

# INTERNATIONAL DERIVATIVES CLEARING GROUP



**NASDAQ OMX<sup>®</sup>**



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International Derivatives Clearing Group (IDCG) is pleased to bring to the market the first central Clearinghouse for clearing over-the-counter (OTC) interest rate swaps (IRS) in a regulated futures environment available to all market participants.

International Derivatives Clearinghouse™ (IDCH), a subsidiary of IDCG, provides an efficient and transparent forum to clear and settle IRS and other fixed-income derivative contracts. IDCH uses the Exchange of Futures for Swaps (EFS) function to convert OTC IRS contracts into economically equivalent IRS futures contracts. This enables IDCH to clear IRS futures contracts, giving customers the benefits of central clearing while maintaining the principles of the over-the-counter interest rate swap market.

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## SUPERIOR TECHNOLOGY

**IDCH** - Best-in-breed clearing system that manages real-time risk for all participants, providing all necessary clearing efficiencies and safeguards.

**IDEX XT™** - State-of-the-art matching system built on proven NASDAQ OMX technology.

IDCH and IDEX XT were built to incorporate the following specifications:

- Open API
- Full redundancy
- Disaster recovery site and procedures
- Proven post-trade efficiency and reliability

## Advantages of Central Clearing

- Reduces counterparty credit risk
  - Provides Guaranty Fund with financial resources, rules and procedures comparable to existing Clearinghouses
  - Eliminates the need for multiple bilateral credit relationships
  - Eliminates the need for ISDA agreements and ongoing credit risk management of bilateral contracts
- Provides transparency not present in the current OTC market structure
  - Includes real-time, normalized pricing data
  - Interest rate curve construction and methodology shared with all participants
  - Potential opportunity for tighter bid/ask spreads
- Reduces transaction costs through streamlined back office processes
- Creates more efficient markets enabling greater liquidity
  - Operates on fast and efficient electronic platform
  - Facilitates the ability to anonymously trade
  - Attracts new participants
- Provides significant benefits due to cleared futures treatment
  - 60/40 tax treatment available where appropriate
  - Bankruptcy protection accorded to segregated funds
  - Regulatory capital requirements mandated by Basel I/II may be reduced or eliminated

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## Product Offerings

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IDCG's centrally cleared IRS futures contracts are designed to be economically equivalent in every material respect to plain vanilla IRS contracts currently traded in the OTC market. Our product offerings include:

- SwapDrop™ – Participants trade IRS contracts bilaterally and then use **SwapDrop.com** to give up the OTC trade to the clearinghouse, thereby replacing the OTC contract with economically identical IRS futures contracts (via the EFS mechanism). These contracts are then cleared and settled through IDCH.
- USD Interest Rate Swap Futures – The exchange of semi-annual fixed-rate payments in exchange for quarterly floating-rate payments. There are thirty years of daily maturities available for trading.

## Risk Management

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- IDCG has entered into a strategic partnership with Razor Risk Technologies to provide IDCH with state-of-the-art risk management technology.
  - New Clearing Members undergo a rigorous review according to defined participation criteria.
  - Initial margin will be set to protect against a one day, three-standard deviation price movement at the greater of the 99.7% confidence interval or largest daily market move over the past 125-day period.
  - Positions will be revalued on a real-time basis throughout the day.
  - All trades are processed by a risk filter with established limits, which restricts clearing and trading if the limit will be breached .
  - Twice daily mark-to-market for margin collection purposes and more frequently if necessary.
  - Clearinghouse exposure is protected by margin, Guaranty Fund and the Clearinghouse's assessment powers, as well as the Clearinghouse's own financial resources.
  - IDCH also maintains a \$100MM line of credit to provide liquidity in the event of a Clearing Member default.
  - Risk management policies are designed to:
    - Respond to potential market exposures.
    - Detect areas of potential financial weakness.
    - Prevent the accumulation of losses.
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## TRANSACTION COMPARISON

	IDCG	Current OTC Bilateral
<b>Pre-Trade</b>	<ul style="list-style-type: none"> <li>• Establish relationship with a clearing member</li> <li>• Provide initial margin</li> </ul>	<ul style="list-style-type: none"> <li>• Negotiating master agreements is a prerequisite               <ul style="list-style-type: none"> <li>– ISDA Agreement</li> <li>– Collateral Agreement</li> </ul> </li> <li>• Counterparty credit review</li> <li>• Establish credit and trading limits</li> </ul>
<b>Trade</b>	<ul style="list-style-type: none"> <li>• Execute trade bilaterally or electronically for clearing via IDCH</li> <li>• No curve negotiation: transparent IDCG Interest Rate Curve</li> </ul>	<ul style="list-style-type: none"> <li>• Two parties agree to transaction               <ul style="list-style-type: none"> <li>– Usually over the telephone</li> <li>– Potential for asymmetric information among participants</li> <li>– Yield curve negotiation</li> </ul> </li> </ul>
<b>Post-Trade</b>	<ul style="list-style-type: none"> <li>• Receive trade details via SwapDrop</li> <li>• Position is marked-to-market and margin account is adjusted</li> <li>• Settlement bank handles cash flows</li> </ul>	<ul style="list-style-type: none"> <li>• Trade capture               <ul style="list-style-type: none"> <li>– Manual or Automated</li> </ul> </li> <li>• Economic affirmation               <ul style="list-style-type: none"> <li>– Counterparties verify key economic details</li> </ul> </li> <li>• Confirmations required               <ul style="list-style-type: none"> <li>– Either one party provides trade details and the other verifies; or both parties submit trade details and both parties match confirm</li> </ul> </li> </ul>
<b>Aggregate Time to Complete Trade</b>	1 day	9 days on average during 2006*

\*According to ISDA 2007 Derivatives Benchmark Survey

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## IDCG and NASDAQ OMX

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IDCG is an independently-operated subsidiary of The NASDAQ OMX Group<sup>SM</sup>. The NASDAQ OMX Futures Exchange (NFX), a wholly owned subsidiary of NASDAQ OMX<sup>SM</sup>, is the designated contract market listing the futures contracts cleared by IDCH.

The NFX platform utilizes NASDAQ OMX Click XT matching technology and the IDCH platform is built on a combination of NASDAQ OMX SECUR clearing technology and Razor Risk technology to create a best-in-breed solution for clearing interest rate swaps. Together, IDCG and NFX plan to launch additional IRS products, reducing systemic risk in the OTC markets.

## Contact Information

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