



Eurex Trading & Clearing Member Information –  
CO<sub>2</sub> related changes

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## Definitions and Abbreviations

<b>Term</b>	<b>Explanation</b>
AWV	Außenwirtschaftsverordnung
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
EEX	European Energy Exchange
ECC	European Commodity Clearing AG
ECAG	Eurex Clearing AG
DEHSt	Deutsche Emissionshandelsstelle
EUA	EU Allowance
ETS	European Trading Scheme
GCM	General Clearing Member
CM	Clearing Member
NCM	Non Clearing Member (Trading Member only)
VAT	Value added tax
WpHG	Wertpapierhandelsgesetz

## **1 Introduction**

Climate protection measures and their impact will increasingly become the determining factor for growth opportunities and resource employment of national and regional economies. Financing and technological implementation of climate protection measures will develop into one of the most dynamic industrial sectors on a global level.

Eurex has therefore entered into a cooperation with the EEX market to drive the development of a global market for emissions. The scope of the cooperation will comprise trading and clearing of emission allowances and any derived instruments like Futures and Options. The cooperation will initially start with Futures on EUAs for the Kyoto phase 2008-2012. The partners will combine Eurex' global financial market membership and distribution power with EEX' energy market membership and connectivity to the European power trading community. The core objective of the strategic cooperation is to create the leading international market place for emissions trading. The product cooperation will result in a significant expansion and internationalization of the participant base for emissions trading. In turn, liquidity in emissions products is likely to increase significantly and market quality and transparency will improve.

The cooperation products subject to the cooperation will be traded in a single order book. To avoid any splitting of liquidity, the order book will be unambiguously allocated to EEX. Trading participants of Eurex will be able to apply for EEX membership in the cooperation products based on a simplified admission process.<sup>1</sup> Trades in cooperation products will be cleared by both the Eurex Clearing AG and the European Commodity Clearing AG (ECC). This way, the cooperation can take full advantage of the existing international connectivity and structures of Eurex and Eurex Clearing AG.

This approach requires the two clearing houses to set up a relation with regard to trade allocation, position alignments, risk and margining procedures. However, ECC will remain the primary clearing house to EEX for all products listed and traded on EEX. Eurex Clearing AG will become the secondary clearing house (Sub-CCP). Since both clearing houses and exchanges operate on the same technical platform, the cooperation will provide seamless access to the cooperation products and the same operational procedures independently of the clearing house relation.

This document provides an overview on the cooperation concept and highlights the differences to the existing Eurex core business. Minor process adaptations are necessary due to the specifics of the cooperation products.

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<sup>1</sup> The Eurex members will legally become EEX members in emission products, but still be called Eurex members throughout this document to allow for better differentiation.

## 2 Trading Model

Trading facilities of both EUREX and EEX operate on the very same technical platform. The trading models, market control and supervision procedures, and finally the surveillance tools are similar – sometimes even identical. But the two exchanges operate in a slightly different regulatory environment, where EUREX is regulated and supervised as a financial derivatives exchange and EEX is regulated and supervised as a commodity exchange. However, there are no material differences with respect to membership admission criteria and trader admission criteria. Consequently, a lean admission process will be established and will allow members to start trading the cooperation products with minimal administrative effort.

EUREX trading members will gain seamless access to the trading facilities of EEX via their existing EUREX infrastructure and Eurex GUI. The cooperation products will be assigned to all Eurex members that have been admitted by EEX for the cooperation products. In addition the respective Clearing Member designated to clear the cooperation products needs to assign the respective product group to the Eurex Trading Member. Once the internal system administrator has assigned the cooperation products and the respective access rights to the individual traders, Eurex traders are able to trade the cooperation products at EEX via their existing Eurex member and trader ID. Since the EEX market model is identical, the Eurex traders can use their existing front end solutions allowing the products to be handled with the same “look and feel” as any other Eurex product.

### 2.1 Products

The cooperation concept foresees the on-exchange trading of EU emission allowances as well as an OTC-facility to register over-the-counter transactions in EU allowances with one of the involved clearing houses.

For Eurex members, the “Second-Period-European-Carbon-Future” on EU emission allowances will be tradable with production launch in December 2007:

#### **Contract Specifications Second-Period-European-Carbon-Future:**

<b>Short Code</b>	F2PE
<b>ISIN Code (WKN)</b>	DE000A0E4PY0 (A0E4PY)
<b>Settlement Type</b>	Physical Settlement
<b>Tick Size</b>	0.01 €
<b>Contract Volume</b>	1,000 EUA
<b>Delivery Day</b>	December 1st, 2008 – 2012 (or next ECC business day)
<b>Min. Tradable Unit</b>	1 Contract
<b>Delivery Rate</b>	1,000t CO <sub>2</sub>
<b>First Trading Day</b>	5.12.2007 (for EUREX members)
<b>Last Trading Day</b>	Last EEX exchange day in November 2008 - 2012

## 2.2 Trading Hours

The following trading and clearing schedule currently applies for these products:

Times are in CET.

<b>Pre-Trading</b>	<b>Opening</b>	<b>Trading</b>	<b>Post-Trading</b>
8.00-8.25	8.25-8.30	8.30-16.00	16.00-17.30

Table 1: Trading Schedule for EUA Futures on EEX

The trading times can also be found in the “Introduction to Exchange Trading at EEX on Xetra and Eurex” under <http://www.eex.com/en/Download/Concepts>.

The same trading timeline applies on the last trading day.

The trading schedule for EUA Futures on EEX will be enhanced as of the joint launch in December 2007. Trading hours are expected to be extended by 1 hour until 17.00 hrs, OTC-trade registration and the end of Post-Trading is expected to be extended to 18.00 hrs.

### **3 Clearing Model**

The cooperation products will be cleared by both clearing houses whereby ECC will be the primary clearing house and ECAG will act as secondary or sub-clearing house.

The huge advantage is, that both clearing houses operate on the very same technical platform and that the core business processes and the principle risk management regimes are identical. Further to this, both clearing houses operate under the very same regulatory and insolvency regime.

Eurex' international trading participants will be able to clear and to settle trades over existing clearing relationships without additional technical and functional effort. Clearing Members of Eurex Clearing AG can easily extend their clearing license to the cooperation products.

The future clearing model for products subject to the product cooperation foresees an effective clearing relation between ECC and Eurex Clearing AG to enable members of Eurex Clearing AG to offer clearing services for cooperation products to their customers and Non-Clearing Members.

Inter-CCP Risk Management will be applied to handle the positions between both clearing houses. It will ensure that members of Eurex Clearing AG will be protected against a potential default of an ECC member and vice versa ECC members will be protected against a potential default of a member of Eurex Clearing AG.

#### **3.1 Inter-Clearinghouse Trade Allocation**

Immediately and simultaneously with the primary clearing house assuming a transaction at the point of trade the following contract chaining will accommodate the different clearing relations an exchange trading member could have.

In principle, the following three cases need to be covered with regard to the contract chain across the clearing relation between the primary clearing house and the sub-clearing house:

**Case 1:**

All counterparties to a transaction maintain clearing relations to the primary clearing house ECC and thus the clearing relation between the primary clearing house and the sub-clearing house is not utilized at all.

**Case 2:**

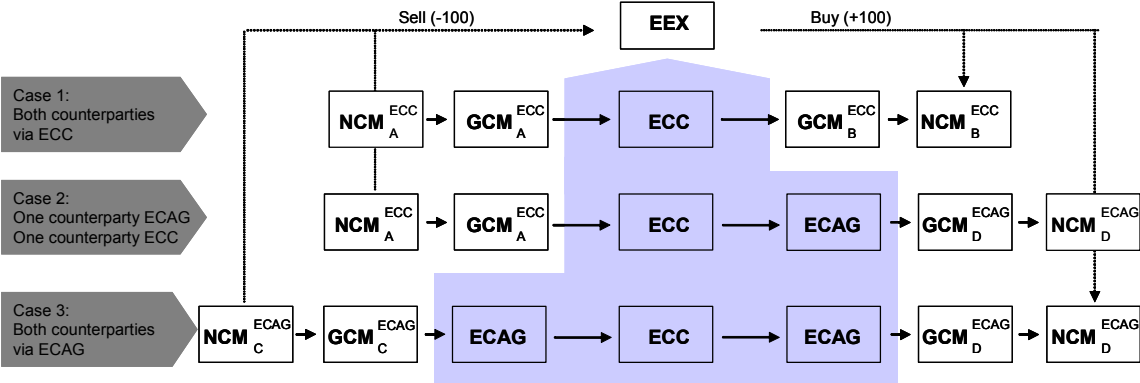
One of the counterparties to a transaction maintains a clearing relation with the sub-clearing house and the other counterpart maintains a clearing relation with the primary clearing house.

**Case 3:**

All counterparties to a transaction maintain clearing relations with the sub-clearing house but not with the primary clearing house.

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The following picture illustrates the different contract chains resulting from transactions:



## **4 Clearing of Cooperation Products at Eurex Clearing AG**

For transactions in cooperation products all existing functions and reports are available and follow Eurex Clearing AG's formats and standards:

- Trade Management
- Give-up/Take-up
- Position Management
- Cash Management and Settlement
- Risk Management

### **4.1 Trade Confirmation Broadcast**

Trade confirmations and back office feeds for EEX-executed trades are sent at the time of their execution. All machine-readable trade information is supplied to the trading members' as well as to his respective clearing members' / participants' front- and back office systems via the existing Eurex VALUES API interface.

The data values on all messages are depicted according to Eurex Clearing AG standards. For example, Eurex member identification, product codes, and accounts are shown.

### **4.2 Give-up / Take-up**

The Eurex system provides NCMs with the ability to give-up and take-up executions from their accounts to the accounts of any other trading member.

The give-up function allows members to transfer trades to other members, requiring the receiving party to accept or reject the give-up (take-up function). Trades can only be given-up from the agent account (A1), but can also be taken-up in the proprietary accounts (P1/P2). Only transactions that originated on the trading day (current give-up) or the previous two business days (historical give-up) may be chosen for give-up (designated).

The user will not recognize a difference between the existing give-up/take-up functionality as both EEX/ECC and Eurex/ECAG run on the same technical platform so that the user can select Non-Clearing Members of either clearing house for the take-up.

Similar to the process of trade allocation, different cases can be covered with regard to the contractual relationships of the involved members and clearing houses. Either the give-up/take-up transaction is executed between members of the same clearing house (either Eurex Clearing AG as the Sub-CCP or ECC as the primary CCP), or the give-up/take-up transaction involves members of both clearing houses so that an inter-clearing house transfer will be executed.

In that case the give-up/take-up transactions lead to transfers of obligations between the transferring clearing house and the receiving clearing house. If a transfer takes place between a Clearing Member of Eurex Clearing AG and a Clearing Member of ECC, then ECC and its CM step into the original obligation whereas Eurex Clearing AG and its CM cease to be the counterparty simultaneously. The transferring clearing house and its member are released from further obligations and rights in connection with such give-up trade.

### **4.3 Cash Management and Settlement**

Variation margin processes follow Eurex Clearing AG standards. Variation margin requirements for EUA futures are computed once per day based on the daily settlement price as determined by the EEX market. The calculation is performed by NCM and position account.

Cash transactions resulting from EUA futures will be included in the standard cash process of Eurex Clearing AG and will be debited or credited to the cash account of the Eurex Clearing Member.

The variation margin, premium, cash settlement, cash amounts from partial position transfers, and VAT payments will be added up and netted per Clearing Member and are reported on a daily basis as part of all cash transactions in the Eurex Clearing Report RPTCD010, which is created and sent in the Eurex End-of-day batch. Report "RPTCD070 - Monthly Cash Account Statement" provides this information aggregated on a monthly level. Furthermore, the screens "Premium / Variation Margin / Fee Overview" and "Cash Account Detail Overview" under the "Cash" menu item of the Eurex @X-tract Clearing GUI provide information on all cash / variation margin related calculations and transactions.

### **4.4 Billing**

With respect to Eurex trading members admitted to EEX for trading in the cooperation products, Eurex Clearing AG will invoice

- trading fees plus VAT on behalf of EEX.
- clearing fees

The billing will be processed via the Bundesbank account of the clearing member.

### **4.5 Legal reporting**

On the level of the clearing house, Eurex Clearing AG will include EEX transactions of its Clearing Members in its AWV reporting to Bundesbank.

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EEX - Eurex CO<sub>2</sub> Cooperation

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As of today, there is no requirement from BaFin concerning §9 WpHG reporting in commodities.

## **5 Settlement Model**

### **5.1 Overview of Settlement Model for EU Allowances**

EU Allowances (EUA) are emission allowances according to European Trading Scheme (ETS), which is governed by EU directives. EUA can be used for compliance within and transferred between all EU member states. The use of EUA for compliance is limited to the 2nd EU compliance period, i.e. the use of EUA is limited to the years 2008-2012. The trading participant's holdings of EUA are kept in accounts of official registries. Each EU member state operates such a registry. EUA transfers are possible without limitations between any accounts in any registry of any EU member state.

ECC will organize the physical delivery resulting from any spot or derivatives transaction in EUA for both, EEX and Eurex members. Physical fulfillment of expired futures position on emission allowances will be done by transferring emission allowances between the internal accounts of seller and buyer held in the ECC delivery management system. This internal account is automatically set up for each trading participant admitted for the cooperation products.

Deliveries of emission allowances are subject to **VAT taxation**. ECC as central counterparty for delivery will always debit or credit VAT with domestic (German) trading participants. The VAT rate is currently 19%. In general, ECC will not debit or credit VAT with non-domestic (non-German) trading participants.

Within this product cooperation a shortcut to the chain of deliveries is introduced: emission allowances are always settled physically between the selling trading participant and ECC as well as between ECC and the buying trading participant. ECC acts as central counterparty to all deliveries and will operate the settlement of deliveries for both partner clearing houses. This shortcut provides two advantages:

- Short settlement times because the number of required transfers of EUAs is minimized
- Clearing members and Eurex Clearing AG as the destination clearing house need not to deal with VAT which is involved in the delivery process

Still, the clearing members and also Eurex Clearing AG remain responsible for the payment cash flows and are liable for the orderly delivery of EUAs. Financial settlement after the execution of deliveries will be effected by means of the clearing member as the paying agent.

The delivery process for emission allowances is designed by ECC in a way that allows for an efficient and reliable delivery mechanism and that reduces delivery risks. Major cornerstones are:

- Short settlement cycles, as the delivery is settled one day after expiry
- "Pre-Deposit" of emission allowances whereby the seller is required to provide coverage of its custody account already on the last trading day / expiry date.

- Netting of delivery instructions from spot trades and expired futures positions
- ECC intends to set up a lending process to accelerate settlement time in case of an insufficient Pre-Deposit of the seller.
- Efficient risk management and penalty system for late or failed deliveries

To manage the delivery process, ECC will operate an internal system for book keeping purposes. Initially, ECC will have a custodial account with the German registry DEHSt. Trading participants can have holdings of emission allowances in the ECC account. Within the ECC system, ECC will mirror the holdings held in the ECC account into internal sub-accounts held for each trading participants.

A trading participant can change its holding by

- purchase and sale of emission allowances at the exchange,
- transferring emission allowances from its registry account into the ECC custody account (deposit) or
- transferring emission allowances from the ECC account into its registry account (withdrawal). Such a withdrawal will be done by ECC on the trading participant's request, if the free balance in its sub-account provides a sufficient amount of emission allowances to meet the request.

Legally, an expired futures position or spot contract is physically fulfilled, if delivery has been settled between the internal sub-accounts of the buyer and the seller. A transfer of emission allowances between the registry accounts of the buyer and the seller is not part of the actual physical fulfillment.

Having an appropriate account with a registry is not an admission requirement. The seller of emission allowances needs to transfer EUAs to the ECC custody account and can use a settlement agent for this purpose. The buyer of the emission allowances will receive a credit of EUAs on its internal account. Upon withdrawal of emission allowances, the buyer needs to inform ECC on the applicable registry account that shall be used. The trading participants will receive information on holdings at their internal account from ECC.

## 5.2 Standard Delivery Process for EUA Futures

The following describes the standard process for physical delivery of EUA Futures. The process for late and failed deliveries will be described in the next sub-chapter.

Timeline	Process Step
Close to expiry	<p>ECC will monitor expected delivery obligations arising from the upcoming futures expiry starting 4 days prior to expiry day.</p> <p>ECC will inform Eurex Clearing AG about trading participants that have not sufficient EUAs on their internal ECC accounts.</p> <p>Where appropriate, Eurex Clearing AG will remind the trading participant to provide for coverage.</p>
Last trading day = Expiry Day Until 18.00 CET	<p>Trading participants are required to deposit emission allowances on their ECC account for the expired futures position before the end-of-day processing is started, i.e. until 18.00 CET.</p>
Expiry Day 18.00 CET – 21.30 CET	<p>If the selling trading participant fails to provide sufficient deposit on its ECC account on expiry day, then Eurex Clearing AG will apply the following actions:</p> <ul style="list-style-type: none"> <li>- freeze of initial margin for the expired futures position in the end-of-day processing</li> <li>- freeze of payment for the net deliveries in the end-of-day processing until the next morning</li> <li>- information of the clearing member about failure of its trading participant.</li> </ul>
Expiry Day End-of-Day processing	<p>In the end-of-day batch run, the Eurex Clearing AG calculates the last variation margin posting based on the final settlement price.</p> <p>The expired futures position will be booked out of the clearing system and will be provided to ECC for the creation of delivery instructions.</p> <p>The payment instruction out of the DVP / RVP instructions will be created and will be incorporated into the standard cash process for Bundesbank payments.</p>
Expiry Day + 1= Delivery Day Before 07.30	<p>Trading participants that have not deposited sufficient balance on the custody account on expiry day can still deposit in the delivery management system of ECC on delivery day (e+1) before the start of</p>

CET	<p>the settlement processing.</p> <p>In this case, the frozen additional margin and the frozen payment will be released by the clearing house. Please note that the deposit needs to be available until 07.30 CET on t+1 (Delivery date), as otherwise Eurex Clearing AG cannot release the frozen payment instructions before the cash settlement at Bundesbank is started.</p>
<p>Expiry Day +1 = Delivery Day</p> <p>After 07.30 CET</p>	<p>The delivery-versus-payment process is started by ECC in the morning.</p> <p>Sale processing takes place until 08.00 CET. Here the net sale delivery instructions are processed and the emission allowances are transferred between the sub-accounts of the seller and ECC. Finally, the sub-account balance for selling trading participants are updated based on the settled sale delivery instructions. A sub-account statement will be reported to the seller. In parallel, the cash payments are debited on the Bundesbank account of the buyer's clearing member.</p> <p>To assure an efficient sale processing, ECC intends to utilize lending facilities if a seller has insufficient balance on its custody account. Please refer to next section for the implications.</p> <p>Purchase settlement processing starts at 08.00 CET. Here the net purchase delivery instructions are processed and the emission allowances are transferred between the sub-accounts of ECC and the buyer. Finally, the sub-account balance for all buying trading participants are updated based on the settled purchase delivery instructions. A sub-account statement will be reported to the buyer. In parallel, the cash payments are credited to the Bundesbank account of the seller's clearing member.</p>

### 5.3 Late and Failed Physical Delivery Process

Both clearing houses manage the different delivery risks:

- Failed payment by the buyer
- Late or failed physical delivery by the seller

If a clearing member fails to pay for the physical delivery on the delivery day, then ECC will freeze the pending delivery instructions for all buying trading participants of the affected clearing member. The frozen emission allowances can be treated like other margins available to cover close-out losses, if a default of a clearing member caused the failure to pay. If payment takes place delayed (technical default), ECC will release the frozen emission allowances and continues the settlement.

If a selling trading participant is late or does not deliver, the following process steps will be applied:

<b>Timeline</b>	<b>Process Step</b>
Delivery Day (d)  Automatic Lending Process	If a trading participant fails to deliver, ECC intends to automatically borrow the necessary amount of emission allowances to continue the settlement without interruption.  The late seller will have to pay a late delivery fee to cover the costs of the lending process.
Delivery Day (d) + Max. 10 days  Buy-in Process	The late seller remains obliged to deposit the required emission allowances into the ECC custody account or to close-out delivery obligations on the spot market as soon as possible.  Should a trading participant fail to meet its obligations, ECC will buy-in the missing emission allowances via EEX on the spot market in one or more buy-in attempts. The first buy-in will be triggered on d+5, the latest on d+10.  The clearing member is liable for all cost from a buy-in.  In addition a contractual penalty will be applied to the trading participant in default according to the ECC Clearing Conditions.
Delivery Day + 10  Final Cash Settlement	If the buy-in process is not successful, ECC will apply a cash settlement. The cost for this cash settlement will be charged to the failed seller.  In addition a contractual penalty will be applied to the trading participant in default according to the ECC Clearing Conditions.

#### **5.4 Trading Member Admission for trading of cooperation products**

In order for Eurex trading members to participate in trading of cooperation products, an admission at the European Energy Exchange (EEX) is required.

#### **5.5 General Process**

Eurex will offer a simplified admission process on behalf of EEX exclusively to Eurex members.

The following supporting documents must be submitted by the Eurex trading members in order to be admitted as trading participant in the cooperation products at EEX :

- Eurex Trading & Clearing Member Information - CO<sub>2</sub> related changes
- Application of admission of Eurex exchange participants as exchange participants for trading in emission rights on the European Energy Exchange (form)
- Exchange traders and contact persons Back Office for trading emission rights at European Energy Exchange (form)
- Mail authority (form)
- VAT (form)
- Application for the Granting of a Clearing Licence of Eurex Clearing AG (form)

The documents should be submitted to the respective Key Account Manager at Member Services & Admission  
Eurex Clearing AG  
60485 Frankfurt  
Phone: +49 69 211 1 1700  
Fax: +49 69 211 1 1701

After the submitted forms have been approved, participants will receive their approval notification by Eurex Clearing AG.

## **5.6 Prerequisites for the Admisson**

Further details concerning particular subjects of the admission process can be found below.

### **5.6.1 Admission of Traders**

As soon as the Eurex member is admitted as EEX member the cooperation products will be assigned to the admitted trading member and his traders.

Only the traders mentioned in the application form are entitled for trading in the cooperation products.

In order to ensure that only the traders on the application form will receive access rights for trading in the cooperation products, the security coordinator has to define the respective access rights for these traders.

Access rights cover the assignment of access levels for the different system functions. They define the right to trade particular contracts and maximum order sizes for each exchange trader

Further traders can be admitted at a later date by submitting respective trader application forms.

### **5.6.2 Clearing Relation**

A trading member requires a clearing relation to ensure the orderly clearing of his transactions. This can either be done by direct participation in the clearing process as Clearing Member or by means of indirect participation via a Clearing Member based on a respective NCM-CM Agreement.

Participants who wish to take part in the clearing process themselves as mentioned before need to apply for an additional ECAG clearing license to clear transactions in the cooperation products. Further information can be found in the information memorandum "Application for the Granting of a Clearing License of Eurex Clearing AG" which is available on the website [www.eurexchange.com](http://www.eurexchange.com).

### **5.6.3 Technical Connection**

No separate technical connection to EEX is necessary as the product will be tradable via the existing Eurex infrastructure, either via the Eurex Trading GUI or with the existing third party front end solution.