NYSE EURONEXT CONFERENCE CALL (INTERNAL ONLY)
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CONFERENCE CALL PARTICIPANTS

- Matthew Leising — Bloomberg News
  Media
- Edgar Ortega — Bloomberg News
  Media
- Jacob Bunge — Dow Jones Newswire
  Media
- Will Acworth — Futures Industry
  Media
- Alexandra Zendrian — Forbes
  Media

PRESENTATION

Operator: Good day, ladies and gentlemen, and welcome to the conference call for New York Portfolio Clearing. My name is Tawanda and I will be your coordinator for today. At this time, all participants are in listen-only mode. We will conduct a question and answer session towards the end of this conference.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the presentation over to Mr. Tom Callahan, Chief Executive Officer of NYSE Liffe U.S. and Mr. Murray Pozmanter, Managing Director Fixed Income Clearance and Settlement for DTCC. Please proceed.

Tom Callahan: Okay, good morning everyone. This is Tom Callahan. I am the Chief Executive Officer of NYSE Liffe U.S. I appreciate everyone's time dialing in today to talk to us about our new derivatives clearing initiative, New York Portfolio Clearing.

With me here at 11 Wall Street is Murray Pozmanter. Murray is the Managing Director of Fixed Income Product Development for FICC or Fixed Income Clearing Corp, who has been working incredibly closely with me and the team for four months on this initiative. It's exciting for us to be able to finally be able to speak publicly about it.

Also dialed in with us from Chicago is Jim McNulty, who I'm sure everyone on this call knows. Jim is the current Chairman of the Board of NYSE Liffe U.S., and also a Board member of NYSE Euronext and the former Chief Executive Officer of the Chicago Mercantile Exchange.

So I'd just like to make some brief opening comments about what we're doing and why we think it's exciting and why we think it's different. Murray's going to talk to you a little bit about the FICC perspective on this. I think most of you know who NYSE is but, despite the central role that FICC plays in the U.S. financial services infrastructure, maybe they're not as well known as they should be. So he'll tell you a little bit about their business and what they do. And then Jim, as, one of the statesmen of the global exchange industry, is going to give you his perspective on this and how it positions NYSE Liffe U.S. from a competitive perspective.

From the NYSE perspective, what I would say is anytime you have the chance to team up with a partner who measures their annual volume in quadrillions, it's easy to get pretty excited. This is not just another clearing announcement, and frankly, from some of the things I've read this morning, I'm not sure people are understanding yet the power of this entity that we are about to create. This isn't just another clearinghouse. The efficiencies that we are able to deliver back to the market are really unmatched and I think that's why you saw a unanimous approval, not only from the NYSE Euronext Board in Amsterdam two weeks ago, but yesterday from the DTCC board as well.

Why are we different? Why is this not just another clearing house? I think to answer that question you need to understand fundamentally why the current status quo of clearing of cash and derivatives is fundamentally inefficient. I think probably most people on this call understand that listed derivatives are the very natural hedge for cash instruments in most markets. But primarily in the U.S. Treasury market, if you are a big Wall Street bank, you would be naturally hedging long Treasury inventory with Treasuries or Euro dollars or interest rate swaps.

The way that the world works right now is you must post those margins independently -- obviously your listed futures at CME clearing and your cash positions at FICC -- and you're not getting any real credit in terms of margin offset between those two asset classes. That's inefficient for a number of reasons. It's capitally inefficient from a regulator's perspective. It's not as easy as it should be to get a single snapshot of risk across a consolidated portfolio and, operationally, it can be enormously challenging for the market and Murray can probably talk about that as well.

So essentially what we are delivering to the market, or will deliver to the market, is a new model. And for those of you who are familiar with the prime brokerage model, which is my background, it's sort of ironic that one of the fundamentals roles that a prime broker plays is to deliver portfolio margining to their clients. Yet the banks right now currently do not enjoy those same benefits from the financial infrastructure as it is currently available. We want to change that and to have cash and derivative positions together in a single portfolio that's going to create tremendous efficiencies in terms of capital, transparency and operational efficiencies.

Finally, what I'd say is there's probably been some justifiable skepticism about NYSE Liffe's or NYSE Euronext's ambitions in the futures market in the U.S. How serious are we? How committed are we? Do we understand the challenges? Well, yes. We do understand the challenges.

And one of the fundamental challenges with trying to compete in the U.S. market is that the CME is an efficient organization, and there is a tremendous amount of margin efficiency that is delivered through CME clearing, just due to the size of their market share. So to compete on price alone in the U.S. futures market is a losing strategy. I think we all recognize that, and to ask clients to split margin pools away from one central point of clearing to trade on another venue is enormously difficult in this capital scarce, or capital starved, environment.

So we are not creating split margin pools via this new clearinghouse. We're actually going one better. We are taking the current infrastructure of how positions are margined between cash and futures and we're putting them together and delivering unique efficiencies back to the market. It's important to understand that from a capital perspective this will be a more efficient place to transact business.

So it gives us multiple areas to compete. We can bring new products to market. We can innovate in terms of our speed and our technology. We can innovate in terms of pricing structures and cross platform incentives, such as our futures incentive program. But most importantly in this environment, it allows us to compete in terms of transparency, in terms of capital efficiency, and in terms of overall operational efficiency to the market, and we think, for us, that really puts us in a strong competitive position. So with that, I'll turn it over to my partner, Murray Pozmanter.

Murray Pozmanter: Thanks, Tom. First and foremost, I'd like to echo Tom's enthusiasm -- we're very excited about this transaction. We think it's truly transformational for the fixed income marketplace. FICC is the sole central counter party service provider for the U.S. government and agency mortgage backed market in the U.S. We currently process over 4.1 trillion in securities transactions each day and our mission has been to reduce risk and bring capital efficiency to those markets.

As of December 2008, we held 39 billion in cash and securities as margin against transactions that we were the guarantor of in those marketplaces. It's clear that the next logical step is to break down the silos that currently exist in the marketplace between cash, security transactions, and listed derivatives. And we think that the NYSE is a very, very logical partner for us. We think it's an ideal time given the environment in the credit markets right now to bring these two marketplaces together, and we think that we have an opportunity to vastly increase transparency into this marketplace and create true efficiencies for our customers.

Tom Callahan: Jim McNulty, you have any thoughts?

Jim McNulty: Sure, Tom, and thanks very much. One of the things that I would say after being involved with these markets for 30 years as an end user and then as a market operator, clients have always wanted three major benefits. One of them was low cost credit risk management from their clearing, particularly central counterparty clearing in futures industry. And right now, 90-plus percent of futures are cleared through one house, which doesn't lend towards the lowest cost credit risk management. And I think by putting together these two world class players, NYSE and DTCC, we have the opportunity to create true low cost credit risk management for our clients.

One of the other things that people wanted was transparency, and that was transparency for regulators and also for end users. I think when you put the cash collateral and futures into the same pot for the first time you can really see that transparency in one place. You can see what the positions look like. That will be good both for the end users and for the regulators.

And then finally capital benefits. You can build a clearinghouse with software but if there are no capital benefits, it's unlikely that somebody will come. What we see here in this operation is a tremendous opportunity to take advantage of the collateral that the major players in this market have in positions with DTCC, FICC and also with their futures contracts that they would have on NYSE Liffe. I think what you will have is a situation where clients get better use of their collateral, and they therefore can offset some of the capital risk and will be able to return capital to the banks and investment banks in a way that makes their operations more efficient.

So those three -- those three things will be delivered by this joint venture. Those are credit risk management, transparency and capital benefits, and I think that does make it a game-changing approach to clear in the futures market in the United States. Thanks, Tom.

Tom Callahan: Thank you, Jim. So with that, if anyone has any questions or comments or thoughts, we'd love to hear them.

QUESTIONS AND ANSWERS

Operator: Thank you.

(Operator instructions)

Your first question comes from the line of Matthew Leising with Bloomberg News. Please proceed, sir.

Matthew Leising: Hi, just a couple quick questions. One, are you guys planning to introduce any clearing for interest rate swaps? And secondly, I noticed in your release you mentioned that NYSE Liffe U.S. would be the first exchange to hook up clearing here but that it's open to other exchanges. Murray talked about breaking out the silos. Are you guys envisioning a sort of horizontal model here for derivatives clearing like OCC does in equity options?

Tom Callahan: Hey, Matt, it's Tom Callahan. Thanks very much for dialing in and thanks for your question. Primarily yes, we do envision interest rate swaps moving into this vehicle. I think you'll see the first suite of derivatives more along the line of listed derivatives, but as you build momentum and you combine multiple assets in the same portfolio, the efficiencies only grow. So if you have cash and you have listed derivatives and then you're able to introduce swaps, we think -- we hope -- that we'll be the very natural destination for the market.

Also understand that this is a very closely aligned initiative with the market. Obviously FICC is industry owned, as we've said very publicly, Matt, and I think you and I have probably privately chatted about this as well, we are bringing in strategic investors from the street into our exchange NYSE Liffe U.S. So we are very closely aligned with the street, and we hope because of the capital efficiencies that Jim outlined and because of our close alignment with the market, that hopefully people will view this as a logical place to bring other asset classes after a list of derivatives, including interest rate swaps.

In terms of the horizontal nature, I'm glad you picked up on that because it is an important part of this feature. Just from a very practical standpoint, there's going to be a period where NYSE Liffe U.S. will be the exclusive exchange clearing into this clearinghouse, just because we need to get it up and running and build it and build in the technology and all of that. But after a period of time, this will go to a more horizontal model. You won't see fungibility between exchanges that are cleared at this new entity, but in terms of risk offsets in a single pot, that will be delivered. So it is a fundamentally different model, I think, than currently what's available elsewhere in the U.S. futures market.

Murray Pozmanter: Just to sort of add on to what Tom said, that's completely in keeping with DTCC's current structure and mission, which is to provide a horizontal platform and services across our entire membership base.

Matthew Leising: Okay, I guess that's what I was getting at and I didn't realize it. It won't be fungible, but it will be a model more like LCH in Europe -- in London.

Tom Callahan: I'm not sure LCH gives margin offsets across exchanges, so this will be something different. I mean there's -- the thing about single pot margining is there's only one pot, right? So any exchanges that go in that all go into this single pot, single collateral movement, single margin call. So I think it's even a bit different than LCH.

Jim McNulty: And that is truly the innovation that we're talking about here. While there are other clearinghouses that offer services across various asset classes, we will be the first to look at them within one portfolio from a risk standpoint.

Tom Callahan: Yes.

Matthew Leising: Okay, so if I'm a customer and I've got trading at two different exchanges that are hooking into this one clearing effort, I'm going to get offsets from my positions on those two different exchanges.

Jim McNulty: That's exactly right.

Matthew Leising: Okay, which is not -- that's a new feature that doesn't exist, for example, at LCH. Is that what you're saying?

Tom Callahan: Yes, yes, sir.

Matthew Leising: Got it.

Operator: And your next question comes from the line of Edgar Ortega with Bloomberg News. Please, proceed.

Edgar Ortega: Hello, this is Edgar from Bloomberg. Sorry to double up on Bloomberg questions here, but I wanted to see if you might also elaborate a little bit on the structure of the joint venture in terms of what kind of financial commitments NYSE brings. In the release you detailed committing 50 million to, as I understand it, the guarantee fund for the joint venture to clear or is there an additional investment that you guys have to make to kind of keep this joint venture running?

Tom Callahan: Hey, Edgar, it's Tom. Yes, there is an initial and substantial capital investment that both NYSE and DTCC are making to build this venture and get it up and going and hire the full-time management team. This is definitively not a virtual clearinghouse. This is a real entity, fully staffed, and that's just going to take us some time. There's going to be some development work on both sides. We both bring a lot to this venture in terms of technology.

NYSE, a lot of people don't know, actually owns probably the premier clearing and settlement and position management infrastructure in the clearinghouse space. The system is not really a household word but it's called TRS/CPS, the clearing system that currently runs our European business, NYSE Liffe in Europe, currently cleared by LCH.

Also the clearing software that ICE Clear uses for their ICE Clear Europe venture. So we are delivering that.

Obviously, FICC has world-class risk management and position management technology as well, but there are going to need to be some amendments made or modifications made to both of those platforms in order to get them up and running. But it's one of the reasons why we think we can get this platform built, obviously pending appropriate regulatory approval. I will say, from our conversations with regulators to date, they do seem to be strongly encouraging of what we're doing from the perspective that it does reduce systemic risk and increase transparency.

But assuming that our regulatory approval goes as we expect it will, we can get this thing up and going by the second quarter of next year, which in terms of speed of delivering a clearing house is pretty darn quick. And again, that's just testament to the fact that really we're adopting existing systems at DTCC and NYSE. We're not building things de novo. So that's kind of an important point.

In terms of the financial details of the size, really what we said in the press release is what we're comfortable publicly disclosing right now. NYSE Euronext is making a $50 million contribution to the guarantee fund of New York Portfolio Clearing because we understand that in this environment, the financial stability of any clearing house needs to be unquestionable, so we wanted to make a strong statement in terms of our faith and confidence and investment in the new clearing vehicle.

Edgar Ortega: Overall, how large will the guarantee fund be or is it sort of pooled together with what FICC has already, or --

Tom Callahan: A lot of it depends. Obviously the guarantee fund scales as risk scales, right? So I think as we get further evolved in terms of products and market share and whatnot, it will be easier to answer that question. But, I just -- I can let Murray talk about the current size of the collateral. He mentioned 39 billion as a starting number. So I think in terms of the stability of this vehicle, it really will be unquestionable.

Murray Pozmanter: Yes, clearly this is going to be in addition to the already substantial resources that FICC holds to support this marketplace. But as Tom said, it will be scaled to risk.

And just to go back to the answer to the previous question, in addition to the absolute logic of bringing these products together, the fact that whole parties are able to contribute industry-leading and proven technology to the transaction just makes it all the more logical to do.

Edgar Ortega: Okay. I have just one more for you. As I understand, FICC already has a cross margin program with other futures clearing houses. Can you tell me just how this differs with what you guys have already offered since 2000? I mean it would seem like at least the cross margining benefits had been something that you had offered users for a little bit now.

Murray Pozmanter: Sure, we do offer cross margining, but that cross margining is very different from portfolio margining. What we have in place right now is a system whereby we and the futures clearing houses do our own internal calculations of our customer's risk and perform internal offsets on the portfolios that we see and just use whatever is the remainder of those portfolios to offset for potential cross margining benefits.

While that is certainly one way to approach it, it is not the most efficient way to approach it because you don't get the most effective correlation on all the positions that you hold. What we're going to do here, which is truly innovative and hasn't been done before is take a list of derivative positions and put them into the same portfolio as the cash obligations, and we're going to margin them based on the fact that they're one investment portfolio.

So as an example, if you're long a ten year note in the cash securities market and short the future, we'll look at that together and give offset first between the cash position and the future's position. That's the key difference between this process and what's currently in place for cross margining. That plus the fact that we're going to use the same margin methodology across the portfolio for both the futures piece and for the cash piece allows us to be much more efficient and much more effective in this process.

Edgar Ortega: I see. So in some sense, the difference is that, at the moment, you guys sort of do a lot of math and imagine what you have across assets, across products, as a way of assessing margins. But what this allows you to do is to, in fact, put the two products together in one portfolio and then do real actual sort of margining on those.

Tom Callahan: That's right. And as a further efficiency to our customers and really a reduction in operational risk is, as opposed to having to maintain margin deposits in two different places, we'll be issuing a single margin call that covers the entire portfolio.

Edgar Ortega: I see.

Tom Callahan: So this is a true streamlining of the entire process, both from a transparency of risk and an operational risk standpoint.

Edgar Ortega: Great, great. That's very helpful. Thank you.

Operator: (Operator Instructions)

Your next question comes from the line of Jacob Bunge with Dow Jones Newswire. Please proceed.

Jacob Bunge: Hey, guys. This is Jacob here. Thanks for taking the questions. I was curious, and I'm sorry if you've addressed this already in some respect, but you have the Treasury securities there on the one side. You're going to introduce some interest rate futures to match against those. I'm curious if there's any target for when those will be introduced on NYSE Liffe U.S. or, alternatively, are you looking to try and get people. You know, you mentioned you're involved with a lot of discussions with people on the Street. Are you trying to get people to maybe put some pressure on CME to let them clear contracts here instead of CME's clearing house and how that might work?

Tom Callahan: No. Hey, Jacob, it's Tom Callahan. No, we're not trying to get people to put pressure on the CME to allow trades to clear here instead of there.

And in terms of the timing – well, first of all, maybe just a slight correction on your question. FICC doesn't just do Treasuries. They do a lot of Treasuries, but they do other things as well. They do agencies, they do mortgage backed securities, and they do repos on all of those things.

So the opportunity for us as an exchange is to create innovative new products in either the Treasury space, mortgage-backed space. This stuff is all very highly correlated. So to the degree that you can create products that have natural efficiencies from a capital and a clearing perspective, then I think that creates a much more compelling value proposition.

So yes, I mean Treasury futures are a part of the answer, but between now and go live of this new clearing vehicle next year, we're obviously going to be out talking to a lot of people in the market. As we all know, in this environment, things change radically in a year. Sometimes they change radically in a day. So we haven't really thought too hard about exactly what products get launched in which order. The beauty of this architecture is that all interest rate products will be highly efficient in this environment.

So in terms of what we launch and in which order, frankly, that's sort of a competitive decision that we'll assess as we get closer to go live. But you don't have to think too hard when you look at the portfolio of risk that currently exists at FICC to get pretty excited about the types of products that we could launch off of this clearing platform that we think, from a market perspective, would be really, really well received.

Murray Pozmanter: Yes, I think Tom's exactly right. The possibilities are pretty broad when looking at the portfolio that's within FICC. FICC basically takes care of all the non-credit rates products in the security space as a subsidiary of DTCC, which is the largest clearer in the security space in the U.S.

Clearly, if we go across agency mortgage backs, if we go across government agencies, if you go across Treasuries and the repos that back all of those products up, there are multiple possibilities for products that can be launched that are the logical hedges to all of those cash products. So we'll really wait and see what the market dictates.

Operator: Your next question comes from the line of Will Acworth with Futures Industry. Please, proceed.

Will Acworth: Yes, hi. Thanks for organizing this press conference. The question is about the participation by clearing members: Are you planning to offer any incentives to the banks and brokers who might be joining this clearing house and would those incentives include, beyond the economic value of what you're offering, would it include any kind of revenue sharing or equity participation.

Murray Pozmanter: Nothing along those lines is considered right now. One of the unique things that we're looking to introduce here is the opportunity for all of the existing FICC members to automatically become members of this new futures clearing house. And in addition to that, all of our new members that come into FICC will have the opportunity to join the futures clearing house. FICC is currently in the process of filing a rule with the SEC to expand our membership to include the buy side of the marketplace.

So once the buy side of the marketplace has direct access to the securities clearing house, we would anticipate that they would also have the same access to the futures clearinghouse, which really expands our membership base and offers these efficiencies over a much broader swath of clientele.

Tom Callahan: Yes, that's an absolutely critical point. As the FICC membership broadens, which it will be shortly, the universe of clients that have access to the new clearing house grows, and it will be truly an open platform of sell side and buy side participation.

But, Will, I think maybe where you were going on the question is whether we are going to be selling equity to strategic investors. The answer is we don't think so because we don't think we need to do that. Generally you do a trade like that because you want to align yourself with the market and have the users feel like they have some interest in the success of the clearing house.

Will Acworth: Exactly.

Tom Callahan: But we think we've achieved that. Because understand, remember FICC is industry owned right now and our exchange is going to have a group of strategic partners as well. So we already feel like we've got a terrific amount of alignment with the market. And then understand also, if we're correct in our analysis of the potential capital relief that this delivers back and the regulatory benefits, the transparency, the more people trade on our platform versus other exchanges, the more capital efficiency they receive. So it becomes a bit self-reinforcing. So the answer is that it's not anticipated because hopefully the market will feel a strong sense of alignment with what we're trying to accomplish.

Will Acworth: Also want to go back a little bit to when you said buy side will have direct access to FICC. When you say direct access, my experience has been that in the futures world, the buy side has access to futures clearing houses but there's a clearing firm that is in between that relationship, and the clearing firm brings those trades to the clearing house for clearing. So when you say direct access, is that what you're referring to or do you mean the buy side will be able to participate or post their positions directly into the clearing house?

Tom Callahan: Well, yes Will, it is going to be a traditional model of FCMs introducing clients, but I think what we were trying to say is that as FICC's membership broadens, which it's about to, that the universe of clients that have access to join New York Portfolio Clearing as clearing members and enjoy the powerful cash versus derivatives offsets that we can deliver just grows. So I wasn't trying to say that this was somehow not a traditional FCM model. It absolutely is.

Will Acworth: Okay. I was just wanting to make sure because there are some places where each participant, including the buy side, is in fact a direct member of the clearing house. One last question, from a technical standpoint -- how often does the FICC do margin calls currently? Is it once a day or more frequently?

Murray Pozmanter: That's a great question. Currently we do it once a day. Part of what we're anticipating doing as we move into this joint venture is shifting to a twice a day model to align with the way the futures markets currently work.

Will Acworth: Right.

Murray Pozmanter: And to also increase the transparency that we have in some members risk on a real time basis.

Will Acworth: Got it. Okay. And is that every day, twice a day, or more of a kind of an optional thing, depending on how volatile the markets are.

Murray Pozmanter: It's every day, but as in the current futures markets, there will be thresholds, so there won't always be a second call.

Will Acworth: Got you. All right. Well, look. Thank you very much.

Tom Callahan: Thanks, Will.

Operator: Your next question comes from the line of Alexandra Zendrian with Forbes. Please, proceed.

Alexandra Zendrian: Hi, thank you for taking my question. I wanted to ask about how this is going to affect NYSE Euronext and its visibility in the futures market going forward?

Tom Callahan: Well, thank you for the question. Yes, we hope that any lingering doubts about the sincerity of NYSE Euronext ambitions in the futures market in the U.S. will be put to rest. Competing in this market was something that was never going to be quick, easy or cheap. It's going to take a multiyear approach with very thoughtful and careful planning, and hopefully we're demonstrating that we're doing that.

If you look at what we've done since we initially acquired our exchange in March of '08 with our regulatory approval in September of '08, the go live, the technology upgrade that we did, the launching of our metals platform, the announcement that we made last month about MSCI equity index products, which we're tremendously excited about and have received really, really good feedback from the user community on.

Our intention -- and our stated intention all along -- has been to be a global multi asset class exchange. And I think we're delivering on that. But also, I think we're being realistic on what it takes to become a global multi asset class exchange, and clearing efficiency is a very, very important part of it. So we didn't want to launch off in directions of new asset classes and throw contracts up on a screen and hope someone trades them.

The value proposition to compete in the U.S. futures market has to be unquestionable or else you'll fail and until we got to the point where we had an unquestionable value proposition in interest rates, we didn't think it made sense to be public in terms of launching new products. We feel very strongly that, in partnership with FICC, we do have an unquestionable value proposition that's innovative, No one's ever don this before, and if we're able to deliver what we think we can, and we're very confident around that, we think it puts us in a very good competitive position.

Alexandra Zendrian: Do you have any other planned additions for the futures market right now?

Tom Callahan: I'm sorry. Any planned what?

Alexandra Zendrian: Additions? Anything new that you want to add to the futures market right now?

Tom Callahan: Well, I think building a new clearing house and launching MSCI futures and launching base metals all -- I'm sorry, precious metals -- all within a six-month period is a lot. So I think you're going to see us focus hard on getting this new clearing house up and running and getting our regulatory approvals. We're still going to be launching our MSCI emerging markets and EPA contracts in September of this year, which we're terrifically excited about.

We would love to grow our market share in our gold and silver contracts, which are terrific products for us in this environment. So we've got a lot on our plate. I wouldn't be expecting a lot new, but we feel like we've done a lot, so hopefully executing and continuing to f say what we mean and mean what we say will be the focus for the next year.

Alexandra Zendrian: All right. Thank you for your help.

Unidentified Corporate Representative: Thanks.

Tom Callahan: Okay, well that looks like it's all the questions. I really appreciate everyone's time in dialing in. Eric Ryan and Rich Adamonis are here, and if anyone has follow up questions, please funnel them in their direction. And otherwise, just thank you, all, very much for your time.

Operator: Thank you for joining today's conference. That concludes the presentation. You may now disconnect and have a great day.