

# **Bond Market 2.0**

## **Powered by Blockchain**

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## Background

The declining market for non-cleared single-name credit default swaps (“CDS”), and failure of the Central Clearing (CCP) market for cleared CDS to provide a cost-effective alternative, is concentrating default risk to dangerous levels and choking bond market liquidity with increasing momentum.

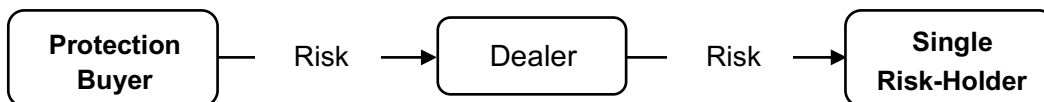
CDS contracts have historically been the singular means of directly hedging credit default risk in the bond market. And, until 2007, they efficiently added a degree of certainty that ensured protection and fostered fixed income liquidity.

That market has declined from its high in 2007 of USD 33 trillion to less than USD 3 trillion in outstanding notional value, with most participants anticipating its decline to continue to extinction. There are now less than 200 bond issuers for which a direct default hedge can be purchased, and the cost of that protection has caused most investors to no longer deem it viable.

To provide efficient utility, the structure and operation of a risk-transferring market must mitigate concentrations of risk at every level. The ideal structure would distribute each risk with sufficient breadth to minimize its potential adverse impact upon any single risk holder, and avoid the correlation of such risks. Optimal distribution would thus diffuse each risk among a broad array of holders, so that even a catastrophic event would produce only a modest impact upon each holder.

Non-cleared CDS transfer risk to a single counterparty, and offer no means for diffusing risk.

### Non-Cleared CDS Market: No Risk Diffusion



CDS cleared through a CCP market are cited by some as a preferred alternative to non-cleared CDS, but the CCP structure also concentrates risk – by limiting the distribution of each exposure to a small number of clearing members. For example, the largest 20 members account for roughly 75 per cent of financial resources provided to all CCPs.

Cleared CDS provide moderate diffusion of individual risks.

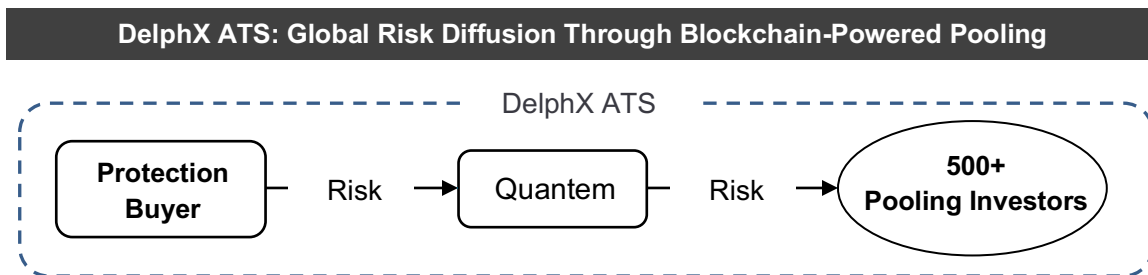
### Centrally-Cleared CDS Market: Moderate Risk Diffusion



While centralizing CDS trading into CCPs has reduced the risk of individual holders, it has magnified the systemic importance of CCPs – causing those facilities to become the latest category of “Too Big to Fail” institutions. A recent study of risks in CCP networks found that “...CCP-related losses are likely to be realized precisely under the extreme circumstances where the members are least able to absorb them.” CCPs are thus most likely to fail when they are needed most.

### A Securities-Based Solution

To facilitate optimal diffusion of credit default risk, DelphX Corporation has designed a securities-based solution through which its wholly-owned subsidiary, DelphX Services Corporation (“DSC”), a securities broker-dealer registered with the U.S. Securities Exchange Commission (“SEC”) (Registration #8-67379) and a member firm of the Financial Industry Regulatory Authority (FINRA) (Member #141368), will operate a neutral all-to-all Alternative Trading System (“ATS”) pursuant to SEC Regulation ATS. Within that transparent trading facility, DSC will employ blockchain technology to enable anonymous negotiation, origination and trading of proprietary new forms of digital smart-securities among the facility participants. Transparently administered within a secure distributed ledger, those securities will be exclusively issued by Quantem Capital Corporation (“Quantem”), a wholly-owned subsidiary of DelphX Corporation, and will operate to broadly diffuse default exposures among many risk holders through dynamic pooling technology developed by DelphX Corporation.



The collective operation of the ATS and the integrated digital securities issued and administered by Quantem therein are designed to:

- a) globally diffuse default risk of underlying third-party credit securities;
- b) enhance yields of institutional investors willing to assume a share of that diffused risk; and
- c) stimulate the liquidity of the underlying securities and global credit markets.

The ATS will be initially deployed in the U.S. to facilitate default protection for underlying corporate, municipal and sovereign debt securities denominated in USD. Its primary-market element will facilitate anonymous negotiation and origination of two new forms of digital securities, known as Covered Put

Options™ (CPOs) and Covered Reference Notes™ (CRNs), which will be continuously administered in real-time within a transparent blockchain-powered distributed ledger maintained by Quantem (“Quantem Distributed Ledger”). The secondary-market element of the ATS will facilitate trading of all outstanding CPOs, CRNs and the cash bonds underlying those securities.

Each CPO will be paired with a single CRN and the interlinked securities collectively operate to provide a cost-effective security-based alternative to CDS and other derivative contracts. That interlinked operation and Quantem’s dynamic pooling of risk will provide both guaranteed default protection to CPO holders and higher investment yields to CRN holders, while effectively converting the underlying fixed income security to a guaranteed-principal credit investment.

Upon the occurrence of a default or other qualifying credit event involving the third-party bond underlying a CPO, the CPO holder can immediately exercise its contractual right (but not obligation) to put (sell) the underlying security to Quantem at its full par value (CPO Strike Price).

Through the ATS and Quantem Securities:

Protection Buyers can:

- a) Receive guaranteed par-value sale proceeds upon the default of an underlying bond they selected from the more than 2 million issues available for protection on the ATS;
- b) Eliminate the need for variation and other collateral margins for credit protection; and
- c) Generate competitive risk-free returns through anonymous basis-trading.

Credit Investors can:

- a) Anonymously negotiate enhanced yields on investment grade notes in which referenced default risk has been embedded; and
- b) Definitively manage or eliminate credit exposures through pairing investments in compensating Quantem Securities.

All Participants can:

- a) Competitively speculate on the future movement of default protection pricing for all underlying securities in an anonymous and transparent all-to-all trading environment;
- b) Negotiate the purchase of new CPOs and CRNs in the Primary-Market of the ATS and trade all outstanding CPOs, CRNs and underlying cash bonds in the Secondary-Market of the ATS; and
- c) Access continually updating and validating MAVEN® benchmark pricing forecasts for all Quantem Securities and underlying issues.

## NRSRO Credit Rating

All CPOs and CRNs will be issued and collateralized at origination by Quantem, a tax-exempted Bermuda corporation formed as a wholly-owned subsidiary of DelphX Corporation. Quantem will limit the assets collateralizing CPOs and CRNs to cash, cash equivalent securities and guaranteed investment contracts (GICs) issued by highly-rated insurers and banks, with all such assets being held in custody by Quantem's custodian, State Street Global Services.

It is not currently intended that Quantem will soon apply to be rated by a Nationally Recognized Securities Rating Service ("NRSRO") agency. However, an application for rating Quantem's Risk-Pool will be filed with one or more NRSRO agencies as soon as the facility has developed sufficient size, diversity and experience to clearly demonstrate its stochastic model, sustainability and risk-diffusing utility. It is anticipated that the risk-mitigating/stabilizing characteristics of the Risk-Pool, and the predictable CPO settlement experience resulting, will qualify the Risk-Pool for high credit ratings. Discussions with several NRSROs indicate that, upon the issuance of a rating of the Risk-Pool, Quantem and its CPO and CRN securities will also be commensurately rated.

On the matter of credit ratings, it should be noted that the current pricing of default protection for a given credit security is both a primary determinant of the current market value of that security, and a superior metric for determining the current credit worthiness of its issuer. Given their post-crisis concerns regarding the accuracy and conflicts of interest of credit ratings issued by NRSRO agencies, it is anticipated that regulators will favor the market-based alternative to traditional credit ratings offered by the ATS and CPO securities -which continually determine in real-time the market's current assessment of the credit-worthiness of a fixed income securities issuer.

## Primary-Market Interaction

ATS participants seeking new default protection (or to speculate on the future pricing of that protection) will anonymously negotiate the structuring of a new CPO by:

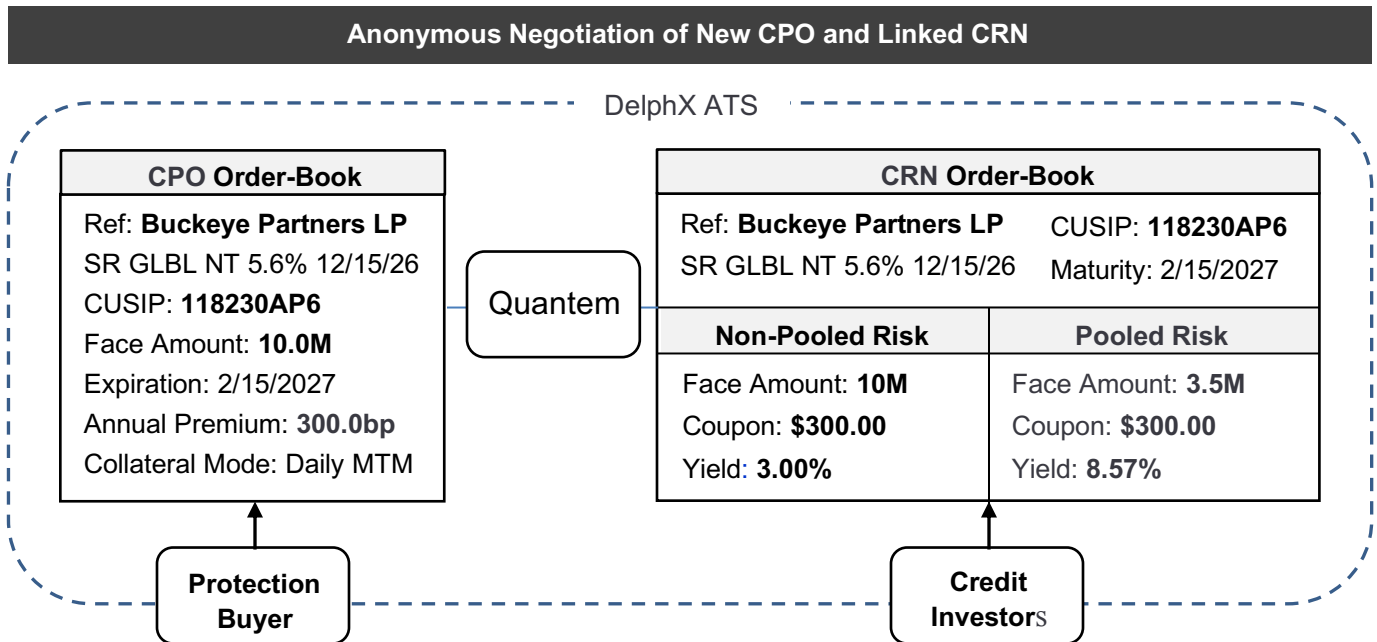
- a) Selecting the underlying security from the ATS Security Reference Database (which includes more than 2 million corporate, municipal and sovereign bonds, asset-backed securities, mortgage-backed securities and other credit securities); and
- b) Specifying the Face Amount, Expiration Date and desired Premium of the pending CPO.

The primary-market functionality of the ATS will then automatically post Quantem's corresponding offer of the required CRN in both the Pooled and Non-Pooled CRN order-books for the underlying security. The Pooled CRN will be offered at a lower Face Amount (and thus higher yield) due to the

lower level of individual risk and lower collateral requirement resulting from Quantem’s pooling of the CRN’s risk.

Prospective buyers of the CRN can then:

- a) Accept the offer at the specified Coupon (determined by the specified Premium of the pending CPO); or
- b) Competitively bid for an alternative Coupon of the CRN (which, in turn, will automatically adjust the CRN’s offered Face Amount and the linked CPO’s offered Premium).



Participation in the DelphX ATS will be available to all financially-sound institutional investors and securities broker-dealers acceptable as a customer and/or potential counterparty to the custodian. The custodian will maintain customer accounts for each ATS participant as may be required to efficiently provide all custody, investment and cash management services required by DelphX, Quantem and that participant.

Mark-to-market collateralization of each CPO consistently exceeds the collateralization requirements specified in Securities Exchange Act Rule 15c3-1e(c)(4), and automatically increases to 100% collateralization on the CPO’s Exercise Date.



All participants will be authorized to anonymously negotiate, purchase and trade new and outstanding CPOs and CRNs on the ATS, with each purchase of a new CPO being facilitated by a concurrent purchase by an unrelated participant of the linked CRN funding the collateral requirement of that CPO. All order books, pending orders and trades will be transparently displayed in real-time to all participants in the Blockchain-powered Distributed Ledger integrated within the ATS.

The following divisions of State Street Corporation will be involved in the operation of the ATS and Quantem:

**State Street Global Advisors (SSGA)**, will provide the asset-related services required by Quantem to manage all non-GIC collateral investments;

**State Street Global Markets (SSGM)**, will underwrite all prospective ATS participants and, for those accepted, establish and maintain Customer/Counterparty accounts for each (and performing independent AML, KYC and other vetting tasks), and provide all securities brokerage and cash bond clearing services required by DSC for operation of the ATS; and

**State Street Global Services (SSGS)**, will provide all custody & payment processing services required by Quantem for management of its securities.

### Quantem Distributed Ledger

Once the terms of a new CPO and linked CRN are agreed and mutually confirmed by the respective buyers, Quantem will immediately execute the respective CPO and CRN sales and notify the custodian of all pertinent information regarding each transaction through redundant encrypted messages transmitted: i) within the secure Quantem Distributed Ledger; and ii) via the Society for Worldwide Interbank Financial Telecommunication (SWIFT) communication environment. All elements of, and subsequent actions relating to, those smart CPO and CRN securities will then be continually recorded and updated in real-time within the transparent Quantem Ledger for all participants to monitor, though the identities of the holders will never be discernable.

It is important to note that:

- a) The proprietary version of blockchain technology developed and employed by the management of DelphX in the operation of the Quantem Ledger is a closed system in which a limited number of nodes (operated by the custodian and selected major participants) will be authorized to enter information into the Ledger;

- b) The Ledger is exclusively an accounting, reporting and verification mechanism, and has no facility for accommodating the transfer of assets or funds within the Ledger. All transfers of assets and funds will be solely performed by the custodian(s) appointed by Quantem and the clearing principal(s) appointed by DSC;
- c) All transfers of assets and funds performed by the custodian(s) and clearing principal(s) will be at the specific direction of Quantem or DSC, each of which must also be confirmed by Quantem or DSC via an external communication protocol established with each such custodian and clearing principal; and
- d) Quantem will employ its proprietary blockchain technology to issue and administer within the Ledger only smart securities that are originated and traded within the regulated ATS and will not offer or facilitate trading of any form of digital coins, tokens or other cryptocurrencies.

### Utility of Risk Pooling

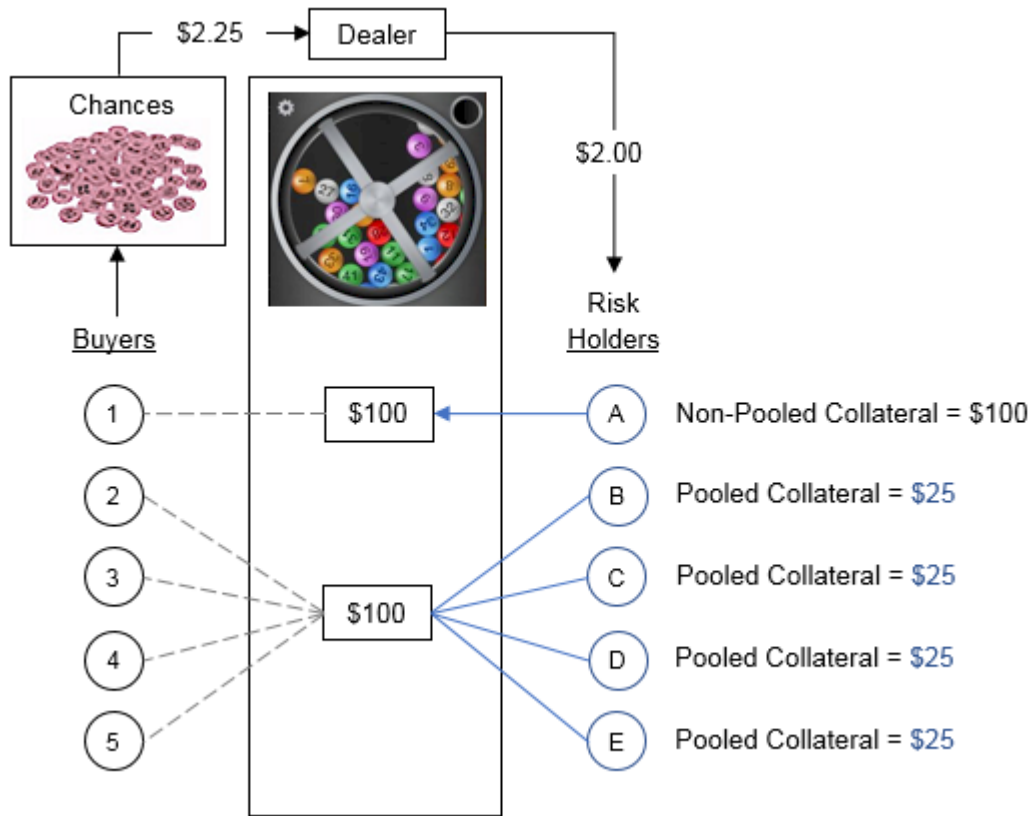
The Law of Large Numbers holds that the average results obtained from a large number of risks will move closer to the expected result as more and more risks are pooled. As the number of risks of an event increase, the number of occurrences of that event get closer and closer to the average chance of the event taking place.

This result can be used to demonstrate that the entry of additional risks to a pool of risks tends to reduce the variation of the mean loss per risk around the expected value. When each contribution of a risk to the pool is accompanied by a contribution to the pool's collateral resources that exceeds the expected loss payment relating to that new risk, the entry of additional risks enhances the accuracy with which the pool's future claim experience can be forecast.

Assuming a stable and independent probability distribution for loss exposure, an insurance company is better served by issuing 500 rather than 150 insurance policies. In turn, that increased accuracy in forecasting aggregate claims enables the insurer to reduce its premiums and aggregate reserves.

To demonstrate the lower collateral requirements produced by pooling, let's assume that a charity event offers a continually-recurring lottery in which participants can buy chances to win \$100. The lottery is operated by a neutral dealer which offers in each lottery a total of 100 Chances, numbered 1 through 100, at a price of \$2.25 each. The number of each Chance corresponds to the number of a ball rotating in a tumbler containing balls numbered 1 through 100.

**Example of Risk Pooling: Lottery Prize = \$100    Chance Price = \$2.25**



Of the \$2.25 collected for each Chance sold, the dealer retains 5 cents, remits 20 cents to the charity, and offers the remaining \$2.00 to other participants willing to hold the risk that a Chance they fund will win. To assure Chance buyers that the \$100 prize will be immediately available to them if their number is released from the tumbler, each Risk Holder is required to post collateral.

If Holder A elects to not pool their risk with the other Holders, he or she will be required to post \$100 as collateral for the Chance held by Buyer 1 and will fully fund the prize paid if Buyer 1 wins. Holder A thus has a 1% risk of losing \$100 in return for its receipt of the \$2.00 payment.

If Holders B, C, D and E elect to pool their risks, each will post \$25 in collateral and will lose that sum if Buyer 2, 3, 4 or 5 wins. Each thus has a 4% risk of loosing \$25 in return for the \$2.00 payment.

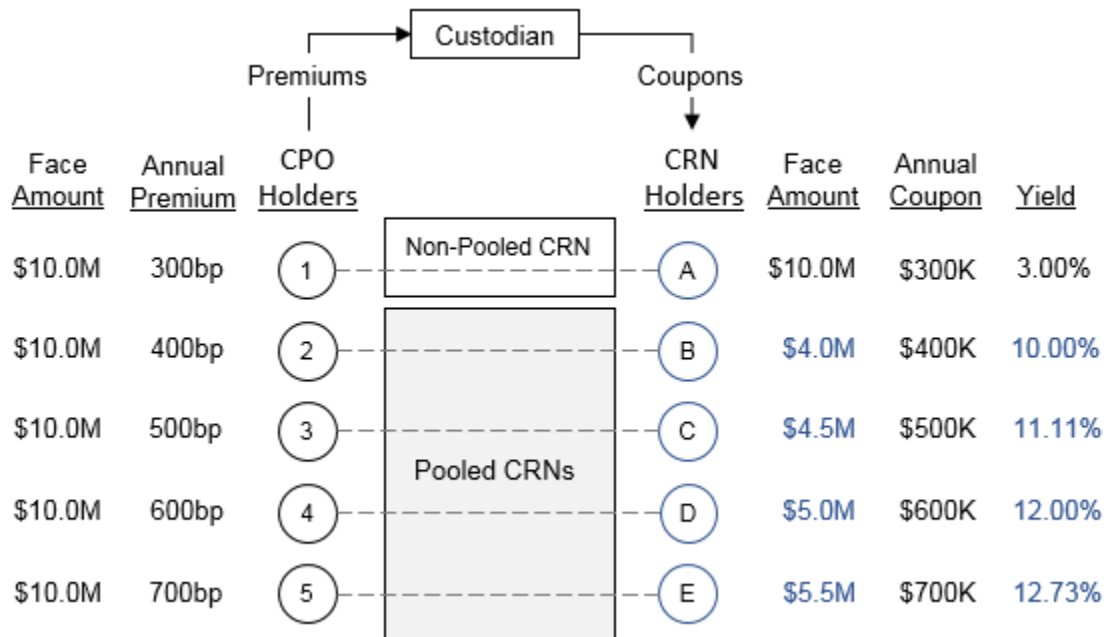
If all Chances in the lottery were sold and all Risk Holders elected to pool, each would post only \$1.00 in collateral for each Chance they funded and have a 100% chance of losing the collateral they posted in return for their receipt of the \$2.00 payment per funded chance. Each Holder would thus earn a 100% profit on their collateral investment.

### Pooling CPO/CRN Risks

When bidding for a new CRN, the prospective buyer elects to purchase either a non-pooled or pooled version of the CRN. If the non-pooled version is purchased, the CRN holder will fully retain the embedded risk of the underlying security defaulting in the future and the loss arising from the exercise of the CPO linked to the CRN. As the lower risk and collateral requirement produced by pooling will not be available to holders of non-pooled CRNs, Quantem cannot offer non-pooled CRNs at a lower face amount (purchase price) than the face amount of its linked CPO.

If pooling of the risk is chosen, the premium of the linked CPO being negotiated will determine the coupon and the discounted face amount of the CRN being offered. As indicated below, as the premium of the offered CPO is increased (reflecting the market's higher assessment of the default risk of the underlying security), the face amount of the linked CRN correspondingly increases. That increase in CRN face amount is the result Quantem's need for an increased level of collateral to fund the increased concentration of risk of the underlying security defaulting.

#### Utility of CRN Risk Pooling: Assuming Common CPO Face Amount of \$10M



In the example above;

- 1) CRN (Risk) Holder A has elected to not pool its risk of loss resulting from a default of the security underlying the linked-CPO held by Holder 1, and thus Holder A must fund 100% of the collateral required by Quantem to guarantee the potential settlement proceeds payable to Holder 1 if the linked CPO becomes exercisable.

- 2) CPO Holder 2 and CRN Holder B have respectively negotiated an annual CPO premium of 400bp (payable by Holder 2 to the Custodian in quarterly installments) and a \$400K CRN coupon payment (payable by the Custodian to Holder B in quarterly installments). As Holder B has elected to purchase a pooled CRN, the 400bp premium (risk concentration) of the linked-CPO enabled Quantem to sell the CRN held by Holder B at a lower purchase price/face amount, thus enhancing Holder B's coupon-yield to 10.00%.
- 3) The negotiated annual premium of a CPO determines the coupon and face amount offered by Quantem for the pooled version of its linked-CRN. For example, the 700bp premium of the CPO held by Holder 5 caused Quantem to offer and sell the linked-CRN held by Holder E with a \$700K coupon and a face amount (purchase price) of \$5.5M. That higher face amount reflects Quantem's increased collateral requirement resulting from the higher premium (risk-concentration) of the CPO held by Holder 5 relative to the concentration of the other pooled CPOs in the example (held by Holders 2,3 and 4).

### Resulting Enhanced Yields

Transferring the risk embedded within a CRN to the Risk-Pool enables the holder to reduce its exposure from 100% of that risk to a small and continually-reducing share of the cost of funding CPO exercise proceeds payable under all CPOs linked to the hundreds (and eventually thousands) of CRNs included in the Risk-Pool.

Through Normal Distribution and operation of the Law of Large Numbers, pooling of risks will facilitate:

- 1) Predictions of aggregate default probability with greater accuracy and stability;
- 2) Lower collateral requirements for any single CRN holder (as all pool participants will only nominally share in each pooled risk); and
- 3) Sales of pooled CRNs at Face Amounts significantly lower than non-pooled CRNs referencing the same underlying security.

That lower collateral requirement for pooled CRNs then:

- 1) Lowers the amount of cash Quantem must collect from its sale of each pooled CRN – enabling it to sell the new CRN at a Face Amount that is lower (e.g. 3.5M) than the Face Amount of the linked CPO (e.g. 10.0M);
- 2) Causes the total annual premium paid by the CPO holder (e.g. 300bp per 1,000 Face Amount times 10.0M Face Amount for a total annual premium of \$300,000);
- 3) Causes the Coupon the CRN holder receives (assuming the full \$300,000 premium for ease of calculation) to be paid directly to the CRN holder by the custodian (not part of the pool mechanics);

- 4) Causes a CRN holder not electing to pool its risk to receive a 3.0% yield (300,000/10M), as the full risk of the linked CPO defaulting and 10M becoming payable is retained by the non-pooling CRN holder); and
- 5) Causes the pooled CRN holder to receive an 8.57% yield (300,000/3.5M) due to the lower Face Amount of its pooled CRN.

The lower risk and collateral requirement produced by pooling is thus conveyed by Quantem to CRN holders through the lower risk-based face amounts. Indicated below are the face amounts resulting from each displayed CPO premium, and the higher post-claim yields rendered by pooling CRN risks.

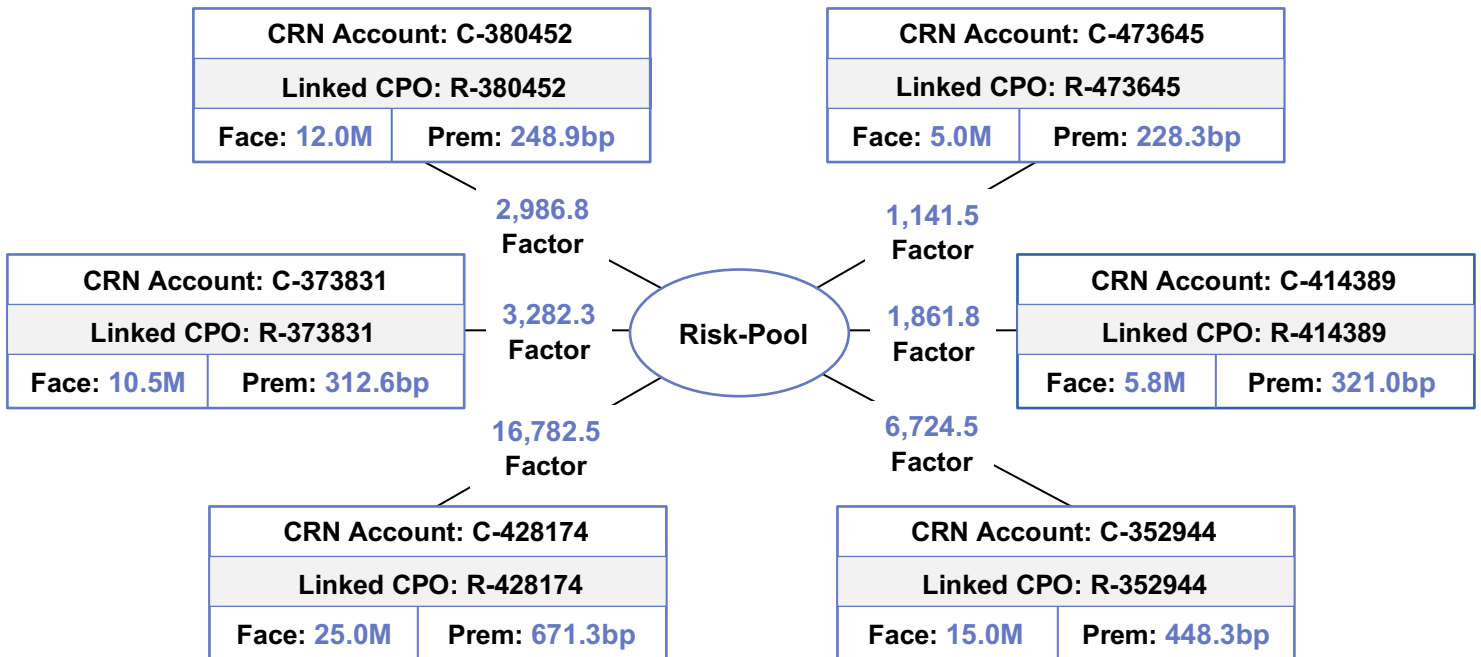
Post-Claim CRN Yields (Assuming 4.0% Annual Risk-Pool Expense Ratio)						
CPO Prem. (bp)	CRN Face Amount	CRN Coupon %	Treasury Yield %	Risk-Share %	Claim Expense	Total Return %
15	200	0.75	2.4	0.10	0.08	3.07
30	200	1.50	2.4	0.19	0.16	3.74
60	250	2.40	2.4	0.39	0.31	4.49
100	250	4.00	2.4	0.65	0.52	5.88
200	300	6.67	2.4	1.30	1.04	8.03
300	350	8.57	2.4	1.95	1.56	9.41
400	400	10.00	2.4	2.60	2.08	10.32
500	450	11.11	2.4	3.25	2.60	10.91
600	500	12.00	2.4	3.89	3.12	11.28
700	550	12.73	2.4	4.54	3.64	11.49
800	600	13.33	2.4	5.19	4.15	11.58
900	650	13.85	2.4	5.84	4.67	11.57
1000	650	15.38	2.4	6.49	5.19	12.59
1100	700	15.71	2.4	7.14	5.71	12.40
1200	700	17.14	2.4	7.79	6.23	13.31
1300	750	17.33	2.4	8.44	6.75	12.98
1400	750	18.67	2.4	9.09	7.27	13.80
1500	800	18.75	2.4	9.74	7.79	13.36
1600	800	20.00	2.4	10.39	8.31	14.09
1700	800	21.25	2.4	11.04	8.83	14.82

### Market-Based Allocation of CPO Settlement Payments

The transparent structure of the ATS, and the anonymous and informed interaction among its participants, enables the premium negotiated for each new CPO to accurately reflect the current market pricing of protection from that risk. That premium (risk concentration) and the face amount of the CPO also determine the pro rata Risk-Factor of its linked CRN.

A pro rata portion of each CPO settlement payment sourced from the Risk-Pool will be collected from the Collateral Account of each pooled CRN. That pro rata Pool-Share will be determined for each pooled CRN at the time of each collection by dividing the Risk-Factor of that CRN by the total sum of all Risk-Factors of pooled CRNs currently outstanding to determine the current Risk-Share of each CRN. Thus, as the size of the Risk-Pool continually increases, the pro rata exposure represented by the Pool-Share of any given CRN will continue to decrease. This continually-reducing exposure to any single risk demonstrates a primary benefit of pooling risk within the transparent Quantem Distributed Ledger.

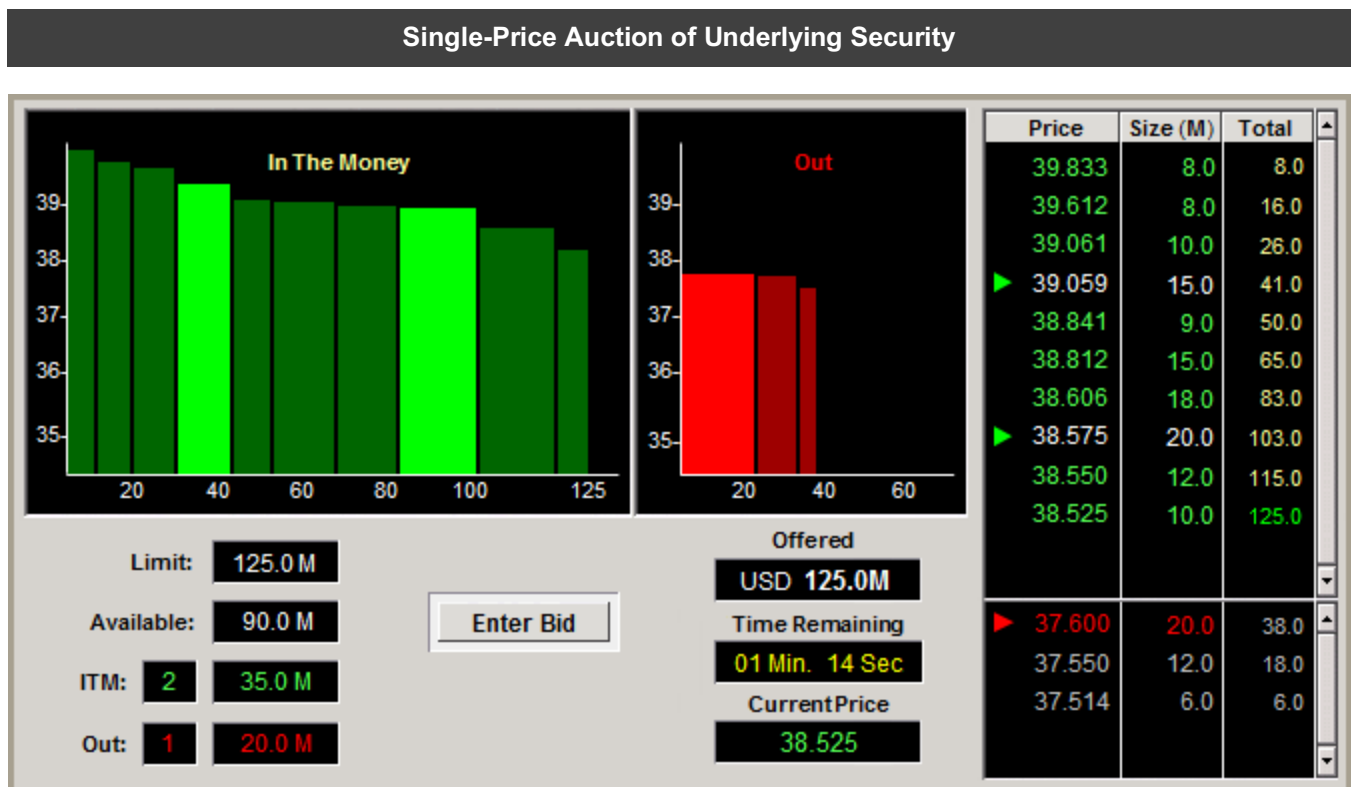
### Risk-Based Sharing of Aggregate Pooled Risk



### Market-Based Determination of Underlying Security Value

The definition and requirements of a qualifying Credit Event are specified in the CPO and CRN documentation. Upon the reporting of a qualifying Credit Event (Exercise Date of the CPO), Quantem will promptly schedule a Single-Price Auction to be conducted on the ATS (occurring no less than 15 business days nor more than 20 business days following the Exercise Date of the CPO), to which all ATS participants will be invited to participate. Prior to the Auction, all participants intending to sell some or all of their holding of the underlying security may post their anonymous Sell order(s) at the single Clearing Price determined in the Auction.

Following the Auction Close, CPO holders electing to Physically Settle will then receive proceeds equal to the Face Amount of the CPO (100% of par value of the underlying security). For CPO holders electing to Cash Settle, the current market value (Auction Clearing Price) of the underlying security will be subtracted from its \$1,000 par value to calculate the cash CPO Sale Proceeds then due. Based on historical CDS trading activity, it is likely that the rate of origination of new and trading of existing CPOs referencing the subject underlying security will materially increase during the period leading up to the scheduled auction.





## Secondary-Market Interaction

### Secondary CPO/CRN Trading

Immediately upon their issuance, all CPO and CRN securities are eligible for pricing and trading in the transparent Secondary-Market of the ATS, wherein all participants can anonymously enter limit-orders to sell CPOs and CRNs they hold, and limit-orders to buy such securities offered by other unrelated participants. The price, size and terms of all secondary CPO and CRN trades are reported in real-time within the ATS, recorded in the Quantem Distributed Ledger and cleared by Quantem, with settlement processing of the trade proceeds being processed by State Street Global Services, the ATS custodian.

It is important to note that, at no time, are any participant funds or assets conveyed or held within the ATS or by Quantem or DSC. All processing of collections, remittances and transfers of currency or assets will be exclusively performed by the ATS custodian pursuant to the instructions of DSC and Quantem.

### Trading of Underlying Securities

DSC refers all trades to SSGM and will not hold or maintain funds or securities, or provide clearing services for other broker-dealers. The SEC has confirmed that DSC will not be acting as an intermediary in making payments or deliveries; instead, it will be collecting and delivering payments/collateral for its own account, not acting as a central clearing counterparty or a central securities depository; it may use a custodian or a clearing agency to make payments, delivery collateral or settle trades.

## MAV<sub>n</sub><sup>®</sup> Benchmark Pricing

The current market value of a fixed income security is generally defined as the price at which it would trade in an orderly arms-length transaction between informed market participants, with each having reasonable knowledge of all relevant facts and neither acting under duress. Through the expansion of the FINRA Trade Reporting and Compliance Engine (“TRACE”) and the Electronic Municipal Market Access (“EMMA”) system of the Municipal Securities Rulemaking Board (“MSRB”), the market prices at which credit securities have been bought or sold in the U.S. has become more accessible. Unfortunately, most credit instruments trade infrequently - making accurate assessment of their current market value a vexing challenge.

The majority of new credit securities are purchased by life insurance companies, pension funds and other institutions seeking long term yields to match their long-term liabilities and/or investment objectives, causing those investors to generally “buy and hold” rather than actively trade those securities. Most outstanding credit issues thus trade infrequently and their current market values are not readily discernable from contemporaneous transactions. However, financial and regulatory reporting, and compliance with increasingly stringent “Best Execution” regulations, require institutions

to periodically determine the current fair market value of the fixed income securities they hold and those they may seek to buy or sell, despite the lack of readily observable market-based pricing.

To provide an effective solution, the management of DelphX Corporation developed a neutral benchmark pricing facility and proprietary data derived from more than 150 million historical and current market transactions to continuously calculate and validate in realtime the “MAV<sub>n</sub>” (Market-Adjusted Value per congruent nexus) forecast of the price at which each security in the universe of bonds it tracks would trade at each instant throughout the current trading day. The current MAV<sub>n</sub> fair-value of each such fixed income security will be calculated as briefly described below.

The historical accuracy of every MAV<sub>n</sub> forecast is also continuously tracked, displayed and permanently recorded for each security, along with all correlated data - including that security’s current Yield, Spread, DV01, Effective Duration, Convexity, Yield of its Reference Treasury, etc.

The MAV<sub>n</sub> market-value forecasts published by DelphX are continuously validated for historical accuracy and designed to facilitate broad pre-trade and post-trade price transparency that enables the ATS participants to cost-effectively:

- a) Access accurate determinations of the current market-value of fixed income securities they hold or are considering buying or selling;
- b) Demonstrate their Best Execution compliance by buying at or below, or selling at or above, the security’s current MAV<sub>n</sub> price;
- c) Determine the markup and markdown levels inherent in their fixed income transactions;
- d) Trade with informed confidence regarding the current market-value of securities they are considering buying or selling, including issues that have not been recently traded;
- e) Perform comprehensive rich/cheap and other price-based analyses; and
- f) Manage risk and capital more efficiently, capitalize on emerging trading opportunities and optimally execute their fixed income investment strategies.

As no forecasting process can produce market-value forecasts with 100% accuracy at all times, the relative historical accuracy of each MAV<sub>n</sub> forecast for every security is continuously monitored and reported. That validation process transparently compares the absolute deviation of the security’s then-current MAV<sub>n</sub> market-price forecast to the actual price at which it traded in each of its five most recent OTC transactions. The aggregate deviation of the security’s MAV<sub>n</sub> price-forecasts from its respective trade-prices is then divided by the total of those trade-prices to determine its Mean Aggregate-Deviation in its five most-recent transactions. That value is then subtracted from 100% to determine the Historical Accuracy “Score” of the security’s MAV<sub>n</sub> pricing-forecasts.

### CPO and CRN Exemptions

- a) All CPOs and CRNs issued by Quantem are securities, as defined under the U.S. Securities Act of 1933 (the “1933 Act”) and not security-based swaps or other derivative instruments;
- b) Quantem’s offering, issuance and sale of new CPO and CRN securities will rely on a valid exemption from registration under the 1933 Act; and
- c) New CPO and CRN securities will be offered and sold to only ATS participants that meet all of the following criteria:
  - i) Accredited Investors, as defined in SEC Rule 501; and
  - ii) Qualified Purchasers, as defined in the Investment Company Act of 1934 (the “1934 Act”); and
  - iii) Currently accepted as a trading counterparty by State Street Global Markets.
- d) Subsequent transfers of CPO and CRN securities resulting from secondary-market trading on the ATS will also be limited to participants that meet all of the above requirements.

### Quantem Exemptions

In light of the eligibility restrictions and requirements for participation on the ATS described above, Quantem will not be required to register as an Investment Company pursuant to the 1934 Act.

As Quantem is an Exempted Bermuda corporation, the investment income accruing on the collateralizing assets it holds for ultimate distribution to the CPO and CRN holders will not be taxed until such funds are distributed to the applicable holder, which will be taxed in accordance with the tax regime of the holder’s domicile.