

Frequently Asked Questions

What is a CCP?

A central counterparty is, on the markets to which it provides service, the buyer to every seller and the seller to every buyer, guaranteeing contractual performance. This definition has been updated by CCP12, an association of the world's leading central counterparties, and classifies a CCP as "an organisation that novates and guarantees trades or positions at or after the time of trade and through settlement". The former is more understandable, the latter more precise, but each of them positions CCPs as being an ultra secure intermediaries' intermediary.

What benefits does a CCP provide?

There are a number of key benefits.

- **Risk Management.** The prime purpose of a CCP is to eliminate counterparty risk for members on market trades. In an anonymous trading environment the certainty of counterparty performance cannot be managed entirely by members' in-house measures. With the interposition of a CCP between every buyer and seller, a member has only one counterparty – the CCP. The CCP is able to mitigate the risk by utilising a range of defences including margin cover, default funds and insurance to protect itself and the market from member default.
- **Settlement Netting.** By virtue of each member having the CCP as its single counterparty, bilateral netting of its similar obligations reduces the number of market settlements it has to make to one per security per day, despite the multi-lateral aspect of the trading environment. The reduction in the number of settlements leads to cost savings and reduces Back Office overheads and operational risk. Moreover, because the netting is on a bilateral basis against the CCP, full Delivery Versus Payment can be retained. Thus a CCP can provide members with greater efficiency of capital by facilitating the netting of positions and deliver cost savings from the resultant reduction in the number of settlements. Netting effectively caps the number of settlements allowing members to increase trading activity without incurring equivalent increases in Back Office costs.
- **Anonymity.** An electronic order book allows members to post orders anonymously. With the introduction of a CCP this anonymity will be retained throughout the lifecycle of the trade. This protects members' trading strategies and reduces the risk of market impact on institutional orders. However, on SWX anonymity will be removed with members able to identify their trading counterpart. This change and removal of this feature does not alter the contractual nature of a trade with each member having a contractual transaction with the CCP.

Why doesn't every market have a CCP?

The benefits are so abundantly obvious that it seems incomprehensible not to take advantage of them! But, in fact, this is an evolving marketplace. Futures and options exchanges have used CCPs for decades but other markets are relative newcomers to the concept. CCPs for fixed income OTC trading have been in existence for some time, as they have for some cash equity platforms, but CCPs for interbank interest rate derivatives are a very new concept.

In the cash equity markets, the historic attitude in London was that the very short settlement period minimized trading risk, and that CCP intervention was therefore unnecessary. In Switzerland, membership of the SWX did not often change and counterparty risk was not an issue as the exchange

guaranteed its members. However, technology has broadened the membership of equity exchanges and the trading anonymity and netting opportunity delivered by a CCP has since been truly appreciated. Indeed those equity markets using CCPs have seen steady and consistent growth notwithstanding the current levels of volatility.

Many European equity exchanges now either have or are moving towards introducing a CCP and the centrally cleared market model is almost certain to become standard in Europe, although there will initially be variations in its operation from market to market.

How does the SWX CCP work?

The clearing services will be provided by x-clear. Each SWX member can either directly or indirectly (via its relationship with a GCM) set-up a relationship with x-clear.

As central counterparty x-clear will offer full clearing services for all SWX trades in 'clearing-eligible' securities.

What is x-clear?

SIS x-clear, a subsidiary of SIS Swiss Financial Service Group AG (SIS Group), has a banking licence and is supervised and regulated by the Swiss Federal Banking Commission (SFBC) and enjoys the status of a Recognised Overseas Clearing House in the United Kingdom. In addition SIS x-clear assumes the role of a centre of excellence in the field of risk management for the entire SIS Group. With the implementation of SIS x-clear as a CCP for virt-x, a seamless integration of clearing services into the Swiss Value Chain has been achieved. Members can use the same technical interfaces to get access to clearing services from SIS x-clear and settlement services from SIS SegalInterSettle. SIS Group, wholly owned by the Swiss banking community, is a full service provider for the international securities industry. It is the parent organisation of four operating units: SIS SegalInterSettle AG, SIS Systems AG, S A G Aktienregister AG and SIS x-clear AG.

As an international provider SIS SegalInterSettle AG offers the complete range of domestic and crossborder services in the field of securities settlement and global custody services. Currently, some 450 domestic and foreign clients settle their securities transactions through SIS SegalInterSettle in about 50 markets.

For further information please visit <http://www.group.sisclear.com>

Why has SWX chosen x-clear to provide CCP services?

x-clear already provides CCP services for virt-x and therefore the opportunity for members to leverage existing technology (and potentially reduce cost) is significant.

Why is the CCP anonymity not set-up as on virt-x

Unlike the virt-x model, SIS x-clear participants will see the identity of their market counterparty, which does not alter the contractual nature of the trade, once a trade has been executed. This change is a condition precedent set by the Swiss domiciled participants of SWX, to facilitate the efficient execution of large trades in the less liquid constituents of the SPI.

Member's internal accounts should reflect all cleared trades with SIS x-clear as counterparty to the trade. However, depending on member's internal accounting processes if they are acting as an NCM they may wish to book trades against their chosen GCM as they do not have a direct relationship with SIS x-clear in this instance.

No changes will be made to the virt-x model.

Will all members trading in a CCP eligible stock see the counterparty, e.g. two UK members trading in an SPI stock or a swiss member with a UK member.

Yes, please refer to the answer in the previous question.

Does the trade transparency require any technical change from the members?

No. The current trade data contains information on the counterparty of the trade. This existing data field currently shows the CCP as counterparty, but will in the future be replaced with the actual counterparty of the trade.

Will SWX provide a list of all eligible GCM's

Yes, a list of eligible GCM's will be available on the SWX website.

Which securities are eligible for the CCP? Is there a flag/indicator in the trading system showing that a security is CCP eligible

There is no flag or indicator in the trading system that shows the eligibility for clearing. This information can be accessed via a separate list on the SWX website.

Will new securities automatically be set-up as CCP eligible (i.e. from day 1?)

No, not by default. This depends on a number of factors, but the members will be notified in the same way as on virt-x.

On T+1, which Clearing and Settlement flag must be used for reversals and what is the impact?

No reversals will be allowed anymore on T+1 via the clearing system, but contra-instructions can be entered via the trading system and will have to be offset manually by the members against their cleared positions.

Will the cancellation and Nostro correction processes remain unchanged?

No, please refer to the cancellation and mistrade question in this document.

Membership and Connectivity

Will I have to use the CCP?

Yes. All SWX members trading on the order book must either:

- be a member of x-clear (Clearing Member); or
- have a valid clearing agreement with a member of x-clear (Non Clearing Member).

This condition must be met at all times. Failure by any member to do so will result in its immediate suspension from trading in Swiss equities, including the removal of outstanding orders from the order book. Clearing members of x-clear wishing to clear trades on behalf of SWX Non-Clearing Members must themselves be members of SWX, regardless of whether they have any trading capacity. Non-trading clearing members will have a special class of SWX membership.

Details for SWX membership can be obtained from SWX Member Relations. Details of clearing membership requirements and of the service provided can be obtained from x-clear.

Do I need to sign a new clearing and settlement agreement with my CCP?

Yes, but the logistic details depend on the CCP. For further information, please contact your CCP.

Does my dealing capacity matter?

No, all contracts cleared with the CCP are on a principal to principal basis.

Will the trader exam change?

Yes, the exam will be extended with a number of questions related to the SWX CCP service and will be applicable for new traders.

Which members of SWX are offering clearing member services?

We are currently exploring which of our members will be offering clearing member services and will publish a list in due course. The list will be available on the SWX website.

How do I apply for Non-trading GCM membership

Please refer to the rules on membership application on the SWX website. For new GCM members, the annual membership fee will be waived for the first year.

Will I need connectivity to x-clear or a clearing member?

Yes, but it will depend on the arrangements provided by your supplier.

Will I have to amend my standing data held by SWX?

This depends on the choice of clearing arrangements that you will make. SWX holds standing instructions and other data relating to members' settlement requirements and enriches matched trades to include the clearing and settlement information necessary for the correct processing of transactions

The members' current virt-x clearing and settlement instructions will become default settlement instructions unless members indicate otherwise.

Members will need to confirm or supply the following standing data fields and advise SWX of any changes: -

- the Clearing Member (for NCMs)
- Clearing Member account number
- whether the clearing account is Segregated/Non-Segregated
- netting indicator
- BPID (SIS Acc No.)

Members will also need to indicate whether they require clearing prevention for trades within their corporate group and, if so, the extent of that prevention (i.e. prevent clearing only or prevent clearing and settlement). SWX will distribute a form for completion in respect of these details. The form will also be available on the SWX web site.

Margin and Collateral

What are the margin arrangements?

The margin requirement consists of two elements: initial margin and variation margin. Initial margin is calculated to cover the risk on open positions from market movements between the time of the initial margin call and the next calculation and call. Variation margin is calculated as the difference between the settlement value of open contracts and the current mark to market value. Details of the margin calculations employed and other risk management measures can be obtained directly from the CCP.

How am I notified of the margin position, and when?

Details of the margin notification procedures can be obtained directly from the CCP.

What assets can I use as collateral?

Details of the eligibility of collateral assets can be obtained directly from the CCP.

Will I get interest on the collateral held at x-clear?

Details of collateral management can be obtained directly from the CCP.

What happens to the existing SWX default fund?

SWX will retain the Collateral Deposit Framework but will remove the Solidarity Fund. We are currently analysing the figures to return the Solidarity Fund to members and further information on this will be made available over the coming months. No changes are envisaged to the SWX default fund.

What happens to the SWX solidarity fund?

This will be defined in the next coming months. Feedback is expected from our external legal advisors, but our objective is to abolish the solidarity fund.

Do I need to pay more into the CCP's default fund?

This will be defined in the next coming months.

Trading & Operations

What securities will be eligible for clearing?

The service will be provided for all equity securities traded on SWX, beginning with eligible constituents of the SWX Swiss Performance Index ("SPI EXTRA").

The SPI is Switzerland's most closely followed performance index. It is a dividend-corrected index that includes all SWX Swiss Exchange-traded equity securities of companies domiciled in Switzerland or the Principality of Liechtenstein. A current list of such securities is available on our SWX member section.

What trade types will be eligible for clearing?

All order-book trades will be subject to the clearing process. Trades agreed between members off-order book and matched via the trading platform functionality (Trade Confirmations, Addressed Offers, and Post-Recorded Trades) will be cleared on an optional basis. The 'manual clearing type' is a code on the input of Trade Confirmations, Addressed Offers, and Post Recorded Trades and is a matchable field which is specific to that trade. The code has three possible values:

- Automatic: the instruction of clearing and settlement is carried out by the system automatically following standing instructions
- Automatic settlement only: clearing is suppressed but bilateral settlement is instructed automatically following standing instructions
- Manual: clearing is suppressed and settlement is carried out by members separately.

Reported Trades will not be cleared. All cleared trades will be for the current trade date and the standard settlement cycle (T+3). No special conditions (e.g. special XD) will be permitted.

How will trades be registered?

During the clearing day, SWX immediately processes all trades matched on the exchange. It determines those that are within the scope of clearing, establishes the transactions that arise under its rules using standing data, and routes them to the appropriate CCP for registration in real-time. The CCP will validate the transactions they receive and immediately register them. Please note that, whilst SWX will have validated each transaction against the data it holds, only the CCP can formally accept them for clearing. Once a trade is registered, the CCP stands as contractual counterparty to its member, removing the risk to that member of a trading counterparty defaulting.

When will the service be available?

The clearing service will be available within the clearing day. All days on which the SWX market is open are clearing days. The SWX market will be open from 06.00 CET to 22.00 CET during which time orders can be put in and trade confirmations can be alleged and matched. However, trades can only be sent to Clearing (to the CCP) between 08.00 CET and 18.15 CET when the link to the CCP will be open. Any trades executed outside these times cannot be cleared.

How does the clearing prevention group work?

Members can declare by standing instruction that orders matched between trading entities within the same corporate group and sharing a consolidated balance sheet are not to be included in the clearing

service. The standing instruction will further indicate whether such trades are to be routed for settlement automatically or settlement instructions are to be submitted separately by the members concerned. The standing instruction is applied at the Member Organisation level and relates to all trades.

Will I be able to cancel an order-book trade?

The service model of SWX enables each trade executed on the SWX platform in an instrument that is eligible for clearing is sent to the CCP in real time. The CCP automatically validates and registers the trade, i.e. interposes itself between the buyer and the seller of the trade. Trade cancellations are therefore no longer allowed, which means that the new mistrade processing rules will be applied.

Trades that are identified as mistrades can only be 'cancelled' by means of a contra-instruction (i.e. an instruction which reverses the original mistrade). This instruction will have to be entered by the members upon request of SWX.

Will I be able to cancel an off-order book trade confirmation?

Yes, this will work in the same way as present, but if the clearing type is set to 'Automatic', the trade can only be cancelled via the entry of a 'reverse trade'. Otherwise today's processing can be applied.

Settlement

Will settlement change after the introduction of the CCP?

Settlement will continue to be provided by SIS SegalInterSettle and operate in a similar way. x-clear members will therefore send their 'locked in settlement instructions' to SIS SegalInterSettle. Please note however that the settlement counterparty will be the CCP and not the original counterparty of the trade.

Split deliveries. The CCP will want to minimise the number and size of failed settlements and maintain flat positions at the end of each day and will, where necessary, part deliver a transaction to achieve this. It should be noted that x-clear will not split gross deliveries.

What will happen if I fail to deliver on time?

The CCP operates a number of measures to ensure timely settlement. These include utilisation of stock borrowing, a fines regime for failed settlement and a buying-in regime. Members should refer to the detailed service description of the CCP for further information on these measures. Transactions not to be settled directly against a CCP will remain subject to SWX's settlement discipline provisions.

If I don't receive delivery of stock who do I chase?

The CCP.

Will the new CCP service have an impact on corporate actions processing?

We are currently examining the impact of the introduction of CCP services on the processing of corporate actions. The results of this work will be added to this document in the near future and a corporate actions service description will be published on our website.

Netting

Will the netting facility be available from day 1?

Yes

Will netting be optional?

Yes. The CCP offers settlement netting on an optional basis as part of its service offering, with each member choosing whether to continue to settle on a gross basis or take advantage of the facility.

How does netting work?

For gross trades to be combined into a single net settlement they must share the following characteristics:

- Security (ISIN and country of register)
- Settlement currency
- Trade date
- Intended settlement date
- Benefit status (not used by x-clear)
- Applicable clearing member
- Applicable clearing account (including Segregated / Non Segregated status)
- Applicable settlement account
- Order priority
- Compensation indicator

Net settlement transactions will be created at the end of the clearing day. Once created, they will not be changed by having new transactions added to them or existing transactions removed from them. Full details of the netting service are described by the CCP within its Service Descriptions.

How significantly will netting reduce the number of settlements?

The most common statistic quoted is that from DTCC, which claims a 96% settlement obligation reduction. LCH.Clearnet's optional netting service provides 97% reduction to the number of settlements netted which in turn represent 75% of the equity trading on the London Stock Exchange.

Please note however that the settlement efficiency will differ for each member as it largely depends on the member's transaction volumes.

Technology

What changes will be made to the trading system to accommodate the CCP?

SWX trading functionality will not change.

Project implementation

When will the new SWX CCP service be operational?

The new service will be taken into operation in the second half of 2007.

The exact live date of the new service depends on a number of external factors (e.g. regulatory approval of the rule changes) which need to be confirmed in the coming months.

Will the project require member involvement ?

Yes, the SWX CCP project plan includes an extensive member testing phase. During this phase we will open up the member testing environment to our members. This will allow the members to become acquainted with the new service and thoroughly test the solution.

The exact details of the member testing phase (timeframe, test data, simulated trading evenings, etc.) will be communicated in due time.

Is the new CCP service a separate software release?

No, the required (minimal) IT changes were incorporated into the EM 8.1 software release. There is no separate release for this new service.

Legal and regulation

Will the project have an impact on existing rules and regs?

Yes, the new SWX CCP service will require a number of changes to the existing SWX general conditions and directives. The updated documents will be available via the SWX website. Please note that the CCP service will rely on 2 new directives; i.e. on Defaults and on clearing and settlement.

How can we find out more about the new SWX CCP service?

All relevant information to the SWX CCP service will be available on the SWX website. Details about the clearing arrangements and processes can be found on the websites of our service partner:
www.SISclear.com.

For more information, please contact: member.services@swx.com