

International Derivatives Clearinghouse, LLC

DEFAULT PROCEDURES

I. Introduction

These Default Procedures summarize the actions that International Derivatives Clearinghouse LLC (“IDCH”) intends to take to address a Clearing Member default. Upon the actual event of default by a Clearing Member, IDCH may take such additional actions as it deems necessary for the protection of the Clearinghouse and other Clearing Members. Certain terms used but not defined herein shall have the meaning set forth in the IDCH Rulebook. The Default Procedures are intended to summarize and supplement the default rules found in the IDCH Rulebook and, in the event of a conflict between these Default Procedures and the Rulebook, the default rules will apply.

II. Responsibilities

The Risk Committee shall have responsibility for the implementation of these Default Procedures in the event of a Clearing Member default, and shall supervise the Chief Risk Officer, Risk Management Department and Treasury Department in the performance of their responsibilities hereunder. The Chief Risk Officer shall be the primary liaison between IDCH and the U.S. Commodity Futures Trading Commission (“CFTC”) in the event of a Clearing Member default.

III. Declaration of a Clearing Member Default

Pursuant to IDCH Rule 604, there are five general events that would cause a Clearing Member to be declared in default. They are:

- a. The Clearing Member fails to meet any of the Clearing Member’s financial obligations to IDCH;
- b. The Clearing Member is suspended or expelled by IDCH or a Participating Trading Facility;
- c. The Clearing Member is declared in default, suspended or expelled by another Derivatives Clearing Organization, clearing agency (as defined in the Securities Exchange Act of 1934, as amended) or other clearing organization;
- d. The Clearing Member’s Settlement Bank notifies IDCH that it is ceasing to act as Settlement Bank for the Clearing Member or that the Clearing Member will not meet its financial obligations to IDCH;
- e. The Clearing Member is bankrupt or insolvent.

The Board of Directors or the Risk Committee will determine whether a Clearing Member is in default. Upon a determination that a Clearing Member is in default, the Chief Risk Officer will notify the CFTC and the Clearing Member’s designated self-regulatory organization (if any), and

the Risk Management Department will issue a notice to Clearing Members informing them of the default.

Upon such Default, the Clearinghouse may cause all positions of the defaulting Clearing Member to be closed, netted or offset, transferred to any other Clearing Member, or otherwise resolved as deemed appropriate by the Clearinghouse and any debit balance owing to the Clearinghouse shall be immediately due and payable.

Events b. and c. are considered technical defaults while events a., d., and e. are actual defaults.

In the event of a technical default, IDCH's Risk Committee will manage the heightened risk by reducing the amount of risk that the Clearing Member poses to IDCH (reducing the Clearing Member's Total Risk Value and/or calling for greater Performance Bond), limit the Clearing Member's clearing to liquidation only or suspend the Clearing Member.

In the event of an actual default, the IDCH Risk Committee will institute its default waterfall which is described herein.

IV. Default Waterfall Legal Framework

As a CFTC-registered Derivatives Clearing Organization, IDCH is subject to the provisions of the Commodity Exchange Act and the rules and regulations of the CFTC (collectively, "CFTC Regulatory Framework"). Additionally, Subchapter IV of Chapter 7 of the US Bankruptcy Reform Act of 1978 has provisions for financial clearinghouses that exempt them from bankruptcy preference periods, providing a high level of assurance that margin collateral pledged to a clearinghouse cannot be clawed back by the estate of a bankrupt clearinghouse participant.

IDCH rules and procedures, which are subject to the CFTC Regulatory Framework, provide for the following;

- a. Once it has suspended a Clearing Member or declared a Clearing Member to be in Default, IDCH has the right to immediately begin the process of liquidating, auctioning off or neutralizing the Clearing Member's proprietary cleared portfolio.
- b. Once it has suspended a Clearing Member or declared a Clearing Member to be in Default, IDCH has the right to immediately begin the process of transferring the Clearing Member's customer cleared portfolios to either a single or multiple non-defaulting Clearing Members. If IDCH cannot transfer (in whole or in part) the customer cleared portfolio or it has determined that a transfer would not be in the best interest of the clearinghouse it can immediately begin the process of liquidating, auctioning off or neutralizing the Clearing Member's customer cleared portfolio.
- c. IDCH has unencumbered access to the defaulting Clearing Member's Guaranty Fund contribution and Performance Bond lodged with IDCH. In the event of a suspension or Default of a Clearing Member, IDCH can immediately apply the Guaranty Fund contribution and Performance Bond to satisfy any of the Clearing Member's financial

obligation to IDCH, which includes any cost associated with the liquidation, auctioning off, neutralization or transfer of a cleared portfolio; however, customer Performance Bond only may be used to satisfy an Clearing Member's obligation related to the Clearing Member's customer cleared portfolio. Any residual Guaranty Fund contribution and proprietary Performance Bond of the suspended or defaulting Clearing Member can be used to satisfy the residual obligations of the Clearing Member's customer cleared portfolio. These provisions do not permit the use of Clearing Member proprietary and customer Performance Bond to satisfy the obligations of other Clearing Members that have been suspended or are in default.

V. Cleared Portfolio Liquidation, Auctioning, Neutralization and Customer Transferring Procedures

IDCH's Risk Management, Market Operations and Treasury Departments shall coordinate the liquidation or sale of the defaulting Clearing Member's positions in its Proprietary Account and the transfer of the defaulting Clearing Member's customer positions to one or more non-defaulting clearing members.

Transfer of Customer Positions

The transfer of customer positions will be attempted if it has been determined solely by IDCH that the transfer is practical and does not place IDCH and its non-defaulting Clearing Members at greater risk. If IDCH has determined that a transfer of customer positions cannot be accomplished in an acceptable manner or timeframe, the customer positions shall be liquidated or auctioned.

a. Customer Cleared Portfolios

Customer Positions

- i. If positions held in a Customer Segregated Account are transferred to a single non-defaulting Clearing Member, all Performance Bond held in the Customer Segregated Account by or on behalf of the defaulting Clearing Member shall be transferred to the non-defaulting Clearing Member.

If positions held in a Customer Segregated Account are transferred to multiple non-defaulting Clearing Members, the required Performance Bond for the positions transferred shall be transferred to the non-defaulting clearing members. Excess Performance Bond shall be retained by IDCH pending instructions from the CFTC or the trustee of the defaulting Clearing Member's estate.

The Performance Bond held in a Customer Segregated Account shall be adjusted for the net Variation Settlements paid or collected. Any IDCH Advance (as

defined below) made to fund a Variation Settlement in a Customer Segregated Account shall be repaid to IDCH prior to any transfer. An IDCH Advance repayment can be made through an offset against the Performance Bond in the Customer Segregated Account.

- ii. If the positions held in a Customer Segregated positions cannot be transferred they will be liquidated or auctioned. Any remaining Performance Bond in the Customer Segregated Account remaining after the liquidation or auction, net of an IDCH Advance, shall be transferred to a special IDCH Customer Segregated Account pending instructions from the CFTC or the trustee of the defaulting Clearing Member's estate. Any negative Performance Bond balance in the Customer Segregated Account, net of an IDCH Advance, shall be added to the defaulting Clearing Member's obligations for its Proprietary Account.

b. Proprietary Cleared Portfolios

Proprietary Account Positions

- i. Any IDCH Advance made to fund Performance Bond in the defaulting Clearing Member's Proprietary Account shall be repaid to IDCH upon the liquidation or sale of the positions in the Proprietary Account. If there remains, net of the IDCH Advance, a positive cash balance in the defaulting Clearing Member's Proprietary Account, the balance shall be applied to any negative balance in the defaulting Clearing Member's Customer Segregated Account. Any remaining Performance Bond in the Proprietary Account shall be credited to an IDCH special Proprietary Account pending instructions from either the CFTC or the trustee of the defaulting Clearing Member's estate.
- ii. If the Proprietary Account has a negative balance (including any negative balance from the defaulting Clearing Member's Customer Segregated Account), the loss shall be allocated as described below.

Note: There shall be no netting of either positive or negative balances between the accounts of multiple defaulting Clearing Members. This provision applies to both Proprietary Accounts and Customer Segregated Accounts.

VI. Collateral Management Waterfall Procedures

In the event of a Clearing Member's actual default (i.e., failure to pay financial obligations to IDCH when due), IDCH's Treasury Department shall take the following actions:

- a. IDCH Line of Credit

IDCH's Treasury Department shall drawdown on its secured committed line of credit. The line of credit is currently at \$125 million and will be maintained at amounts based on IDCH's Risk Management Department's Stress Test. In considering the amount at which the line of credit is to be maintained, IDCH's Risk Management Department and Treasury Department will take into consideration the following:

- i. The dollar amount relationship between the Stress Test loss and IDCH Surplus Capital. Surplus Capital is defined as liquid working capital less 12-months of operating expenses. If Surplus Capital is materially larger than the Stress Test loss, a smaller line of credit will be considered. Conversely, if the Stress Test loss is materially larger than Surplus Capital, a larger line of credit will be considered.
- ii. The liquidity of the Performance Bond lodged by the Clearing Members selected for the stress test. IDCH's Performance Bond collateral rules require that 50% of a Clearing Member's Original Performance Bond requirement is satisfied through cash or highly rated and liquid sovereign debt securities that can generally be converted into cash in a single day ("Tranche 1 Margin Collateral"). The remaining composition of lodged Performance Bond can consist of corporate debt securities that have high credit ratings and can be converted into cash somewhat less quickly than highly rated and liquid sovereign debt securities ("Tranche 2 Margin Collateral"). If Tranche 1 Margin Collateral can satisfy the entire stress test loss a smaller line of credit is to be considered. If Tranche 2 Margin Collateral is needed to cure a Stress Test loss a larger line of credit will be considered.
- iii. The liquidity of all Clearing Member Performance Bond will be considered. If the majority of Original Performance Bond is Tranche 1 Margin Collateral a smaller line of credit will be considered. If 50% (the maximum) of initial margin is Tranche 2 Margin Collateral a larger line of credit will be considered.

The amount of the line of credit to be drawn during a Clearing Member default shall be no greater than the defaulting Clearing Member's Proprietary Account and Customer Segregated Account Original Performance Bond requirements and Guaranty Fund contribution. Proceeds of the draw are to be deposited in IDCH's central depository variation margin account to provide backup funding for the defaulting clearing member's unsatisfied Proprietary Account and Customer Segregated Account Variation Settlements (defined as an "IDCH Advance").

IDCH Advances shall be made while the defaulting Clearing Member's Proprietary Account positions are liquidated, auctioned or neutralized by IDCH's Risk Management Department and the defaulting clearing member's Customer Segregated Account positions are transferred to or guaranteed by a non-defaulting Clearing Member

("Counterparty Substitution") or liquidated, neutralized or auctioned. IDCH Advances shall be repaid as described herein.

b. Defaulting Clearing Members' House and Customer Initial Margin and Guaranty Fund Deposits

Upon the instruction and approval of IDCH's Chief Risk Officer, IDCH's Treasury Department is to begin the process of generating cash from the defaulting Clearing Member's Guaranty Fund contribution and Performance Bond deposits. This process can occur prior to any CFTC or court appointed trustee involvement.

- i. *Cash Guaranty Fund Contribution and Initial Margin Deposits:* All defaulting Clearing Member Guaranty Fund contributions are made in the form of cash. Additionally, Performance Bond can be satisfied through cash deposits. IDCH's Treasury Department shall convert all related investments (made by IDCH) held in the defaulting member's Guaranty Fund Account, Proprietary Account and Customer Segregated Account to cash by redeeming from all money market fund investments and selling all securities held on deposit which would be in the form of bank CDs, US Treasury Repo and US Treasury securities. Bank deposits and US Treasury Repo have maturities of no more than 90 days. US Treasury securities have maturities of no more than one year.

Proceeds from the defaulting Clearing Member's cash Performance Bond and Guaranty Fund investments are to be credited to IDCH's central depository variation margin account to fund the defaulting Clearing Member's Variation Settlements in its Proprietary Account and Customer Segregated Account.

Proceeds from the defaulting Clearing Member's Customer Segregated Account are to be transferred to IDCH's Customer Segregated Account at IDCH's central depository.

Performance Bond in the Customer Segregated Account shall only be used to fund Variation Settlements related to positions in the Customer Segregated Account of the defaulting Clearing Member.

Excess Performance Bond in the Proprietary Account and Guaranty Fund cash of a defaulting Clearing Member can be applied to satisfy Variation Settlements in the Customer Segregated Account of the defaulting Clearing Member to the extent there is a shortfall in the Customer Segregated Account of the defaulting Clearing Member.

In the event of the default of more than one Clearing Member, there shall be no netting between defaulting Clearing Members' Proprietary Accounts. For example, a post default resolution positive balance in a Proprietary Account or

Customer Segregated Account of one defaulting Clearing Member cannot be used to cover a payment in the respective Proprietary Account or Customer Segregated Account of another defaulting Clearing Member.

- ii. *Non-US Treasury Securities Lodged to Satisfy Performance Bond:* Clearing Members can satisfy their Performance Bond and Customer Segregated Account Performance Bond requirements with Government Sponsored Entity (“GSE”) debt; GSE guaranteed mortgage backed securities and certain sovereign debt and non-sovereign debt securities.

These securities are somewhat less liquid than US Treasury securities and if the defaulting Clearing Member is systemically important the default of the Clearing Member might impair the normal liquidity of these Non-US Treasury securities markets. As such, the sale of these securities shall proceed promptly after a Clearing Member default has occurred.

The timing of the sale of these securities shall be influenced by the nature of the defaulting Clearing Member’s cleared portfolio and the deposition of the defaulting Clearing Member’s Performance Bond. If IDCH’s Chief Risk Officer has determined that the cleared portfolio can be neutralized quickly with modest funding needs from Performance Bond collateral the sale of collateral will be managed accordingly thus preserving the Performance Bond collateral without a sale or a limited sale. If the Performance Bond collateral is principally cash and US Treasury securities there may be a limited sale of these other forms of collateral.

- iii. *US Treasury Securities:* Even in the event that a systemically important clearing member was to default with a knock-on effect on other markets, it is expected that US Treasury securities will be converted to cash quickly. As such, this category of collateral would be sold if IDCH’s Chief Risk Officer expected that during the unwinding of the cleared portfolio the unwinding would consume a significant portion of the Performance Bond deposit.
- iv. If Customer Segregated Account positions are subject to a Counterparty Substitution, the Performance Bond in the Customer Segregated Account will be transferred to the new Clearing Member’s Customer Segregated Account Performance Bond deposit at IDCH.

Post the default resolution; Performance Bond will be used to repay any IDCH Advance and fund any other obligation that the defaulting clearing member has to IDCH which shall include, but not be limited to, any Variation Settlement payment made, any expense incurred by IDCH to resolve the default and any fees due to IDCH from the defaulting Clearing Member. Performance Bond

balances held in the Customer Segregated Account shall only be applied against obligations due from the Customer Segregated Account. Performance Bond balances held in the defaulting clearing member's Proprietary Account shall be applied to any obligation due from the defaulting Clearing Member including any post default resolution negative net residual loss in the Customer Segregated Account.

If post default resolution there is a net positive balance in the defaulting Clearing Members Proprietary Account and/or Customer Segregated Account, the balance is to be held by IDCH pending instructions from CFTC and/or the court appointed trustee of defaulting clearing member's estate.

Note: In the event that IDCH sells or transfers the defaulting Clearing Member's positions in its Customer Segregated Account or Proprietary Account, and incurs a loss on the sale or has paid a third party a concession fee to assume the defaulting clearing member's customer and proprietary portfolios, IDCH may charge the account of the defaulting clearing member for any such loss or concession fee and such amount shall be added to the net negative liquidation amount for Clearing Member Assessment.

c. Allocation of Defaulting Clearing Members' Net Negative Liquidation

Note: Each source of funds set forth below will be completely exhausted, to the extent practicable, before the next following source is applied.

- i. The net negative liquidation of the defaulting Clearing Member first will be funded by IDCH through the application of the surplus capital of IDCH in excess of funds necessary for normal operations. IDCH currently maintains a \$50 million surplus fund. Such amounts will be deemed a liability of the defaulting Clearing Member, which IDCH may collect from other assets of the defaulting Clearing Member or by process of law. Any amounts collected from the defaulting Clearing Member shall be applied to replenish IDCH's surplus capital or repay other sources of the funds used to cover such losses.
- ii. Any amount not covered by IDCH surplus capital will be payable from the IDCH Guaranty Fund deposits of all other Clearing Members on a pro rata basis, based on each Clearing Member's average deposit in direct proportion to the total Guaranty Fund deposit requirement of each non-defaulting Clearing Member.
- iii. Any amount not covered by the Guaranty Fund deposits, will be covered first by IDCH's default insurance policy, if any such policy is maintained, then by an additional capital contribution by IDCG, if any.

- iv. Any amount not covered by default insurance or additional capital contributions will be assessed to the Clearing Members on a pro rata basis, based on each Clearing Member's average deposit in direct proportion to the total Guaranty Fund deposit requirement of each Clearing Member, subject to a cap equal to the lesser of \$30,000,000 or 40% of such Clearing Member's adjusted net capital. Clearing Member Assessments shall be payable within one day of the Clearing Member Assessment. Any remaining deficiency shall be reassessed until the deficiency has been paid or each clearing member has paid its maximum required amount.

VII. Testing of Default Procedures

IDCH will conduct and document a test of its default management plan on at least an annual basis.

VIII. Public Access to IDCH Default Procedures

These IDCH Default Procedures shall be amended as Clearing Members join the Clearinghouse. Detailed procedures along with committee responsibilities and roles will be dependent on the capabilities of the Clearinghouse's membership. IDCH shall post these default procedures on its website along with its rulebook.