

## **CDS CLEAR ARRANGEMENTS**

### ***Introduction***

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

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

### ***The CDSClear Agreement***

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

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

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

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