

RECOMMENDED COMMON PRINCIPLES FOR RELATIONSHIPS BETWEEN CUSTOMER AND EXECUTING BROKER ("EB") AND CLEARING MEMBER ("CM")*

The following principles have been derived from a series of meetings among representatives of prospective customers, dealers and clearing houses. The principles are intended to facilitate negotiation of relevant agreements in the context of different clearing platforms. The drafting group stresses that these principles do not reach many of the remaining issues that may be the subject of further group and individual discussions. The mere absence of treatment of an issue in these principles should not prejudice such discussions. The drafting group will remain available, to the extent participants wish, as a forum for addressing related issues as they develop.

Some comments received during development of these principles fell outside the scope of the project. ISDA believes that each platform-specific drafting group should have freedom, beyond these principles, to create its overall agenda going forward.

- 1. Fallbacks in the Event of Rejection for Clearing** [Note: These fallbacks apply after the clearing cut-off time. It is assumed here and in (a) that EB has the ability to clear, e.g. all the proper documentation exists (in conformance with clearing platform rules and related practice). It is also assumed that each trade is intended for a designated central counterparty ("CCP").]

If a trade is rejected for clearing by CM, an attempt may be made to find an alternative CM before the clearing cut-off time. If an alternative CM is unable to be found before the clearing cut-off time and the trade is rejected for clearing, then the following fallbacks would apply, the first two being elective:

- (a) EB may elect to accept the trade as a bilateral cleared trade (i.e., EB acts as CM for the trade).
- (b) EB may elect to accept the trade as a bilateral trade (assuming the appropriate documentation between the parties exists at the time or the parties can agree on appropriate documentation at the time).
- (c) Breakage, with calculation to be determined on the basis of which party is responsible for the trade not being accepted for clearing:
 - i. If EB fails to submit or otherwise breaches obligations to Customer, breakage will be calculated at Customer's side of the market.
 - ii. If (A) Customer breaches obligations to CM, (B) CM rejects a trade for clearing, including, without limitation, because Customer has violated a trading limit or (C) CCP rejects a trade because CM has violated a trading limit, breakage will be calculated at EB's side of the market.
 - iii. If CCP rejects a trade for clearing for any other reason, breakage will be calculated at mid-market.

* **Note: It is recognized that pending legislation may have an effect on these principles, to be determined as legislation evolves.**

- (d) Any trade not cleared by the clearing deadline is deemed rejected for clearing. However, each CCP may establish its own clearing deadline (which may or may not be the same date as a given trade).

2. Ability to Reject Trades

CM has the ability to reject trades, but must specify in a notice to EB the circumstances under which it rejects a trade.

3. Reduction of Limits

CM may reduce Customer's trading limits by notice to the Customer, with any such reduction effective upon receipt of such notice, but such limits would not apply to trades executed before the effectiveness of such notice, even if any such trade has not yet been cleared.

4. Market Decisional Bodies and the CCPs

- (a) If a relevant industry sanctioned decisional body (such as, in the case of credit derivatives, the ISDA Determinations Committee) makes a determination, all relevant CCPs will act in accordance with such determination in a consistent manner in order to avoid introducing new basis risk into the market.
- (b) With respect to a cleared trade and a question potentially subject to the judgment of such a decisional body, CCPs should cooperate to achieve a coordinated result in the absence of a determination by the relevant decisional body.