

# Service Description

## Central Counterparty (CCP) for SIX Swiss Exchange

October 2009

## Service Description

### Central Counterparty (CCP) for SIX Swiss Exchange

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#### 1.0 Introduction

As a Central Counterparty (CCP) for securities trading SIX x-clear chiefly assumes the following three functions:

- to ensure post-trade anonymity in order to prevent market distortions
- to eliminate bilateral counterparty risks from trade date to settlement date – a requirement which, in view of the globalization of electronic trading platforms, is continually gaining in importance
- to permit settlement netting and, in consequence, reduction of settlement volumes.

The degree of importance attached to these three functions differs between market participants and depends on the developments in the financial markets (for example in the context of Basel II). Along with the netting functionalities, risk minimization plays a major role: Due to the fully-automated matching of orders on electronic trading platforms, a trading party is not free to choose its counterparty. In view of the continued opening up of markets, stock exchange participants find it increasingly difficult to assess their individual credit and counterparty risks since they no longer form part of a local, manageable group.

This Service Description describes the main functionalities and features of the Central Counterparty SIX x-clear, a service for equity trades and ETF transactions offered by SIX Group on SIX Swiss Exchange.

#### 2.0 Concept of the Central Counterparty (CCP)

##### 2.1 Clearing

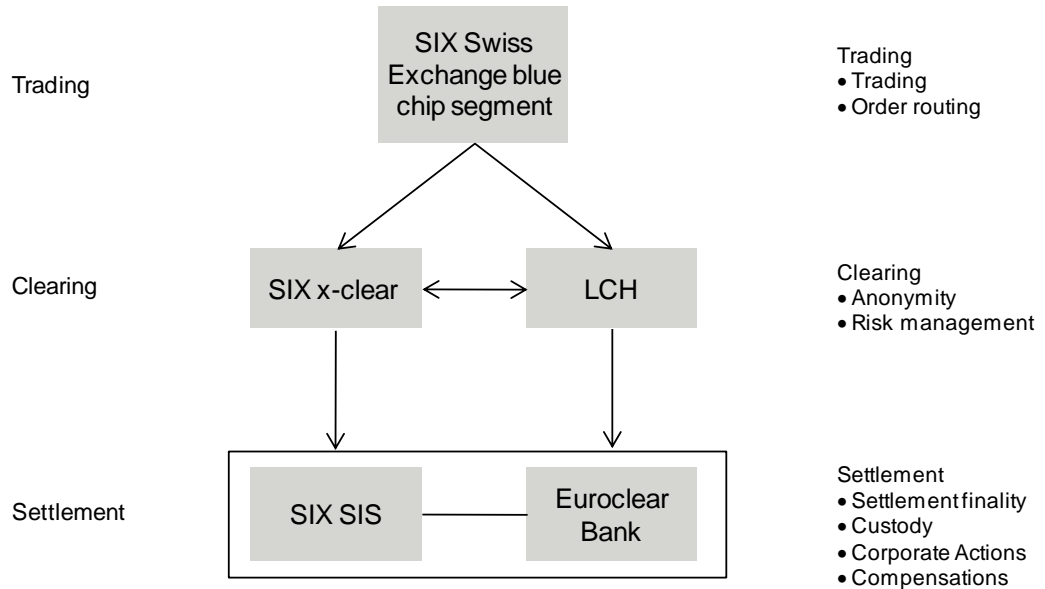
Clearing is performed after a trade has been concluded (matched) but before it is settled. The purpose of clearing is the efficient handling of risks inherent in concluded but still unfulfilled (trading) contracts. The Central Counterparty steps into the contracts as intermediary and represents the buyer to each seller and the seller to each buyer.

##### 2.2 Clearing model for the blue chip segment on SIX Swiss Exchange

Members can freely choose their central counterparty (SIX x-clear or LCH.Clearnet) and the settlement organization (SIX SIS or Euroclear Bank) in SIX Swiss Exchange's blue chip segment. Accordingly, they also have the choice with respect to the applicable jurisdiction.

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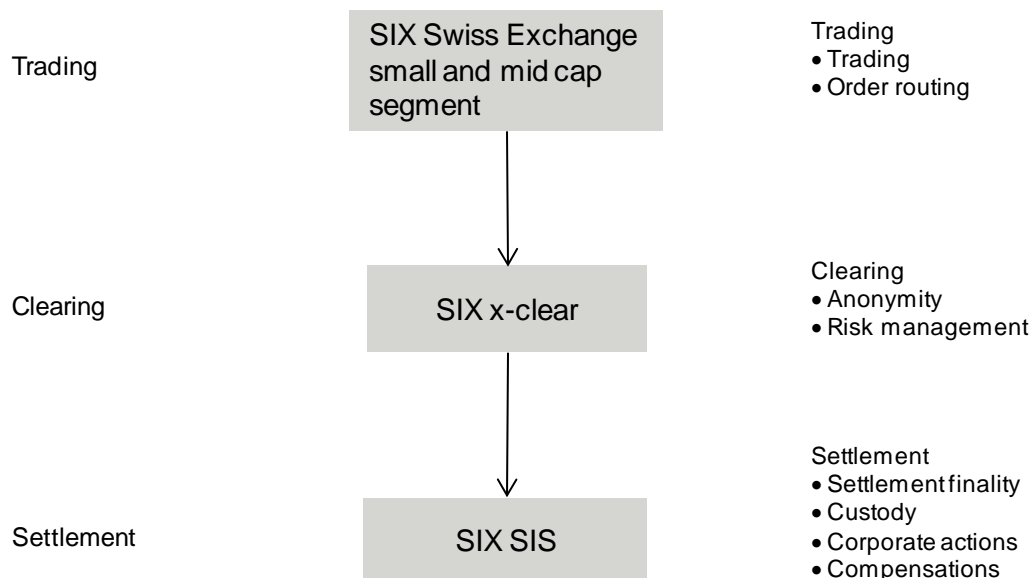
In a trade concluded between a member of SIX x-clear and a member of LCH, only the individual trading partner's own CCP is revealed.

### 2.3 Clearing model for the small and mid cap segment on SIX Swiss Exchange

SIX x-clear also clears trades in SIX Swiss Exchange's small and mid cap equities and Exchange Traded Funds (ETF) segments. The model is flexible, allowing for further central counterparties to offer their services at SIX Swiss Exchange alongside SIX x-clear at a later stage. Settlement is performed by SIX SIS.

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#### 2.4 SIX x-clear as Central Counterparty

SIX x-clear is a wholly-owned subsidiary of SIX Group. The company has a banking licence under Swiss law and is thus regulated and supervised by the Swiss Financial Market Supervisory Authority (FINMA). The Financial Services Authority (UK) has granted SIX x-clear the status of a Recognised Overseas Clearing House (ROCH). SIX x-clear started business operations in May 2003.

SIX Group offers a Swiss clearing house that is fully integrated into the efficient and cost-effective Swiss Value Chain. Members of SIX x-clear (hereinafter referred to as members) profit from this seamless extension of the Swiss Value Chain without the need for additional interfaces and from the possibility of having clearing and settlement performed under Swiss law.

SIX x-clear provides the following functionalities:

- Assumption of counterparty risk: SIX x-clear automatically becomes the counterparty for all its members trading clearing-eligible securities at SIX Swiss Exchange. When a trade is accomplished on the trading platform (matching), a contract resulting from this trade is no longer concluded between the two stock exchange participants; instead, the Central Counterparty steps into the trade by representing the buyer to each seller and the seller to each buyer.
- Post-trade anonymity: As a clearing house, the Central Counterparty occupies an intermediary position between the trading parties. This ensures full post-trade anonymity at the Central Counterparty and CSD level.

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- Settlement netting: The optional offsetting of delivery and payment obligations allows for reduction of the overall settlement volume and the number of delivery instructions.
- Risk management: A central risk management serves to determine the members' individual risk positions and margin requirements. Compared to calculation on a gross basis, net exposure, i.e. the offsetting of risk positions, reduces the total collateral to be pledged.

### **3.0 Relationship between SIX x-clear and London Clearing House (LCH) in SIX Swiss Exchange's blue chip segment**

Within the clearing model for the blue chip segment, SIX x-clear is an equal clearing member (co-CCP) alongside London Clearing House (LCH) and has, depending on the constellation of a trade, different functions as CCP or co-CCP of LCH respectively:

- SIX x-clear functions as Central Counterparty in all trades concluded between clearing participants if both trading parties are either members (ICM/GCM) or non-clearing members (NCM) of SIX x-clear.
- SIX x-clear functions as co-CCP of LCH in stock exchange trades concluded between clearing participants if one of the clearing participants is a member of LCH and the other a member of SIX x-clear.

### **4.0 Membership of SIX x-clear**

#### **4.1 General requirements**

SIX x-clear members may be natural persons and legal entities which are commercially active in securities trading or settlement for third parties and which are members of SIX Swiss Exchange and participants of SIX SIS, such as:

- Banks in accordance with the Swiss Federal Law on Banks and Savings Banks of 8 November 1934 (Swiss Banking Law);
- Foreign banks that are subject to the same degree of regulation and supervision as banks in Switzerland;
- Securities traders as defined by the provisions of the Federal Law on Stock Exchanges and Securities Trading of 24 March 1995 (Stock Exchange Law);
- Foreign securities traders who are subject to the same degree of regulation and supervision as securities traders in Switzerland.

In addition, each member must comply with various requirements related to hardware, software and the overall system.

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The application for membership with SIX x-clear must be submitted in written form, together with a declaration issued by SIX Swiss Exchange or SIX SIS confirming the admission as stock exchange member or SIX SIS participant respectively.

#### 4.2 Member structure

There are two categories of clearing membership available at SIX x-clear:

- Individual Clearing Members (ICM)
- General Clearing Members (GCM)

Unlike ICMs, GCMs may provide clearing services for other stock exchange participants without clearing membership (so-called Non-Clearing Members, NCMs).

#### 4.3 Individual Clearing Members (ICM)

ICMs provide clearing for both their own stock exchange transactions and transactions effected by their clients. These include group-internal transactions effected for affiliated companies provided that the member is fully consolidated within the group and that the other affiliated companies have no securities dealer licence and/or no admission to listing on the stock exchange.

##### 4.3.1 Minimum rating

An external, long-term counterparty rating of A-/A3 or better is required. The second highest grade available in the respective rating system serves as reference value. If no external rating is available, an internal rating is defined by means of benchmarking. Although the rating represents no criterion for exclusion, it has an impact on the risk premium and the determination of the amount of collateral to be provided (margining).

##### 4.3.2 Default Fund

Please refer to chapter 6.6.

##### 4.3.3 Margining

The initial margin is continuously calculated on the basis of the net positions of all open contracts per security held by the member. Computation of the initial margin is based on the historical Value-at-Risk (VaR). For the calculation of the initial margin, the securities are allocated to different risk buckets, depending on a security's VaR. Opposing positions within a risk bucket are netted. In addition, risk netting coefficients across the individual buckets are applied. The process of computing the initial margin is explained in detail later. Depending on the member's rating, the margins are increased by the applicable risk rating coefficient. Additionally, a variation margin is calculated on the basis of the mark-to-market valuation of the net positions of all open contracts per security held by the member.

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#### 4.4 General Clearing Members (GCM)

GCMs provide clearing for their own stock exchange transactions as well as transactions effected by their clients and third parties, i.e. stock exchange participants without direct access to a clearing house. Thereby, the GCM is responsible for its NCM's compliance with all rules and regulations of SIX x-clear.

##### 4.4.1 Minimum rating

The minimum rating required is A+/A1 (also refer to chapter 4.3.1).

##### 4.4.2 Default Fund

Please refer to chapter 6.6.

##### 4.4.3 Margining

Please refer to chapter 4.3.3.

The GCM is obliged to demand from its NCMs margins that equal or exceed its own margins.

##### 4.4.4 Operational capabilities

Since GCMs are also responsible for transactions of third parties (i.e. its NCMs), they must ensure smooth operation of their trading, operating and settlement systems as well as availability of sufficient human resources.

##### 4.4.5 Duty of disclosure

The GCM is obliged to disclose the identity of the NCMs to SIX x-clear.

#### 4.5 General notification requirements

In the following cases, members are obliged to provide SIX x-clear with a written notification:

- the member's regulatory status has changed;
- new circumstances emerge that may substantially affect the member's financial stability or creditworthiness;
- the member appoints an additional or another CSD for the settlement of its trades;
- the member is no longer in a position to meet the technical specifications.

All members are obliged to submit their annual reports to SIX x-clear without prior request.

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#### 5.0 Money/Custody account structure

#### 5.1 Clearing

Irrespective of existing money and safecustody accounts kept with SIX SIS or other settlement organisations, members require specific money and safecustody accounts for clearing via SIX x-clear. In all money and custody accounts, the positions resulting from blue chip, small and mid cap and ETF transactions are presented in consolidated form. The money and custody accounts listed below are kept with SIX SIS on behalf and for account of SIX x-clear.

##### 5.1.1 Clearing accounts

The member's open positions are recorded in clearing accounts.

##### 5.1.2 Margining

##### 5.1.2.1 Collateral accounts for margins

For each member, SIX x-clear opens collateral accounts with SIX SIS in the name of SIX x-clear. These are used to transfer the margins provided. The collateral is transferred or ceded to SIX x-clear as an irregular pledge with right to refund. SIX x-clear thus becomes the collateral owner.

The member can avail of the following collateral accounts:

##### **Custody collateral account**

##### **Money collateral account**

##### 5.1.2.2 Dispo collateral account

SIX x-clear opens dispo collateral accounts with SIX SIS for each member. These accounts are held in the name of the member and are linked with the member's SIX x-clear collateral accounts.

##### 5.1.3 Default fund collateral account

SIX x-clear opens for each member a collateral account with SIX SIS for the SIX x-clear default fund. This account is held in the name of the member. Holdings in the collateral account are pledged to SIX x-clear by means of regular lien.

For more information on the money and custody accounts required, please refer to SIX x-clear's Clearing Terms for SIX Swiss Exchange.

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#### 5.2 Settlement

SIX x-clear allows clearing participants to settle their blue chip trades optionally via SIX SIS or Euroclear Bank. Trades effected in the small and mid cap and ETF segments are settled via SIX SIS since SIX SIS is the sole settlement organisation admitted by SIX Swiss Exchange.

#### 6.0 Risk management

As Central Counterparty, SIX x-clear assumes the risk on the buy/sell side and is liable towards the respective member for the fulfillment of obligations (both on the money and securities side) arising from stock exchange trades. SIX x-clear guarantees the fulfillment of these obligations even in the event of default of a member; however, it does not guarantee timely execution of the transactions on settlement date.

#### 6.1 Objectives/Overview

The primary objective is to minimise potential risks through effective and accurate risk management. In the event of default of a member, the risk should be primarily borne by the defaulting member itself. Therefore, risk minimisation is achieved through the following measures:

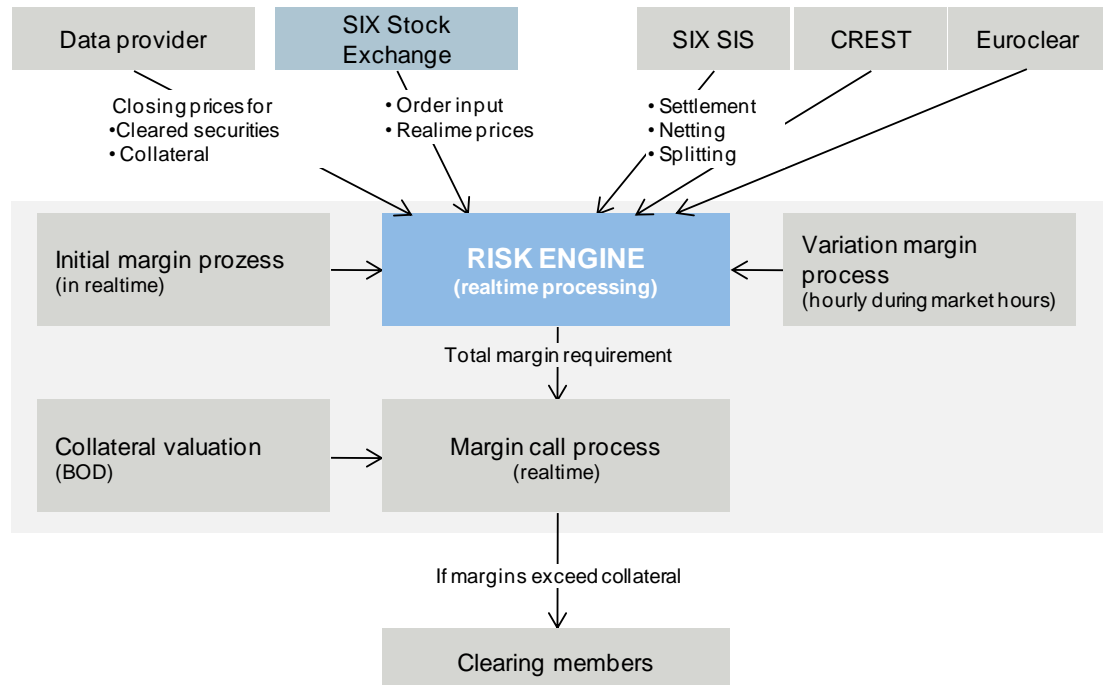
- Safeguarding against the market risk to be expected subsequent to any default of a member by means of the margins and collateral deposited by the member
- Pledging of collateral to cover unpredictable losses in the Default Fund.

#### 6.2 Risk management process

The following diagram provides a high-level overview of the risk management process:

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### 6.3 Margins

The total margin required is the result of the initial margin multiplied by the risk rating coefficient, plus the variation margin.

Risk management consists of the following processes:

- Calculation of margin requirements
- Valuation of collateral
- Checking of margin coverage
- Margin call

Daily valuation of the collateral is normally based on the previous day's closing price. Depending on market conditions, valuation may be done more frequently.

The initial margin serves as cover for absorbing future market price fluctuations (market risks) occurring between the default of a member and close-out of unsettled securities positions by the CCP, whereas the variation margin is used to retrospectively adjust the collateral according to current market prices.

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#### 6.4 Calculation of margins

Open net positions of all open contracts per ISIN at SIX Swiss Exchange are calculated on an ongoing basis, i.e. each change in positions entails an automatic update of values. These open positions as well as Corporate Actions not yet settled form the basis on which the initial margin and the variation margin are calculated. Please note that the initial margin and the variation margin are always calculated on a consolidated basis for all SIX x-clear exchanges.

##### 6.4.1 Initial margin (IM)

Calculation of the initial margin is based on the VaR of the underlying securities. According to this system, margins are differentiated according to the volatility of the shares and debited in real time.

Value at Risk is defined as the maximum possible loss for a given financial portfolio with a given confidence level. For example, if the 2-day VaR of Nestle is 5.6% with 99% confidence level, Nestle's 2-day price changes are expected to exceed 5.6% in only 1 out of 100 instances.

For each clearing-eligible security, 2-day VaR is periodically computed based on a price history. In addition to the long-term VaR based on prices over the past two years (approx. 500 trading days), a short-term VaR based on prices over the past three months (approx. 90 trading days) will be determined. The procedure for computing VaR for a security is as follows:

- Compute 2-day historic returns using 2-year or 3-month price history
- Arrange such 2-day returns in ascending order (largest negative return on top)
- For 500 2-day returns, the 6th largest negative return is the one which has not been exceeded more than 1% of the times. The determination of the short-term VaR is also based on a confidence level of 99%. If the short-term and the long-term VaR deviate, the higher of the two will be applied as VaR per ISIN. The VaR is recalculated and adjusted at not less than weekly intervals. In case of difficult market conditions, it may also be calculated daily, if required.

##### 6.4.1.1 Risk buckets

Securities will be grouped in risk buckets, and each security could fall into any of them depending on its VaR. There are six risk buckets with the following parameters:

Bucket name	Minimum VaR	Maximum VaR	Initial Margin (%)
BU01	0.00	5.00	3.50
BU02	5.00	10.00	7.50
BU03	10.00	15.00	12.50

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BU04	15.00	20.00	17.50
BU05	20.00	25.00	22.50
BU06	25.00	und höher	27.50

The process of forming the risk buckets always follows the computation of VaR, which is done weekly.

#### 6.4.1.2 Risk netting coefficient I (intra-bucket netting coefficient, or Intra BNC)

Opposing open positions within a risk bucket (i.e. a net long position in one share and a net short position in another) have the effect of reducing the market risk posed by such open positions. There is no perfect positive correlation between the individual securities contained in a risk bucket. Therefore, by means of the risk netting coefficient I, an average correlation is reproduced within a risk bucket and takes effect accordingly. Opposing open positions within a risk bucket are netted off using this intra-bucket coefficient.

The following example, using an Intra BNC of 0.80, explains the process:

Risk bucket	Security	Long or short	Open amount (CHF)	Initial margin (%)	Initial margin (CHF)	Bucket initial margin (CHF)
BU02	A	Long	1000	7.50	75.00	75-(52.5 * 0.80) = <b>33.00</b>
	B	Short	-700		-52.50	
BU03	C	Long	400	12.50	50.00	100-(50*0.80) = <b>60.00</b>
	D	Short	-800		-100	

Formula: Initial margin of risk bucket = The higher of "Bucket IMLong" or "Bucket IMShort", less the lower value multiplied by the risk netting coefficient I, i.e.

- bucket IMLong is the absolute sum of IM for all long positions within a risk bucket;
- bucket IMShort is the absolute sum of IM for all short positions within a risk bucket;

The lower value (of bucket IMLong and bucket IMShort) multiplied by the risk netting coefficient I corresponds to the reduction of margins for opposing positions within a bucket.

#### 6.4.1.3 Risk netting coefficient II (inter-bucket netting coefficient, or Inter BNC)

Similar to opposing positions within a risk bucket, opposing positions across risk buckets also have the effect of reducing the market risk. The inter-bucket coefficient II is applied to net positions across risk buckets in case of opposing net positions across different risk buckets and has the effect of reducing the initial margin. The risk netting coefficient II is applied at the level of margins per bucket.

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The following example, using an Inter BNC of 0.40, explains the process:

Risk bucket	Security	Long or short	Open amount (CHF)	Initial margin (%)	Initial margin (CHF)	Bucket initial margin (CHF)	Net bucket margin (CHF)	Inter-bucket margin offset (CHF)	Total initial margin (CHF)
BU02	A	Long	1000	7.50	75.00	75-(52.5 * 0.80) = <b>33.00</b>	22.50	22.50*0.40 = <b>9.00</b>	33+60-9 = <b>84.00</b>
	B	Short	-700		-52.50				
BU03	C	Long	400	12.50	50.00	100-(50*0.80) = <b>60.00</b>	-50.00		
	D	Short	-800		-100.00				

Each bucket would have one "net bucket IM" which could be either positive or negative. Positive values of "net bucket IM" should be added across all risk buckets to arrive at the "total net long IM". Similarly, negative values of "net bucket IM" should be added across all risk buckets to arrive at the "total net short IM". The smaller of these two figures (in absolute) multiplied by the Inter BNC is the value by which margins would have to be offset (inter-bucket reduction).

Total IM =  $\sum$  (IM for each bucket) less "inter-bucket margin offset", where

- " $\sum$  (IM for each bucket)" is the sum of margins for all risk buckets. "IM for each bucket" incorporates the effect of Intra BNC.
- "inter-bucket margin offset" is the amount by which margins would be reduced to account for the opposing nature of net positions across buckets = (lesser of "total net long IM" or "total net short IM") \* Inter BNC;
- "total net long IM" is the absolute sum of the net bucket IM, where the net bucket IM is positive;
- "total net short IM" is the absolute sum of the net bucket IM, where the net bucket IM is negative;
- "net bucket IM" is the arithmetic sum of the IM of all securities within a risk bucket (with plus/minus sign).

#### 6.4.2 Variation margin (VM)

Calculation of the Variation Margin is done several times a day (usually on an hourly basis), including upon beginning and end of day processing, according to the current market and market price developments (mark-to-market) and based on the net positions of all open

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contracts per ISIN. In the small and mid cap segment, the VM is calculated on the basis of bid/offer prices.

#### 6.4.3 Total margin

The total margin requirement for each clearing account is calculated as follows:

Total margin = (initial margin \* risk rating coefficient) + variation margin

Hence, if a member has a "gain" from the variation margin due to favorable market movements, this would have the effect of reducing the total margin, provided that the total margin does not sink below zero.

A risk rating coefficient of 1.0 would usually be applied, provided that the rating of the clearing member is at least A-. The risk rating coefficient may be increased for members with a lower rating.

It may also be temporarily increased for members having extreme unilateral and net long or short positions. Such measures are communicated to the member orally and are valid only for the duration of the necessary settlement of these positions.

The risk rating coefficient can also be increased for all members during periods with extraordinary market conditions or due to instructions from regulators.

#### 6.4.4 Margin calls

If margin requirements exceed the collateral value, a margin call is automatically triggered in real time to settle the difference.

A margin call must be met within one hour at the latest, which is exclusively done by direct debit (money side) of the SIC account or an account held with SIX SIS (by means of direct debit authorization). A member that fails to meet a margin call may be declared in default by SIX x-clear.

#### 6.5 Open positions

Initial and variation margin is applied on a clearing account's open positions. All unsettled trades on a member's clearing account are summarized per ISIN and currency (of trade) into one position called "open position". Hence, a clearing account would normally have one open position per traded ISIN. Open positions are computed in real time by SIX x-clear and also include unsettled corporate action claims.

The following transactions would impact a clearing account's open positions:

- A clearing-eligible SIX Swiss Exchange trade
- Settlement of such trades

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- Raising a corporate action claim by SIX x-clear, when the order becomes eligible for claims/compensation due to an appropriate corporate action
- Settlement/Booking of such claims/compensation
- Cancellation of a SIX Swiss Exchange trade (possible due to netting, during corporate action transformation or a cancellation by SIX Swiss Exchange)

The process of computing open positions nets all unsettled trades, subject to being on the same ISIN, clearing account and currency. Hence, the open positions for a clearing account would be the same whether a member opts for settlement netting or not. A clearing member could get details of its open positions at end of day by subscribing to a daily data format report, RDXL040 or RDXL050 respectively.

#### 6.6 Default Fund

The initial margin and the variation margin combined should cover all expected market risks that may arise due to the default of a member. However, there is no guarantee that an initial margin calculated from historic data will withstand all future price developments under extreme market conditions. Therefore, a Default Fund is additionally set up to cover unpredictable risks and losses. This Default Fund serves in particular to cover any system risk (domino effect) A common Default Fund is maintained for all clearing segments on SIX Swiss Exchange. Therefore, participants active in several segments need to make but one single contribution.

The Default Fund is supported by contributions from members. The amount to be contributed is on the one hand determined by the membership category (ICM/GCM) and on the other hand by the member's average gross open position of the last three months. This exposure is recalculated monthly based on the consolidated open positions from SIX Swiss Exchange trades and may entail adjustments to the contributions. If the contribution needs to be adjusted, the respective member is notified. The adjustment must be made within the notified period. If the increase is not effected within the stipulated period, SIX x-clear will send a margin call and perform a direct debit.

Contributions to the SIX x-clear Default Fund are to be made in the form of money or securities rather than cash payments. Contribution to the Default Fund may be done by depositing marketable securities in a separate custody account. The securities are subject to daily mark-to-market valuation and the lending value may not fall below the value of the contributions required. The value of the deposited securities is calculated on the basis of their market value and not of their par value.

Should mark-to-market valuation reveal that market values have fallen below that minimum value, a margin call, which has to be met within given deadlines, is triggered. Default Fund contributions are secured by means of a regular lien.

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#### 6.6.1 Adjustment duty

Each member is obliged to make additional contributions to the Default Fund. On the one hand, changes in the average gross open position of the last three months can entail adjustments to the Default Fund contributions. On the other hand, price fluctuations resulting in a negative value change of the deposited collateral entail the member's obligation to make additional contributions.

Furthermore, each member is obliged to replenish the Default Fund up to the amount of its current contribution. These additional contributions may be claimed in one payment or, if required, in instalments. SIX x-clear may demand members to make additional contributions when the Default Fund has been made use of once or more times. The additional contribution is calculated on a proportional basis (membership contribution as a percentage of the total Default Fund volume).

#### 6.7 Defense lines

Initial margin, variation margin and Default Fund are not the only means for SIX x-clear to absorb losses.

The defense lines of SIX x-clear are applied in the following order:

- Margins, i.e. the collateral provided by the defaulting member itself for the respective relevant exchange. If the default occurs only on one of the SIX x-clear exchanges, the available net margin will be prorated to the SIX x-clear exchanges in proportion to the gross margin of the SIX x-clear exchanges. The part of the SIX x-clear exchange where the default occurred will be utilized first.
- Contributions, i.e. the collateral provided by the defaulting member in favor of the Default Fund for SIX Swiss Exchange
- Per calendar year a maximum of 50% of the provisions available for default risks of SIX x-clear
- Default Fund for SIX Swiss Exchange
- Replenishment of the Default Fund for SIX Swiss Exchange
- Provisions (remaining amount), capital and reserves of SIX x-clear

The defense lines and the Default Fund respectively are intended to help prevent system risks (domino effect) for the entire financial market.

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### Central Counterparty (CCP) for SIX Swiss Exchange

#### 7.0 Deposit of collateral

Collateral to be provided within the framework of the overall risk management for margins and the Default Fund must be deposited with SIX x-clear or SIX SIS respectively, which has been appointed for this purpose (refer to 5.0 "Money/Custody account structure").

The deposited collateral is accounted for at market value less a haircut. The instruments generally accepted as collateral and their current lending values are listed below:

Collateral
Cash (marketable, freely convertible currencies accepted by SIX x-clear)
CH government securities, federal and cantonal; in CHF
Other first-class CHF bonds (minimum rating of A-); including SNB money market book claims
First-class foreign currency bonds (minimum rating of A-); including ECB money market book claims
Blue chips admitted to trading at SIX Swiss Exchange (SMI securities)*

\*only allowed for margins

The current haircuts are published via Clearing Notice. Bonds should generally be SNB repo eligible and must be substituted 15 days prior to final maturity (after which date bonds are no longer taken into account as margin collateral).

American securities cannot be accepted due to IRS issues.

#### 8.0 Open offer

##### 8.1 Principles of open offer

An open offer implicates that only contracts between the Central Counterparty and its clearing members result from the matching process.

##### 8.2 SIX x-clear open offer

SIX x-clear offers to step, as a Central Counterparty, into a trade that results from stock exchange orders matched at SIX Swiss Exchange provided that the two matching parties are either a member or a NCM of SIX x-clear. A detailed legal explanation of the open offer facility and its attendant mechanisms is given in the General Terms and Conditions of SIX x-clear.

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### Central Counterparty (CCP) for SIX Swiss Exchange

#### 9.0 Off-order book trades

SIX x-clear acts as Central Counterparty for SIX Swiss Exchange trades in clearing-eligible securities – even for trades concluded outside the order book – provided that these transactions take place between 8:00 am and 7:00 pm (CET) and are concluded and reported in conformity with the rules. A transaction thus concluded between two SIX Swiss Exchange members entails a bilateral contract between these two SIX Swiss Exchange members. Under certain conditions, the contract is cancelled and SIX x-clear steps into the trade as Central Counterparty. This results in two new contracts: a contract between the selling member and SIX x-clear on the one hand and a contract between SIX x-clear and the buying member on the other. Outside the above-mentioned clearing times, SIX x-clear does not step into a transaction and no clearing is performed, i.e. transactions continue to be settled bilaterally between the two trading parties.

#### 10.0 Settlement

The settlement of SIX Swiss Exchange transactions takes place on the third trading day after trade date (T+3). The member must ensure that a sufficient amount of funds or securities is available on settlement day.

SIX x-clear offers its members the clearing of on- and off-order-book transactions in clearing-eligible securities that are concluded within the clearing time frame defined by SIX Swiss Exchange (8:00 am to 7:00 pm CET). Transactions concluded outside this time frame and those that are excluded from clearing are settled according to the previous settlement model of SIX Swiss Exchange (without CCP).

#### 10.1 Settlement organisation

SIX x-clear offers its participants settlement of transactions in SIX Swiss Exchange's blue chip segment. They can choose between SIX SIS and Euroclear Bank (hereinafter CSDs). SIX x-clear is itself a member of both CSDs, which allows its members to have their trades settled inhouse. Trades effected in the small and mid cap as well as the ETF segment can only be settled via SIX SIS.

The member must indicate in the CSSI ("Clearing and Settlement Standing Instructions") form of SIX Swiss Exchange the settlement organisation and the account used for settlements.

#### 10.2 Settlement mode

Gross settlement is offered by all settlement organisations. Members settling via SIX SIS can additionally avail of settlement netting. Netting reduces settlement transactions to one single transaction per security/currency and trade date. Settlement netting has no impact on the margining of open positions.

The member must indicate on the CSSI form of SIX Swiss Exchange whether settlement is to be effected on a gross or net basis.

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#### 10.3 Order routing

Settlement instructions are sent directly from SIX Swiss Exchange to the CSDs via a router. The CSDs process the settlement instructions on the basis of existing booking instructions. Basically, this so-called locked-in environment requires no manual order input by the member.

Members settling SIX Swiss Exchange transactions via Euroclear Bank must sign a power of attorney (PoA) for SIX SIS and SIX x-clear. The PoA for SIX SIS allows the router to send instructions. The PoA for SIX x-clear allows SIX x-clear to send instructions to the member.

#### 10.4 Settlement between GCM and NCM (SIX x-clear)

In a GCM/NCM structure, the NCM has the option of having transactions settled directly against SIX x-clear or against the GCM. This has, however, no impact on the contractual situation since the GCM remains the only contracting counterparty of SIX x-clear, even on an individual trade level. A separate contractual relationship exists between the GCM and the NCM of SIX x-clear.

Settlement via the GCM entails two settlements: SIX x-clear against a GCM and a GCM against a NCM. All appendant settlement instructions are automatically routed to the CSD. Transactions between the GCM and the NCM are always effected on a gross basis. GCM and NCM may choose different settlement organisations.

The parties involved (NCM and GCM) must indicate in the CSSI form of SIX Swiss Exchange the party against which settlement is to be effected.

**Note:** When transactions are settled at SIX SIS, it is possible that the NCM has a so-called Assigned Business Partner (ABP) relationship. In this case, the ABP can use the account of another SIX SIS participant (e.g. its GCM's account). Settlement between the ABP and SIX x-clear means that transactions are directly settled between the NCM and SIX x-clear. Even in the case where the GCM makes its account available to the ABP, the GCM must characterise itself in the CSSI form as "not participating in the settlement chain". The NCM must indicate its wish to directly settle against SIX x-clear.

The following description is restricted to settlements involving SIX x-clear (i.e. no NCM-GCM settlements).

#### 10.5 Settlement at SIX SIS

SIX SIS participants maintain their own custody account for securities at SIX SIS.

##### 10.5.1 Settlement instruction

In analogy with the current procedure, SIX Swiss Exchange trades are transmitted as locked-in transactions directly from the trading platform to SIX SIS. These locked-in transactions also contain information about whether they are to be settled on a gross or on a net basis.

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Securities and money accounts are defined according to participant master data, on the basis of the so-called booking instructions. Changes to these booking instructions must be communicated to SIX SIS directly.

#### **Settlement transaction**

After successful validation of the instruction, SIX SIS generates the settlement transactions. Status "201 matched" is allocated to DVP transactions and status "207 matched generated" to RVP transactions. The order issuer is SIX Swiss Exchange. Transactions intended for settlement netting contain the reference "/NET/Y" in field 79. The counterparty revealed to the member is always SIX x-clear.

Example: Field 79 in the status intimation of a SIX Swiss Exchange gross transaction intended for settlement netting:

:79:/STATUS/201

/EBS/16x

/ORDRISSR/4

/NET/Y

/SETR//TRAD

"NET" and "SETR" are not displayed in the case of gross transactions not intended for settlement netting.

#### **10.5.2 Gross settlement**

Transactions that are not intended for netting are settled individually (on a gross basis). The process is identical with the current inhouse settlement at SIX Swiss Exchange. SIX x-clear is always the counterparty in these transactions.

#### **10.5.3 Netting process**

At the end of each clearing day, the transactions intended for settlement netting and showing the same contents in the fields below are pooled in a net settlement transaction for each SIX SIS participant.

Clearing account (not displayed in the status intimation)

Settlement account

Money account

Counterparty (always SIX x-clear)

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### Central Counterparty (CCP) for SIX Swiss Exchange

Security

Settlement currency

Trade date

Settlement date

Settlement priority

Compensation indicator

Only transactions in "released" status are netted. Transaction in status "hold" at the moment of netting are settled on a gross basis.

Transactions received by SIX SIS after conclusion of the netting process are exclusively netted on a gross basis. However, SIX Swiss Exchange and SIX SIS make sure that all clearing-eligible transactions are transferred to SIX SIS before the netting process begins.

The netted gross transactions are allocated the new status "412 – cancelled, due to netting". Status intimation MT598-910 also serves to communicate the five-digit net reference of the net transaction in which the gross transaction is contained. The net reference is displayed in field 79 "/NETREF/".

Example: Field 79 in the status intimation of a netted gross transaction at SIX Swiss Exchange:

:79:/STATUS/412

/EBS/16x

/ORDRISSR/4

/NETREF/5x

/SETR//TRAD

After netting of a transaction, the place of trade (field tag 31P) will no longer be indicated in the status intimations MT598-910/MT54x.

Modifications are possible as long as transactions are not netted (status "412 - cancelled, due to netting"), deleted (status "401 - cancelled") or in status "601 - settled/executed".

Netted gross transactions cannot be cancelled.

SIX SIS participants may choose whether or not to receive specific status intimations of gross transactions intended for settlement netting.

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### Central Counterparty (CCP) for SIX Swiss Exchange

#### 10.5.4 Net settlement instruction

SIX SIS generates, as a result of the netting process, a new net settlement transaction. This transaction features the five-digit net reference which was already contained in status intimation 412 of the netted transactions. This reference is additionally displayed in field 21. The order issuer is the CCP or CSD respectively.

Example: Fields 79 and 21 in the status intimation of a net transaction:

:79:/STATUS/201

/NETREF/5x

/ORDRISSR/5

/SETR//NETT

:21:5x

The possible transaction types for net settlement are listed below:

	Transaction		Transaction type for MT598-910	Transaction type for SWIFT
	Securities	Money		
1	Delivery	Receipt	DVP	MT547
2	Receipt	Delivery	RVP	MT545
3	Delivery	0	DVP	MT547
4	Receipt	0	RVP	MT545
5	0	Receipt	RMO	MT547
6	0	Delivery	PMO	MT545
7	Delivery	Delivery	DSM	MT547
8	Receipt	Receipt	RSM	MT545
9	0	0	NLR	MT545

The following table gives an example of how transaction type RSM (DSM respectively on the delivery side) is created.

Transaction type	Quantity	Price	Settlement amount
Purchase	100	2.50	-250
Purchase	80	2.40	-192
Sale	-170	3.00	510
<b>Net: Purchase</b>	<b>+10</b>		<b>+68</b>

DVP, PMO and DSM net transactions are allocated status "201 – matched". RVP, RMO, RSM and NLR net transactions are allocated status "207 – matched generated". The transactions run through the normal succession of statuses until status "601 settled/executed" is reached.

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### Central Counterparty (CCP) for SIX Swiss Exchange

Amounts with value "0" are booked to securities accounts, but not to money accounts.

#### 10.5.5 Shaping

As a result of the offsetting of gross settlement transactions, the net settlement transaction may be worth an undesirably large amount of money (for SIC etc). To prevent such large amounts, the member may instruct SIX SIS to define a maximum amount per currency. In the case where the net transaction amount exceeds this cap a "shaping" process takes place, in which the net transaction is divided into net transactions with smaller amounts.

Example: The netting process results in a net DVP transaction with a payment amount of CHF 120 m. The cap for shaping is fixed at CHF 100 m. This net transaction is divided into two transactions of CHF 60 m each.

All shape transactions contain the same net reference. The net reference is displayed in field 79 "/NETREF/". However, two different references appear in field 21 (refer to chapter 10.5.7 "Reference number").

Shaping is part of the netting process and takes place at the end of each clearing day.

**Note:** Shaping is not applied for gross transactions.

#### 10.5.6 Splitting

Whereas shaping is oriented towards the cash amount involved in a transaction, splitting refers to the availability of securities on settlement day. Splitting is optional and may only be applied by the party delivering the securities for net transactions in status 302 ("overdue, lack of security"). The counterparty (receiver of securities) has to accept the split. Thereby, the net transaction is "cancelled" and replaced by two new net transactions. The split order is usually entered by a delivering party with insufficient securities holdings.

The delivering party instructs SIX SIS by means of a new message type (MT598-106) or via webMAX, indicating the number of securities to be allocated to the two new split transactions. The transaction to be split is allocated the new status "414 – cancelled, due to split". The participant is informed accordingly via status intimation.

Example: Fields 79 and 21 in the status intimation of a split net transaction:

:79:/STATUS/414

/ORDRISSR/5

/NETREF/5x

/SETR//NETT

:21:(refer to chapter 10.5.7. "Reference number")

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At the same time, SIX SIS generates two new split transactions. Normally, one of these transactions is settled immediately if sufficient holdings are available while the other transaction is allocated status 302 ("overdue, lack of security"). The transaction in status 302 can be split again. The sequential order for the settlement of transactions at SIX SIS ensures that the number of units stated in the MT598-106 message is settled first.

Example:

- The holdings of SIX SIS participant "A" in security X amount to 30.
- "A" has a pending net DVP transaction of 45 units with settlement date corresponding to today's date.
- "A" transmits a split order to SIX SIS for 20 units (MT598-106).
- SIX SIS cancels the DVP transaction of 45 units and creates two new transactions: one transaction of 20 units and one of 25 units.
- SIX SIS settles the order for 20 units. The order for 25 units is allocated status "302 - overdue lack of security".

The money amount is split in the same proportion as the securities.

#### 10.5.7 Reference number

##### **Net reference (field 79)**

This is a five-digit reference appearing in the status intimation in field 79 as "/NETREF/" and is indicated in status 412 as well as in the appendant net transaction. All other split transactions are allocated the same reference.

##### **Bank reference (field 21)**

This reference appears only once per net transaction. The original net transaction (before splitting) has the same value in field 21 as the net reference in field 79. All further shapes/splits have new references that are created by adding more digits to the net reference.

The maximum length of the reference is sixteen digits.

Example:

- The original net reference of a possible net transaction is: P9999.
- If this transaction is divided into two through "shaping", the new transactions will have the reference P999910 and P999920 respectively.

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- In the event of a split of the first of these two net shape transactions on settlement date, the two new net split transactions are allocated the following references: P9999101; P9999102.
- If the second net split transaction is split anew, the two new net split transactions are allocated reference P99991021 and P99991022 respectively.

#### 10.5.7 Reconciliation

SIX SIS participants receive upon request report RDOS802 indicating those gross transactions that are based on the original net transaction. The report specifications, which are based on those of the SWIFT message MT537, are explained in the BP Specs of SIX SIS.

#### 10.6 Settlement at Euroclear Bank

For settlement at Euroclear Bank, members of SIX x-clear need a custody account with Euroclear Bank and funds in those currencies in which settlement is to be effected. SIX x-clear requires its members to sign a power of attorney. This allows automatic instruction for both the DVP and the RVP transaction and saves the Euroclear client a manual order entry.

Settlement netting and shaping are not possible.

#### 10.7 Late delivery

Should it not be possible to settle a trade by 12:30 pm (CET) on settlement date (T+3) due to late delivery of securities, SIX x-clear tries to perform settlement with borrowed securities. The seller who has failed to deliver the securities to SIX x-clear on time by EOD has to bear the borrowing costs. If settlement is not effected on T+3, a late settlement fee is charged to the defaulting seller. If borrowing, and therefore timely delivery, was not possible, 50% of the fee is passed on to the buyer.

The member will not have to pay any late settlement fee to SIX x-clear if both SIX x-clear and the member are in default of delivery of the same security with the same maturity.

In the case where securities are not delivered within a defined time frame a "buy-in" takes place, the costs of which are charged to the defaulting party. In addition, SIX x-clear may initiate a default procedure to exclude the delivering party from trading. Should it prove impossible to provide holdings, an adequate compensation payment is made according to the Clearing Terms of SIX x-clear.

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#### 11.0 Corporate actions

The execution of corporate actions is different for securities that are already held in a custody account (existing positions) and for securities that have been purchased but not yet delivered (open transactions).

Distributions on existing positions are made in accordance with the rules of the settlement organisation with which the securities are deposited. Distributions on positions deposited with SIX x-clear as collateral are directly credited by the main paying agent to the members of SIX x-clear (not via SIX x-clear).

With respect to distributions on open transactions, two types of corporate actions must be distinguished:

- Mandatory corporate actions, such as cash dividends or bonus shares
- Corporate actions with a choice of options (elective corporate events), such as takeover offers, repurchase offers, rights issues/capital increases

#### 11.1 Mandatory corporate actions

In the case of transactions concluded on a "cum" basis (i.e. with trade date before ex date) and settled on an "ex" basis (i.e. with settlement date on or after ex date), compensation procedures are applied to ensure that entitlements arising from corporate actions are transferred from the seller to the buyer. The necessary transactions are automatically generated by the respective settlement organisations.

SIX x-clear always acts as the counterparty in its members' compensation transactions, and therefore these transactions fall under SIX x-clear's risk management until they are booked/settled.

##### **Timeline for bookings of compensations:**

Compensation transactions are booked at the times fixed by the individual settlement organisations. Euroclear Bank and SIX SIS book compensations on the later of the two pay dates of the corporate action or on the settlement date of the open transaction.

##### **Withholding tax rates for claims/compensations:**

All taxable compensations are taxed at the same default tax rate (non-treaty default rate) in both settlement organisations.

##### **Rounding down of compensations in the form of securities:**

In corporate actions involving the distribution of securities, decimal places may be handled in different ways (rounding up, rounding down etc). In the case of SIX Swiss Exchange transactions, however, they are rounded down at both settlement organisations.

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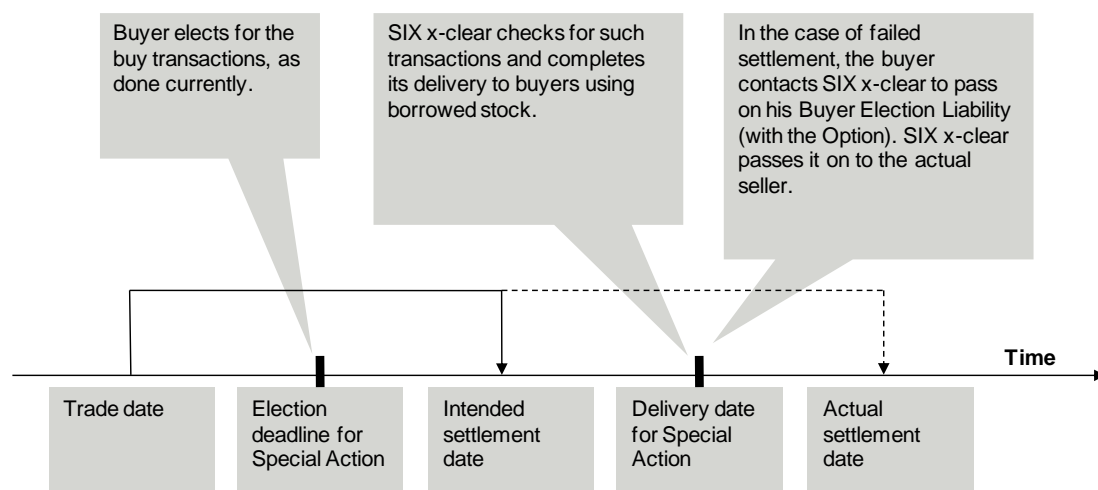
### Central Counterparty (CCP) for SIX Swiss Exchange

#### 11.2 Corporate actions with a choice of options

Corporate actions with a choice of options are also executed in accordance with the rules of the settlement organisations. Under certain circumstances, however, SIX x-clear is exposed to risks that are not covered by the margins provided by the members. This occurs in case of so-called "buyer elections", i.e. options a buyer can choose in open transactions with SIX x-clear as the seller. Special processing rules (explained in this chapter) apply for buyer elections.

##### 11.2.1 Buyer election on Swiss securities

If, in the case of corporate actions with a choice of options, SIX x-clear is late in delivering securities to a member and, as a result, the member is not able to deliver the securities to the main paying agent on time, the member may contact SIX x-clear and choose its preferred option via SIX x-clear. SIX x-clear, in turn, obligates the selling member that is responsible for the delay to perform the option chosen by the buyer (delivery of securities or the corporate action related to it).



The following conditions apply:

#### Trades entitling buyers to buyer election with SIX x-clear:

- Trade date = election deadline -1 or earlier

and

- Contractual settlement date = pay date (delivery date) -1 or earlier

#### Trades of sellers that may be brought in by SIX x-clear for the performance of the option chosen:

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- Trade date = election deadline -1 or earlier
- Contractual settlement date = pay date (delivery date) -1 or earlier
- Current settlement date = pay date (delivery date) 12:00 noon or later

#### **Time window for buyers to contact SIX x-clear (all times in CET):**

From end-of-day processing at SIC until 4.30 pm on pay date (delivery date). The contact address for the Settlement Desk responsible is published on the SIX x-clear website.

Buyers must inform SIX x-clear which option they wish to choose concerning their securities.

#### **Time window for SIX x-clear to contact sellers (all times in CET)**

From end-of-day processing at SIC on pay date (delivery date) until 6:00 pm on pay date (delivery date) +1.

SIX x-clear informs the sellers about the option chosen.

#### **Settlement of the chosen option**

Sellers designated by SIX x-clear must perform on pay date (delivery date) +4 a delivery according to the option chosen. The delivery must be effected in accordance with the conditions applicable to the corporate action. The attendant settlement instructions are automatically generated by SIX x-clear. The sellers only have to ensure that the funds/securities required for settlement are available on pay date +4. The subsequent settlement between SIX x-clear and the buyer also takes place on pay date (delivery date) +4 and in accordance with the conditions applicable to the corporate action. The necessary settlement instructions are, again, automatically generated by SIX x-clear.

### **11.2.2 Buyer elections on non-Swiss securities**

Currently, SIX x-clear is not in a position to accept buyer elections on securities that are not Swiss as the settlement organizations do not support this function.

### **11.3 Manufactured dividends**

Basically, compensations are processed automatically (as described in chapter 11.1).

The only exception are compensations in the Euroclear Bank system with sellers who have not previously received the compensation they are to deliver to the buyer. Such compensations are known as manufactured dividends; they are suppressed in the Euroclear Bank system since they are supposed to be handled manually outside of the system. The buyer has to contact the seller, agree on the amount of the compensation and decide on whether the compensation should be with or without withholding tax. If the seller is not able to provide a tax voucher that allows the buyer to reclaim the withholding tax, the

## Service Description

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compensation has to be gross (without deduction of withholding tax). If SIX x-clear is contacted by a buyer about such a compensation, it will in turn contact the seller and check whether the seller is delivering the compensation with or without a tax voucher. The buyer is compensated accordingly, either gross without tax voucher or net with tax voucher.

#### **12.0 Default**

A member that fails to fulfil its obligations under certain conditions can be declared by SIX x-clear as a "defaulting member". After having declared a member as "defaulting member", SIX x-clear issues a default notice and transmits it to the member and to SIX Swiss Exchange. The consequences of a default notice take immediate effect.

After issue of the default notice, SIX x-clear will no longer register any new contracts of the defaulting member. In order to liquidate existing positions, a close-out netting is done via SIX Swiss Exchange.

To compensate for any damage incurred by the default of a member, the collateral of SIX x-clear is used according to chapter 6.7 "Defense lines".

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This Service Description serves for information purposes only. SIX x-clear Ltd reserves the right to make changes at any time. SIX x-clear Ltd disclaims all liability for the inaccuracy or incompleteness of the information given therein.

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