

Credit Overview

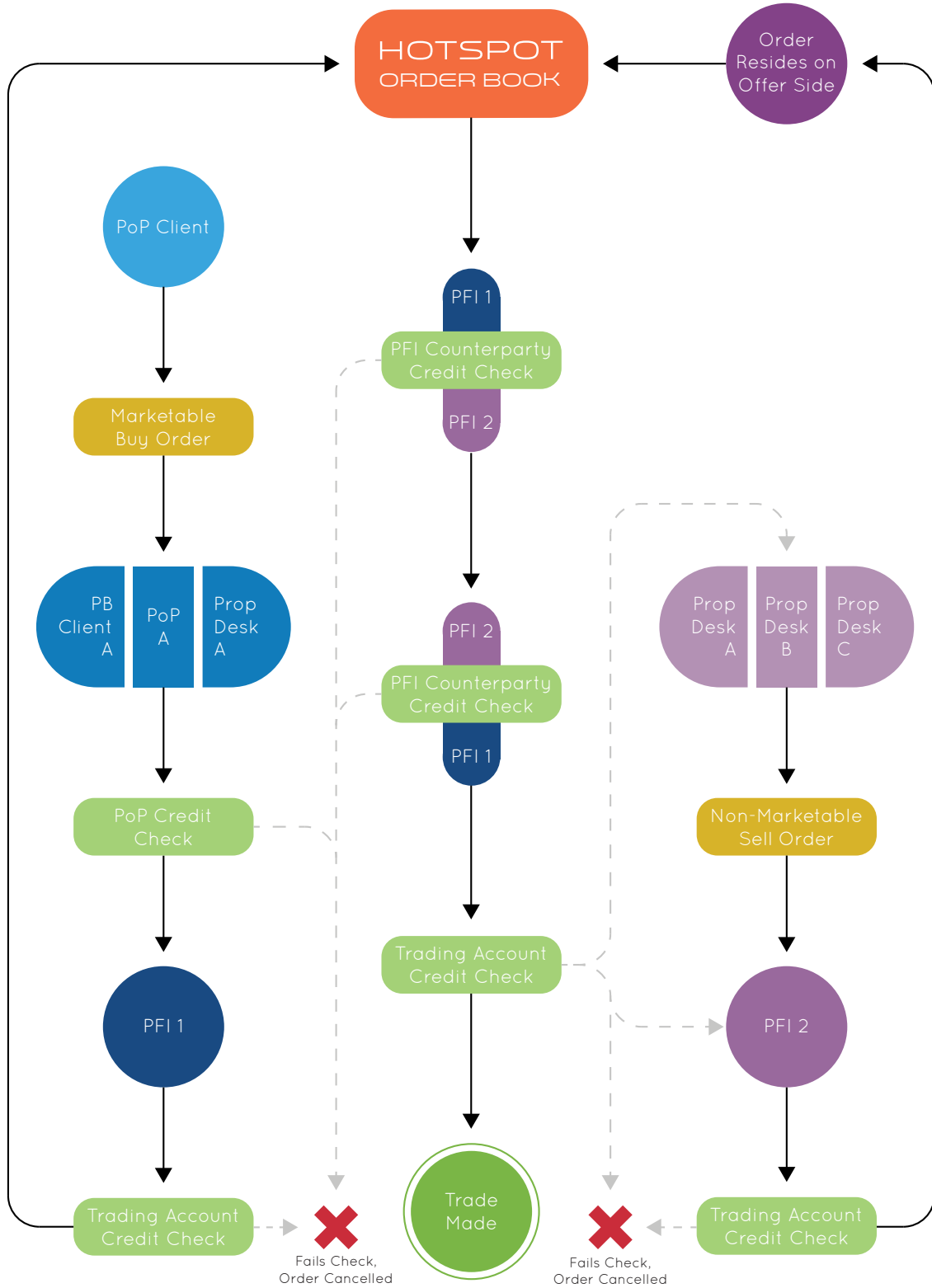
Hotspot provides a multilateral credit system that enables Participating Financial Institutions (PFIs), our network of leading FX dealers and clearing banks, to dynamically manage credit allocations for trading activity, and monitor exposure to clearing counterparties. All PFIs can create tiered account structures to support any combination of proprietary trading activity or client trading activity via prime brokerage (PB) and prime of prime brokerage (PoP, i.e. reseller of credit) businesses.

Every order submitted to Hotspot is subject to a minimum of two pre-trade credit checks: (1) PFI-to-trading account (proprietary or that of a PB client), and (2) a PFI-to-PFI (i.e. between clearing counterparties). The first check is internal to the PFI, ensuring no individual trading account, whether proprietary or that of a PB client, exceeds the credit limit assigned by the PFI. The second check certifies that an executed trade would not result in either PFI exceeding its predetermined credit limit with its PFI (clearing) counterparty. This check is performed instantly for marketable (aggressive) orders. Non-marketable orders will sit on the order book and undergo a check before being matched with another order. If two trading accounts clear through the same clearing counterparty (e.g. a bank's prop desk versus a PB client), then the PFI-to-PFI check is not performed. In a prime of prime scenario, an additional credit check takes place prior to the two above, ensuring that the end user (PoP trading client) does not breach the credit limit defined by its PoP broker. If a credit limit is breached during any of the pre-trade credit checks, the order will be rejected by the Hotspot system.

The allocation of credit limits for each trading account and PFI counterparty is currently managed by bank/prime staff via the Hotspot PB Admin credit portal. Hotspot automatically monitors credit utilization in real-time, and sends email alerts to its customers as utilization crosses 75%, 90%, and 95% on any credit line. A PFI may then opt to increase a credit line or cease trading activity. If a line reaches 90% and has not been addressed, the Hotspot liquidity desk will contact the PFI directly to ask for instructions. If instructed by the PFI, the Hotspot liquidity desk can increase the credit line on its behalf.

The following diagram details the workflow of a PoP trading client's marketable buy order matching with a prop desk's non-marketable sell order to produce a trade. The various credit checks throughout the orders' lifecycles are noted, and the orders can only continue on if the checks are passed.

Figure 1 - Credit Workflow of a Sample Trade



Multiple Marketplaces (London & New York)

In early September 2015, Hotspot will offer trading on its London matching engine. Hotspot's London marketplace represents a distinct liquidity pool and will operate independently of its NY market. There will be no routing of liquidity between London and NY and all trading participants in the London marketplace will be issued new trading account IDs.

As noted above, the maintenance of a PFI's total credit limit for each PFI counterparty is currently administered by bank/prime brokerage staff via the Hotspot PB Admin credit portal. This will not change, and PFIs will continue to manage one limit for each of their clearing counterparties. The allocation of this credit limit between the New York and London venues will be determined by trading volumes in each location and will be monitored by the Hotspot liquidity desk. Bank / prime brokerage staff will have visibility within PB Admin into how the split is allocated.

For any PFI that trades on both the New York and London platforms, Hotspot will manage the existing credit lines between the New York and London venues by assigning a portion of credit to each location (e.g. New York: 70%, London: 30%). Intraday, Hotspot will automatically rebalance the credit lines between London and New York as necessary, subject to availability.

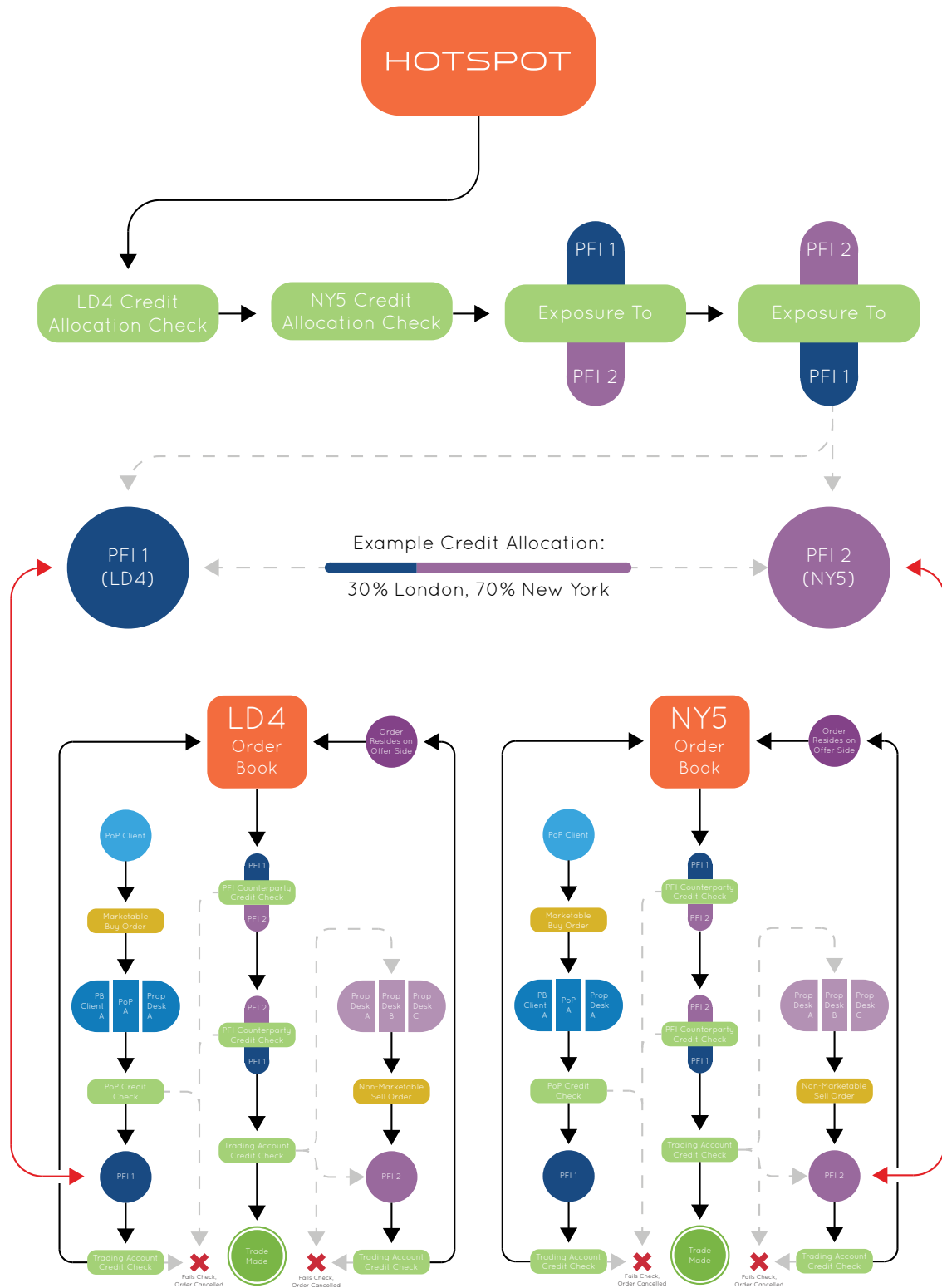
A credit reallocation from 70/30 to 60/40 first requires a check of open exposure at the remote market (New York in this example). To ensure that credit limits are not breached, rebalancing will be done by first debiting credit from the remote market, before crediting the local market. While the values that trigger a rebalance event can be changed, initially a rebalance check will occur every minute and a rebalance event will occur if exposure exceeds 90% of its limit. At end of day (5pm ET for both New York and London), values will reset to their start of day values.

The allocation values and rebalance thresholds above are configurable by Hotspot, and will be set to the most appropriate value based on observations of trading patterns once London is online.

A sample workflow is provided below. For reference, detail of the NY5 and LD4 locations is the same as Figure 1 above.

Hotspot Credit Workflow

Figure 2 - Credit Workflow between London



CLS and Non-CLS Pairs

PFI's can elect to include/exclude different currency pairs in the credit lines they extend to clearing counterparties in any combination of the following currency groups:

- CLS pairs (<http://www.cls-group.com/ABOUT/Pages/Currencies.aspx>)
- Non-CLS pairs
- Metals (Gold and Silver)

As of June 2015, each PFI can maintain only one limit against each counterparty PFI, and can choose among the currency groups above. It is not currently possible to manage three discrete limits for each currency pair category in parallel and Hotspot does not intend to add this capability prior to the London Matching Engine launch.

Exposure Calculation

Hotspot calculates currency exposure by breaking down positions in different pairs into individual currencies to arrive at the net position per currency. Hotspot then uses the sum of the USD equivalent of all short positions, including the USD position if it is short, to determine exposure. Hotspot uses the current midpoint rate in the Hotspot marketplace in all calculations. Examples below:

#	Currency	Currency Amount	Rate	Counter Currency	Counter Amount
1	EUR	(6,455,244.50)	1.549128	USD	10,000,000.00
2	USD	(10,000,000.00)	96.867461	JPY	968,674,610.00

In this example the net positions are:

- EUR (6,455,244.50)
- JPY 968,674,610.00
- USD flat

Exposure = SUM (USD equivalent of short positions) = (USD rate 1.549128 * EUR 6,455,244.50) = USD 10,000,000.00

#	Currency	Currency Amount	Rate	Counter Currency	Counter Amount
1	EUR	10,000,000.00	1.510423	CHF	(15,104,230.00)
2	USD	(12,500,000.00)	0.996382	CHF	12,454,775.00
3	EUR	(10,000,000.00)	134.195165	JPY	1,341,951,650.00
4	USD	12,500,000.00	96.867461	JPY	(1,210,843,262.50)

In this example the net positions are:

- EUR flat
- USD flat
- CHF (2,649,455)
- JPY 131,108,387.50

Exposure = SUM (USD equivalent of short positions) = (USD rate .996382 * CHF 2,649,455) = USD 2,639,869.27