Central Collateral Repository

Protect Collateral
Reduce Risk
Enable Clearing

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Conceptual Overview – for discussion purposes only

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MERCHANTS DATA REPOSITORY, LLC

The Landscape

- The traditional clearing model -- which relies on FCMs to protect customers' collateral -- has suffered in the wake of MF Global and PFG.
- The MFG and PFG debacles have shaken trust in the futures markets to their core.
- Further, until investors can be confident that their collateral is as safe in a cleared environment as it is under an ISDA CSA in a tri-party custody environment, the swap clearing mandate will remain problematic.

Solution: A Central Collateral Repository

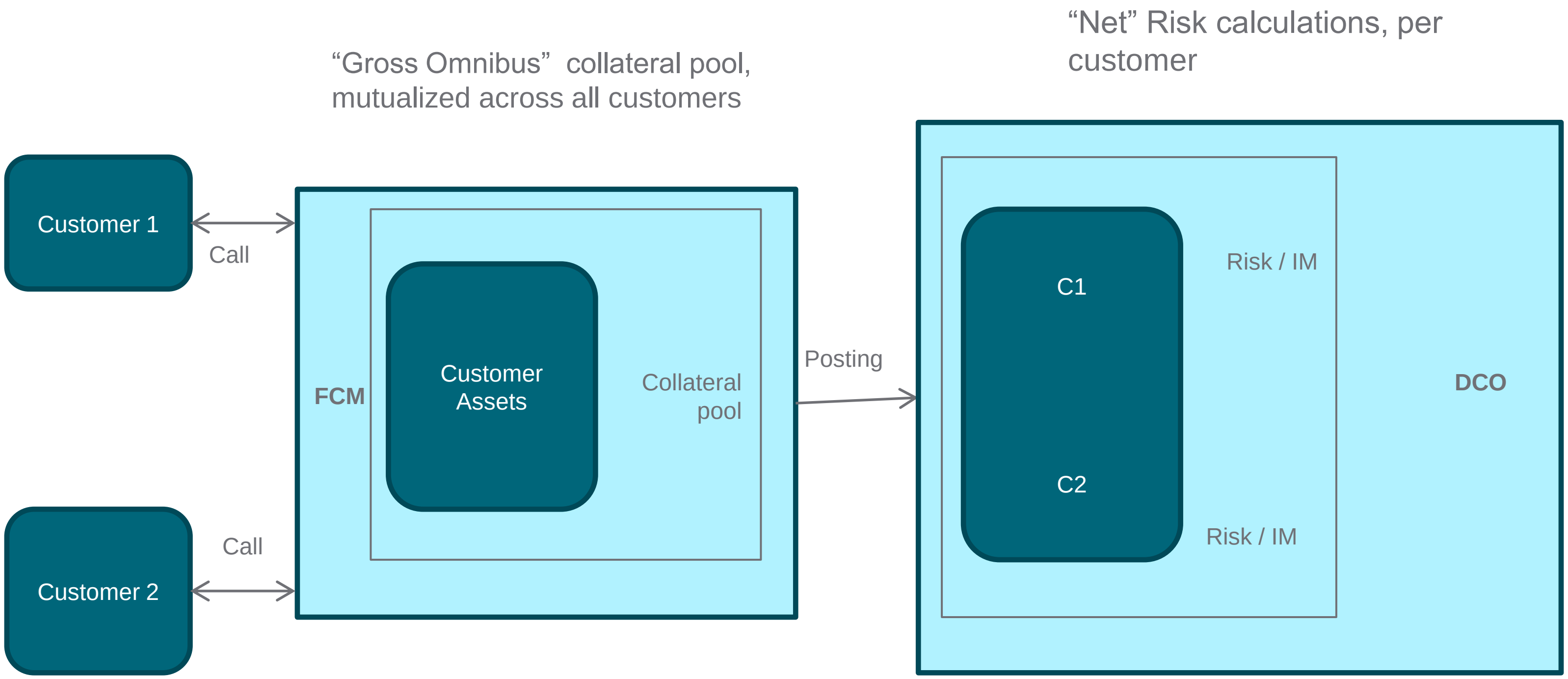
- **MDR proposes that the efficiency, safety and soundness of the ISDA CSA tri-party custody model can be made scalable and replicable through the establishment of a Central Collateral Repository:**

  - Single-purpose entity operated by neutral third-party.
  - Captures and matches trade parameters in a consistent manner
  - Maintains a secure database of portfolios that is sortable, reportable and available to both customers and regulators
  - Aggregated collateral data pursuant to CPSS/IOSCO recommendations.
  - **Full segregation of customer funds**
  - Transparent view of collateral for customers, FCMs and regulators

Key Features

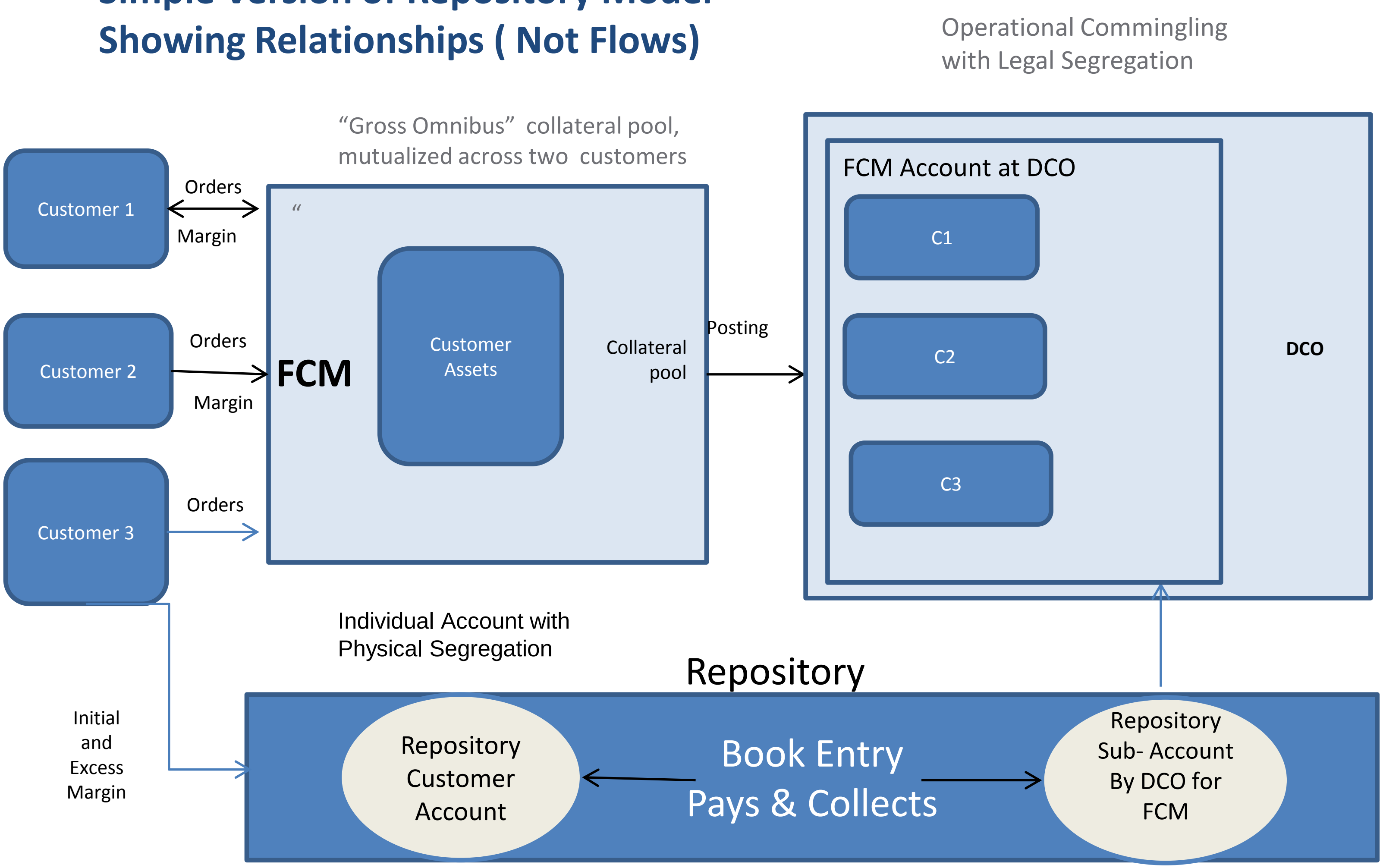
- Service Bureau for FCMs
  - utility model
  - no risk-taking activity
- Repository holds deposit accounts at custodian bank or trust company that is a settlement bank of the DCO.
- Rulebook defines relationships and responsibilities
  - Rulebook supplants control agreements with custodians
  - Custodians exercise no discretion in managing the accounts
- FCM business model is preserved
  - FCM remains as the clearing member for the customer..
  - FCM retains control over minimum margin requirements and position limits .
  - FCM outsources managing of customer custodial accounts to the Repository
    - Shared outsourced solution
    - Leverage existing custody infrastructure to minimize cost
- Model could be expanded to cover customer collateral for uncleared swaps (not depicted in these slides)

Current “Omnibus” Futures Model



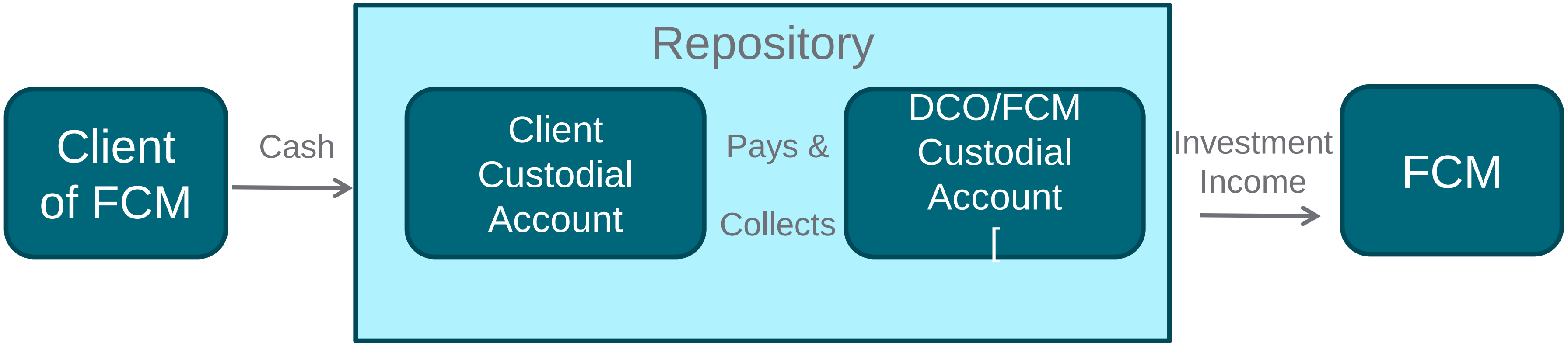
In this model the risk across clients is mutualized and the losses are shared. Trades from two or more customers are margined discretely, but the resulting margin requirements are aggregated at the FCM who calls each customer for their contribution to the asset pool and nets the flows between itself and the DCO.

Simple Version of Repository Model Showing Relationships (Not Flows)



This view shows an FCM doing business with two customers using the traditional FCM model while offering enhanced collateral protection services to customer 3 via the Repository. Customer 3 will pay a fee for this enhanced level of service .

Simplified Flows



- FCM provides customer access to the Repository
- Repository opens a custodial account for the customer at a trust bank that is also depository for the DCO.
- As the DCO calls for margin, Repository allocates funds to the DCO/FCM account.
- As the DCO pays margin, flows work in reverse.
- All accounts are held at leading trust & custody banks that are DCO depositories
- Relationships and responsibilities as between customers, custodians, FCMs and DCOs are defined in a Rulebook approved by CFTC

Benefits for End Users

- Bankruptcy – remote account
  - Funds held by neutral intermediary not FCM
  - Repository is not envisioned under 766 (h)
- Structural protection
  - Funds held on deposit at leading trust/custody banks
  - Rulebook defines rights and responsibilities of all participants
- Transparency
  - Balances in accounts are electronically accessible by customers via established banking platforms
  - Balances easily verifiable by FCMs and regulators

Benefits for FCMs

- **A new collateral protection service offered to customers for a fee**
  - Maintain customer relationships and access to clearing
  - Provide a “full-segregation” option for customers willing to pay for it.
  - Enhance (not impair) the existing business model

- **Cost efficiencies**
  - Shared outsourced solution
  - Leverage existing custody platforms

- **Restore trust and confidence in futures markets**
  - Address customer concerns about collateral protection

Conclusion

- The MFG and PFG debacles have shaken trust in the futures markets to their core.
- Farmers in Iowa who transact in futures should enjoy the same level of collateral protections that the largest institutional investors utilize in the swaps market.
- Until all futures market participants can be confident that their collateral is safe, the implementation of the swap clearing mandate will remain problematic.
- MDR proposes that the efficiency, safety, and soundness of the individually negotiated tri-party custody model can be made scalable and replicable through the establishment of a Central Collateral Repository.

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END