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To Whom It May Concern:

### **Daily Cash Settlement (Mark to Market) for NGX Financial Power Contracts- Overview and Transition**

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Effective November 1, 2010, Natural Gas Exchange Inc. (NGX) will be transitioning to daily cash margining for Canadian financial power contracts cleared through NGX.

Currently, daily mark-to-market gains increase the notional value of collateral posted with NGX, and mark-to-market losses increase the collateral requirements of the respective counterparty which in turn must be supported by acceptable collateral as defined in the NGX Contracting Party's Agreement ("Collateral"). Any gains or losses remain in the counterparty's collateral account until the contract goes to term.

Under the new initiative for financial power contracts cleared through NGX, all trades executed after October 31, 2010 will provide for daily cash margining against all open positions at the close of each business day. Any unfavorable margin against the end of the day mark will be due to the exchange two business days (T + 2) after the position is marked at the close of business. Offsetting mark-to-market gains will be paid on a similar cycle. Legacy positions (those positions open at end of business October 31, 2010) will be grandfathered under the existing settlement regime.

## ***Background***

Growth in NGX financial power business has led to increased demand for new products and more traditional margining. Other reasons for the migration to a more traditional margining model include;

- *Increase in Financial Market Participants* – banks, funds and speculators
- *Alignment with Traditional Futures and Swaps Markets* – daily settlement will allow NGX clients to manage their cash flows in line with other financial energy derivatives which transact and clear at other exchanges and clearinghouses'
- *Efficiency and Risk Reduction* – movement of funds with daily cash margining is more efficient than the current cycle to the extent that there is less stranded capital on deposit pending the ultimate monthly settlement date.

## ***Mark to Market Cash Settlement – Overview and Mechanics***

Effective November 1, 2010, any position opened in a financial power contract on NGX which remains open at the end of the trading day will be marked-to-market against NGX's settlement prices for each corresponding power instrument ("MtM Price"). Mark-to-market margining will occur at the close of each business day in which the position is open, and settlement of such open positions will occur two business days later (T+2). A cash account in the name of the each counterparty will be provided at The Toronto Dominion Bank (TD) to facilitate settlement.

## ***Final Settlement Against Indices***

In addition to the above daily mark-to-market positions, NGX will, on a daily basis, calculate the value of all notionally delivered financial power positions based on the underlying indices as provided by the electric system operator ("Index Price"). This value shall be calculated as the difference between the Index Price and the same day MtM Price for the corresponding notionally delivered volumes for each counterparty. This aggregated amount will continue to be included in each counterparty's margin requirements until settled on the 6<sup>th</sup> business day following the end of the term.

## ***Impact on Collateral Accounts***

With the implementation of the T+2 cash settlement, favorable mark-to-market moves in NGX financial power contracts will no longer increase a counterparty's Collateral as these amounts will be due to the customer within two days of settlement. Unfavorable mark-to-market moves will be immediately charged against a counterparty's Collateral until cash payment has been received.

## ***Cash Settlement Accounts***

Each counterparty executing trades in financial power contracts will have an interest-bearing cash settlement account assigned by NGX's clearing group. Counterparties can access this account to view transaction flows and cash balances and may request return of funds from this settlement account at any time such counterparty is not in default. Payments will be made out of and received into the respective settlement account for all mark-to-market changes. Counterparties may accumulate cash in these respective accounts or wire funds daily as they become due. Cash balances in the settlement account will not form part of a counterparty's Collateral. Funds will be moved into the account upon favorable mark-to-market moves.

## ***Cash Settlement – Legacy Power Positions***

Legacy Positions will be either taken to term for settlement, or offset through an over the counter arrangement whereby two counterparties are simultaneously closing positions. Grandfathered positions will not offset against positions opened and transacted after October 31, 2010 under the T+2 cash settlement.

## ***Summary and Requirements***

The following is a brief summary of the highlights and requirements of this transition.

- Legacy positions will not be available for trading after October 31, 2010
- Legacy position may be offset in the OTC market and facilitated by NGX
- An interest-bearing cash account will be opened in the name of each respective counterparty trading in Canadian financial power contracts at The Toronto Dominion Bank
- Invoices will be available for cash settlement the morning after the close of business mark the previous day
- Payment in respect of unfavorable market moves must be made within two business days following invoicing

We have enclosed a presentation detailing the product / contract description, examples and transitional issues. If you have any questions prior to the implementation of this initiative, please do not hesitate to contact an NGX representative.

Yours truly,

**Natural Gas Exchange Inc.**

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