Bank of England in June 2006 against the CPSS/IOSCO recommendations for Central Counterparties (the "CPSS/IOSCO Recommendations").¹⁵ LCH.Clearnet was assessed as meeting 14 out of 15 of the CPSS/IOSCO Recommendations.¹⁶ At that time, the remaining recommendation was broadly observed. LCH.Clearnet believes that, as of the date of this letter, it meets all 15 of the CPSS/IOSCO Recommendations.¹⁷

E. Margin Collateral

Arrangements for the provision (but not the quantum) of margin are a matter for negotiation between the customer, broker and clearing member. LCH.Clearnet accepts a variety of collateral types from clearing members in respect of their margin liabilities to LCH.Clearnet. These apply to both initial margin and NLV payments. Members may meet margin requirements by cash

¹⁵ Bank for International Settlements, Committee on Payments and Settlement Systems, Technical Committee of the International Organization of Securities Commissions, *Recommendations for Central Counterparties*, November 2004 (the "RCCP Report").

¹⁶ Financial Services Authority, *Assessment of LCH.Clearnet Limited against the CPSS-IOSCO recommendations for Central Counterparties*, June 2006 (www.fsa.gov.uk/pubs/other/lchclearnet.pdf).

¹⁷ We note that LCH.Clearnet's compliance with the remaining recommendation has not been independently verified.

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payments in the following currencies: sterling, US dollars, yen, Swiss francs, and euro. In addition, LCH.Clearnet will accept an extensive range of collateral including approved bank guarantees, certain UK treasury bills, UK gilts, sterling and US dollar certificates of deposit, and German, Italian and Spanish government bonds. Any such securities must be charged to LCH.Clearnet by the clearing member in accordance with LCH.Clearnet procedures.

To avoid frequent changes in the amount of collateral provided, clearing members may lodge margin in excess of (but not substantially if lodged in cash) the LCH.Clearnet minimum. LCH.Clearnet pays interest to clearing members on such cash balances currently at the overnight London Inter-Bank Bid Rate (LIBID) minus 25 basis points.

F. Default

Both LIFFE A&M and LCH.Clearnet have default rules, as required by the Recognition Requirements. If a clearing member appears to LCH.Clearnet to be unable, or to be likely to become unable, to meet its obligations to LCH.Clearnet, it may be declared a defaulter under LCH.Clearnet's default rules in relation to the contracts registered by it with LCH.Clearnet. Where a clearing member has been declared a defaulter by LCH.Clearnet, contracts between such clearing member and its non-clearing members and clients will be dealt with under LIFFE A&M's default rules. A default by a non-clearing member will also be dealt with under LIFFE A&M's rules.

LIFFE A&M's default rules permit LIFFE A&M to direct that open contracts to which a defaulting non-clearing member is party be dealt with in one of a number of ways including, for example, off-set against matching contracts to which the defaulter is party, closing-out through trading out in the market, transfer to another member or invoicing back.

Where the defaulter is a clearing member, LCH.Clearnet's default rules take primacy, although all actions in such circumstances are typically coordinated between LCH.Clearnet and the relevant exchange. In this way, the statutory protections afforded to an RCH may be fully utilized.

IV. The Bclear Service

A. Use of the Bclear for Index CDS contracts

As noted above, Bclear will provide a means by which counterparties to an Index CDS may negotiate the transaction on a bilateral basis and then submit the transaction for processing and clearance. Bclear accepts only completed transactions and is not a matching system for counterparties.

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Parties wishing to use the Bclear Service will directly negotiate and agree with each other the terms of a CDS on a credit default swap index, meeting the contract specifications established by LIFFE A&M. The Index CDS may then be submitted to Bclear by a LIFFE member or a customer that has been authorized by a LIFFE member to access Bclear.¹⁸ The LIFFE member or its authorized customer (or in the case where more than one LIFFE member is party to the Index CDS, the LIFFE member as agreed between the parties) will submit specific transaction information regarding the Index CDS to LIFFE A&M and LIFFE A&M will either accept or reject the transaction. LIFFE A&M is not obligated to accept an Index CDS that is submitted to Bclear and may reject an Index CDS for a number of reasons. For example, the transaction may be rejected if it does not meet the applicable contract requirements or if LIFFE A&M does not consider the transaction to have been entered into at a fair value. If LIFFE A&M accepts an Index CDS, the Index CDS is replaced by an exchange contract,¹⁹ subject to LIFFE A&M rules, and having LCH.Clearnet as the central counterparty. As the central counterparty for the transaction, LCH.Clearnet is responsible for ensuring the financial performance of all Index CDSs registered with it. There will not be a central order book for Index CDSs. Accordingly, transactions may only be closed out by negotiating an off-exchange transaction to offset the original transaction and submitting such offsetting transaction to Bclear. The process by which an Index CDS is registered and cleared is described in greater detail in Appendix A attached hereto.

Index CDS contracts are cleared and managed using LIFFE A&M's Trade Registration System/Clearing Processing System (TRS/CPS), which may be connected to proprietary or third party back office systems for position and risk management. An Index CDS may be submitted to Bclear through a secure, web-based application that members access via their own internet connections or through the Bclear API, which members can integrate with their own in-house systems.

B. Eligibility of Index CDSs for Submission to Bclear

Initially, Bclear will only accept for processing and clearance CDSs on three of the iTraxx Europe Indices. There are six iTraxx Europe Indices—Europe, Non-Financials, Senior

¹⁸ A LIFFE A&M member may request that its customer be permitted to submit transactions directly to Bclear in the name of the member. Any transaction so submitted must be authorized by the LIFFE A&M member. Such authorization may be undertaken on a transaction by transaction basis, or transactions may be automatically authorized, subject to certain restrictions.

¹⁹ An exchange contract refers to a contract that is subject to the rules of LIFFE A&M; it does not indicate that a central order book exists for such product.

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Financials, Sub Financials, Crossover and High Volatility.²⁰ The number of entities in each index ranges from 25 (Senior Financials and Sub Financials) to 125 (Europe) and the entities are equally weighted in all indices. Credit events on these indices include bankruptcy, failure to pay, and modified restructuring. During the term of the Index CDS, the buyer makes a “coupon” payment based upon a percentage of the notional amount of the contract.

While LIFFE A&M’s legal contract specification in respect of Index CDSs remains subject to finalization, it is intended that credit events will be handled on the basis set forth in the following paragraph.

Upon the determination by LIFFE A&M that there has been a credit event with respect to any reference entity in the relevant index during the term of the contract, holders of positions in the Index CDS will be provided with a position in a separate Event Protection Contract (“EPC”) in relation to the relevant reference entity. EPCs are non-tradable instruments which are cash settled. They have a settlement value which is equal to 100 minus a recovery rate for the underlying bonds. Through the EPC settlement process, the protection buyer will receive payment to the extent that the value of the underlying bond or loan falls below par. Following determination of a credit event, the entity that was the subject of the credit event will be removed from the index and the notional amount will be reset.

All contracts submitted to Bclear must meet the contract specifications established by LIFFE A&M. The contract specifications for the three iTraxx Europe indices that will initially be offered through Bclear are set forth in Appendix B attached hereto.

C. Rules relating to the Bclear Service

LIFFE A&M has adopted rules governing the use of the Bclear Service.²¹ These rules set forth the process by which members may submit transactions to the Bclear Service for confirmation, administration and clearing. All transactions submitted to Bclear must comply with these rules, as well as all other applicable rules of LIFFE A&M.

D. Maintenance of Transaction Information

Upon submission of a transaction to Bclear, LIFFE A&M captures transaction information and, on a T+1 basis, reports to the FSA, on behalf of its members, the “market side” of transactions cleared in LIFFE A&M’s Equities and Financials Trade Registration System (TRS). A number

²⁰ We note that the Bclear Service will initially be offered on CDSs on the iTraxx Europe, iTraxx Crossover and iTraxx High Volatility indices. CDSs on the remaining three iTraxx Europe indices, as well as other credit default swap indices, may be offered at some time in the future.

²¹ The London International Financial Futures and Options Exchange Rules—Book II, Section 12.

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of files are transferred to the FSA daily, including transaction data (presented in buy-side and sell-side format), position data, member details and series details. Index CDS products will be added to this data feed and will include the same level of information, i.e. executing member, product code, expiry date, initial premium (price), coupon (fixed premium) and number of contracts. LIFFE members separately report on a T+1 basis to the FSA²² the “client side” of transactions, which identify the non-member clients who are parties to the reported transactions. With both the “market side” and “client side” reports, the FSA has a complete audit trail of a market participant’s activity in reported products, such as the Index CDS products to be processed through Bclear. The FSA will be able to use this information itself or provide it to other European and US regulators in accordance with existing Memoranda of Understanding, as necessary and on a confidential basis.

V. Representations of LIFFE A&M and LCH

As noted above, LCH.Clearnet was assessed by the FSA and the Bank of England as meeting 14 out of 15 of the CPSS/IOSCO Recommendations in June 2006 and believes that, as of the date of this letter, it meets all 15 of the CPSS/IOSCO Recommendations.

LIFFE A&M represents that:

1. The following information regarding Index CDSs will be available on its website (www.nyx.com): (a) contract specifications for Index CDSs that may be processed and cleared through the Bclear Service, and (b) a description of the Bclear Service and rules applicable thereto.
2. It only considers for membership entities located in jurisdictions with regulatory arrangements it deems satisfactory regarding: (i) supervision of investment activity; (ii) information sharing and cooperation between the supervisory authority of the jurisdiction concerned and LIFFE A&M and/or the FSA; and (iii) capital adequacy, liquidity, and segregation of customers’ funds and securities (and related books and records provisions).
3. Before offering Index CDS services to U.S. persons,²³ LIFFE A&M will adopt a requirement that will prohibit a member from directly or indirectly submitting, or permitting an authorized customer to submit, an Index CDS to the

²² The FSA’s transaction reporting requirements in respect of OTC derivatives (including OTC CDSs) are currently the subject of a Consultation Paper (CP08/16) and, as a result, are subject to change.

²³ LIFFE A&M launched the Index CDS service for non-U.S. persons on December 22, 2008. LIFFE A&M notified members at that time that the service may not be offered to U.S. persons until LIFFE A&M issues an additional notice.

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Bclear Service when the member receives or holds funds or securities of U.S. persons for the purpose of purchasing, selling, clearing, settling, or holding that Index CDS position, unless the member, in connection with such Index CDS activities, is regulated by: (a) a signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, (b) a signatory to a bilateral arrangement with the Commission for enforcement cooperation, or (c) a financial regulatory authority in Ireland or Sweden.

LCH.Clearnet represents that:

1. Its rules and procedures are available on its website and such rules and procedures generally set forth the sequence of protections to be applied in the event of a default by a clearing member.
2. Its rules require its clearing members to: (a) meet specific capital adequacy standards that vary depending on the type of activities undertaken by the member; (b) provide copies of audited annual financial statements to LCH.Clearnet; and (c) notify LCH.Clearnet upon the happening of certain material events, such as significant reductions in shareholders' funds or net capital.

VI. Conditions to the Granting of Exemptive Relief

LCH.Clearnet understands that the granting of the requested exemptive relief is conditioned upon LCH.Clearnet and, in the case of the second sentence of paragraph 7 below, LIFFE A&M, complying with the following requirements:

1. LCH.Clearnet shall make available on its website annual audited financial statements.
2. LCH.Clearnet shall keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made or received by it relating to its Index CDS clearance and settlement services. These records shall be kept for at least five years and for the first two years shall be held in an easily accessible place.
3. LCH.Clearnet shall supply information and periodic reports relating to its Index CDS clearance and settlement services as may be reasonably requested by the Commission.

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4. Subject to coordination with the FSA and upon such terms and conditions as may be agreed between the FSA and the Commission, LCH.Clearnet shall provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), records, and personnel related to LCH.Clearnet's Index CDS clearance and settlement services.

5. LCH.Clearnet shall notify the Commission, on a monthly basis, of any material disciplinary actions taken against any of its members utilizing its Index CDS clearance and settlement services, including the denial of services, fines, or penalties. LCH.Clearnet shall notify the Commission promptly when it involuntarily terminates the membership of an entity that is utilizing LCH.Clearnet's Index CDS clearance and settlement services. Both notifications shall describe the facts and circumstances that led to LCH.Clearnet's disciplinary action.

6. LCH.Clearnet shall provide the Commission with notice of all changes to its Default Rules and Default Fund Rules, not less than one day prior to effectiveness or implementation of such rule changes or, in exigent circumstances, as promptly as reasonably practicable under the circumstances. All such rule changes will be posted on LCH.Clearnet's Web site. If LCH.Clearnet gives notice to, or seeks approval from, the FSA regarding any other changes to its rules regarding its Index CDS clearance and settlement services, LCH.Clearnet will also provide notice to the Commission. Such notifications will not be deemed rule filings that require Commission approval.

7. LCH.Clearnet shall provide the Commission with reports with respect to automated systems used in connection with Index CDS clearance and settlement services, other than the TRS/CPS system, prepared by independent audit personnel that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy statements ("ARP statements").²⁴ LIFFE A&M shall provide the Commission with reports with respect to its TRS/CPS system prepared by audit personnel from Risk and Audit Services, an independent department of NYSE Euronext, that are generated in accordance with risk assessments of the areas set forth in ARPs. LCH.Clearnet shall provide the Commission with annual audited financial statements prepared by independent audit personnel.

²⁴

Policy Statement: Automated Systems of Self-Regulatory Organizations, Release No. 34-27445, File No. S7-29-89 and Policy Statement: Automated Systems of Self-Regulatory Organizations (II), Release No. 34-29185; File No. S7-12-91.

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8. LCH.Clearnet shall provide notice to the Commission at the same time it provides notice to the FSA in accordance with FSA REC 3.15 and FSA REC 3.16 regarding the suspension of services or inability to operate its facilities in connection with the clearance and settlement of Index CDSs.

LIFFE A&M and LCH.Clearnet understand that to the extent that a LIFFE member receives or holds funds or securities of U.S. persons for the purpose of purchasing, selling, clearing, settling, or holding Index CDS positions:

- (i) Each such U.S. person shall not be a natural person.
- (ii) The member shall segregate such funds and securities of such U.S. persons from the member's own assets (i.e., the member may not permit U.S. persons to "opt out" of applicable segregation requirements for such funds and securities even if regulations or laws would permit the person to "opt out"); and
- (iii) The member shall disclose to such U.S. persons that the member is not regulated by the Commission and that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the member.

LIFFE A&M and LCH.Clearnet also understand that relief from the broker-dealer registration requirements under Section 15 of the Exchange Act for a LIFFE member utilizing the Bclear Service for Index CDSs will be conditioned upon such member's material compliance with the rules of LIFFE A&M and, if a clearing member, the rules of LCH.Clearnet, and applicable laws and regulations, in each case relating to capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to Index CDSs cleared by LCH.Clearnet.²⁵

LIFFE A&M and LCH.Clearnet understand that the Index CDS processing and clearance services described herein may only be made available to U.S. persons meeting the definition of "eligible contract participant," as defined in Section 1a(12) of the Commodity Exchange Act (other than paragraph (C) thereof). In addition, such services may only be made available with respect to an Index CDS where the reference entities or reference securities underlying the index that in the aggregate account for at least 80% of the weight of the index meet one of the following criteria: (i) the reference entity is a reporting entity under the Exchange Act; (ii) the reference entity provides information in accordance with Rule 144A(d)(4) under the Securities Act of 1933, as amended; (iii) information about the reference entity is publicly available; (iv)

²⁵

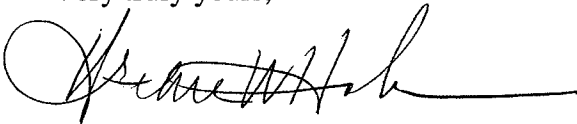
A member will not be in material compliance if the member has failed in any way to segregate customer funds and securities consistent with such rules, laws and regulations.

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the reference entity is a foreign private issuer that has securities listed outside the United States and has its principal trading market outside the United States; or (v) the reference security is a foreign sovereign debt security, an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports, or an asset-backed security issued or guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation or the Government National Mortgage Association.

If you have any questions or require additional information concerning this request, please contact the undersigned at 312-902-5241.

Very truly yours,

A handwritten signature in black ink, appearing to read "Arthur W. Hahn", with a long horizontal flourish extending to the right.

Arthur W. Hahn

AWH:kmg⁶⁰⁶⁹⁷⁰⁶³

Process for the Registration and Clearance of Index CDSs

The rules of LIFFE A&M provide for members to trade for their own account and/or for their customers, but all transactions must be in the name of the member effecting the trade and that member will be counterparty to those transactions. Thus, a LIFFE member will be considered to be “acting as principal” for purposes of the LIFFE A&M rules, even though the member may be acting as agent for other purposes. This means that any transaction automatically generates a sequence of matching contracts: between customer and member, between member and clearing member and between clearing member and clearing house.

The purpose of these rules is to ensure that a party to a transaction need only to look to its immediate counterparty for performance and need not concern itself with parties at other points along the contractual chain. Thus, the clearing house need only to look to the clearing members and would have no contractual relationship with, nor knowledge of, the non-clearing members or customers on whose behalf the transaction was executed.

LCH.Clearnet is the counterparty to clearing members each acting as principal, in respect of, inter alia, Index CDSs registered by such clearing members with LCH.Clearnet. Non-clearing members and non-member customers are not party to any contracts registered by clearing members with LCH.Clearnet. Once an Index CDS has been accepted by LIFFE A&M, a chain of linked contracts are created, all having the same terms. Specifically, the process by which the chain of linked contracts is created is as follows:

1. When a non-member customer enters into an Index CDS with or through a non-clearing member, the non-clearing member submits the contract to Bclear. Once LIFFE A&M has accepted the contract, an exchange contract is created between the non-clearing member, as principal, and its customer. If another customer was originally a counterparty to the Index CDS, an exchange contract is created between the non-clearing member, as principal, and the second customer. These contracts are referred to as the “customer contracts.” The customer contracts replace the initial Index CDS, which ceases to exist from this point.
2. Simultaneously, a matching contract between the non-clearing member and its clearing member (a “parallel contract”) comes into existence for each of the customer contracts.
3. If the counterparty to the trade is a customer of another non-clearing member, a “related contract” is created between the respective clearing members. The related contract is presented to LCH.Clearnet for registration. If there is a single non-clearing member involved in the transaction, the parallel contracts are presented to LCH.Clearnet for registration.
4. The related contract is replaced by contracts between LCH.Clearnet and the clearing member on each side of the transaction.

Through this process, the Index CDS is discharged and a set of on-exchange contracts arise imposing equivalent obligations on and granting equivalent rights to the original parties to the Index CDS, but with LCH.Clearnet as the central counterparty. As noted above, because the non-member customer will not be a party to a contract registered with LCH.Clearnet by the clearing members, the relationship between the non-member customer and the non-clearing member will remain intact, although such relationship will now be based upon the exchange contract, rather than the Index CDS originally entered into by the respective parties.

Credit Default Swap Index Contracts –Summary Contract Specification

Indices	iTraxx Europe Index iTraxx Europe Crossover Index iTraxx Europe Hi-Vol Index
Contract Size	Credit Event protection on €100,000 notional principal
Contract Maturity	3¼ year, 5¼ year, 7¼ year and 10¼ year maturities listed on each index series with June or December maturity as appropriate
Protection Period	Each Contract offers protection on Credit Events occurring in Reference Obligations from the First Trading Day to Last Trading Day of the Contract Maturity
Protection Coverage	Contract offers protection on Credit Events (Bankruptcy, Failure to Pay and Restructuring) for the Reference Entity
Initial Payment	Upfront amount paid by the Buyer to the Seller, or by the Seller to the Buyer, reflecting any difference between the Fixed Rate and rate agreed between the parties to the transaction. Valued in € per lot €0.01 minimum price movement Paid in full on the business day following trade
Fixed Payments ('Coupon')	Amount paid by the Fixed Rate Payer (the Buyer of the CDS Index Contract) to the Floating Rate Payer (the Seller of the CDS Index Contract) over the life of the Contract Maturity. Based on the Fixed Rate expressed in basis points per annum of Notional Principal A predefined single Fixed Rate will be established by the Index Sponsor for each Contract Maturity The Fixed Payment Amount per lot will be calculated based on the following formula: $\frac{\text{Days in Accrual Period}}{360} \times \text{Notional Principal} \times \text{Fixed Rate}$ Fixed Payments are calculated in Euro and paid in arrears on a quarterly basis on the Fixed Payment Dates
Fixed Payment Dates	20 th calendar day in each quarterly month (March, June, September and December) during the lifetime of a particular Contract, or the following Business Day if the 20 th is not a Business Day
Accrual Periods	The accrual periods used to calculate the Fixed Payment Amount will be determined as follows: (i) First Accrual Period - From the 20 th day of the quarterly month preceding the Trade Date, or such amended date, as published by the Exchange from time to time, to the day preceding the next Fixed Payment Date

	<p>(inclusive).</p> <p>(ii) Last Accrual Period - From the Fixed Payment Date to the 20th day of the next quarterly month (inclusive).</p> <p>(iii) All other Accrual Periods - From the Fixed Payment Date to the day preceding the next Fixed Payment Date (inclusive)</p>
Trading Hours	08:00 – 18:00 hours London time
Daily Valuation	<p>Value established at 16:00 hours London time for margin purposes</p> <p>Valuations quoted in € per lot</p> <p>Value represents net present value of each position – can be positive or negative</p>
Last Trading Day	20 th calendar day of Contract Maturity month, or preceding Business Day if that day is not a Business Day
Credit Event Delivery	<p>Delivery of 'Event Protection Contracts' at value of €0.00 to holders of positions in affected Contract Maturities</p> <p>EPCs are delivered in sufficient number to maintain the notional value of the combined CDS and EPC position</p> <p>The number of units in an Event Protection Contract issued per CDS lot is determined according to the following formula:</p> $\frac{\text{Reference Entity Weighting} \times \text{Notional Principal of CDS}}{\text{Contract Size of EPC}}$ <p>Payment of Fixed Payments continues at lower pro rata amount based on reduced Surviving Notional Principal</p>