



Eurex Clearing

Stakeholder Response to

ESMA/2012/474

Report and Consultation Paper

Guidelines on ETFs and other UCITS issues

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***Annex IV – Consultation paper on the treatment of
repurchase and reverse repurchase agreements***

Frankfurt am Main, September 25th, 2012

A. Introduction

Eurex Clearing is a globally leading central counterparty (CCP). We offer fully auto-mated and straight-through post trade services for derivatives, equities, repo, energy and fixed income transactions. As a central counterparty, our focus is to increase market integrity.

Eurex Clearing AG is a company incorporated in Germany and licensed and regulated as a credit institution under supervision of the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin) pursuant to the German Banking Act (Gesetz über das Kreditwesen). The Financial Services Authority (FSA) has granted Eurex Clearing status as a Recognised Overseas Clearing House (ROCH) in the United Kingdom.

Eurex Clearing is a subsidiary of Deutsche Börse AG and acts as the central counterparty for Eurex, Eurex Bonds, Eurex Repo, European Energy Exchange (EEX) the FWB® Frankfurter Wertpapierbörse (the Frankfurt Stock Exchange) - both Xetra® and floor - and the Irish Stock Exchange.

Eurex Clearing will launch a clearing service for over-the-counter (OTC) derivatives in the fourth quarter of 2012. The new EurexOTC Clear for Interest Rate Swaps (IRS), Eurex Clearing will fully integrate the clearing and collateralization of OTC and listed derivatives in a single clearing house in one single legal and operational framework. We are working on specific solutions for buy-side institutions to meet margin requirements by means of a CCP-enabled repo and collateral transformation services - side-by-side with our OTC derivatives clearing service.

As part of Eurex Group, Eurex Repo is the leading provider for international financing in the secured money market business (repo and securities lending). Its marketplace combines electronic trading with standardised collateral management and settlement for secured funding and financing transactions. The Euro Repo and the GC Pooling Markets offer trading opportunities with a fully integrated trading, clearing and settlement. As soon as a trade is concluded Eurex Clearing steps in as central counterparty and performs a comprehensive risk and delivery management. Eurex Repo GmbH is a Multilateral Trading Facility (MTF) according to the Financial Instruments Directive 2004/39/EC (MIFID) and is supervised by the German Federal Agency for Financial Market Supervision (BaFin).

The next part, section B, of this document contains some general remarks we have on the "Guidelines on ETFs and other UCITS issues" in Annex III of ESMA/2012/474. In particular, we are concerned about the implications of some of the provisions provided in chapter "XII. Management of collateral for OTC financial derivatives transactions and efficient portfolio management techniques" of the guidelines in Annex III. We conclude

in section C of this document with some detailed remarks on questions to stakeholders raised in Annex IV of ESMA/2012/474.

B. General remarks

The G20 agreement envisaged to strengthen the international financial system by improving the functioning of over-the-counter (OTC) derivatives markets through legislative and regulatory reforms to be implemented by end of 2012. In particular, the mandate was to promote the attractiveness of CCP clearing and thereby increase its use to mitigate counterparty risk and increase market integrity.

As a result on 27 July 2012 the Regulation on OTC derivative transactions, central counterparties and trade repositories ("EMIR") has been published in the Official Journal of the European Union. While the legislative process took significantly longer than expected, the remaining time for defining and implementing the regulatory standards is very tight and puts both ESMA and the financial industry under significant pressure in order to adhere to the milestones set and to cope with operational and economic implications.

One of the most critical implications of the mandate for central clearing of OTC derivatives is the additional demand for collateral transformation and margin financing for buy-side institutions to meet the collateralization and margining requirements of CCP clearing arrangements. These additional demands could be met through repo and securities lending markets. But for the most part, these markets are still fragmented, opaque and predominantly bilateral in nature. Hence, the central clearing of OTC derivatives might cause significantly increasing bilateral exposures in repo and securities lending markets. To avoid this odd scenario, we are convinced that such demand for margin financing and collateral transformation should be met by means of efficient, transparent and accessible securities lending and repo markets.

Against this background, we fully share the assessment of these markets which was put forward by ESMA in the context of the shadow banking discussion as comments to the Green Paper of the EU Commission on Shadow Banking (Brussels, 19.3.2012 COM(2012) 102 final). We strongly support ESMA's position toward designing an appropriate and harmonized framework for repo and securities lending markets. Being it built on existing regulation (MIFID, CRD, UCITS) or being it a standalone initiative it should in our opinion ensure transparency, market integrity and central clearing where appropriate.

However, as to the Report and Consultation Paper published by ESMA on 25 July 2012 comprising Guidelines on ETFs and other UCITS issues we do have some concerns on the adverse implications of effectively limiting access and usage of securities lending

and repo markets. We are convinced that there is a need for buy-side firms to participate in these markets for the purpose of efficiently managing margin and collateral requirements of centrally cleared OTC derivatives. Sell-side banks and clearing members will not be able to fully meet the increasing demands of buy-side customers for collateral and margin financing because of the severe impact on their balance sheets and capital charges.

Consequently, we consider some of the limitations imposed on the management and use of cash and non-cash collateral received as counterproductive in the context of central clearing of OTC derivatives. Without access to competitive and liquid repo and securities lending markets buy-side institutions like ETFs and UCITS would have to draw from expensive, non-transparent bilateral credit arrangements, be required to sell assets permanently in order to maintain a sufficiently large cash portion at all times or, finally, have to resent from using derivatives and thereby be exposed to larger liquidity risks, tracking errors. All in all, this will have an adverse impact on the return offered to investors.

C. Detailed comments on the consultation paper

The proposed guidelines and questions to stakeholders in “Annex IV – Consultation paper in the treatment of repurchase and reverse repurchase agreements” put emphasis on the ability of UCITS to execute redemption requests in accordance with Article 84(1) of the UCITS Directive. In this context, preference is given to repo and reverse repo arrangements allowing for cash and non-cash collateral to be recalled at any time. In our view, both the guidelines and questions do in our opinion neither adequately reflect the drawbacks and diseconomies of recall provisions nor consider alternative approaches available in repo markets.

In principle, recall provisions in repo and reverse repo arrangements represent contingencies and uncertainty for the collateral taker. Hence, such Open Repo arrangements trade at less favourable terms and with much lower liquidity. In fact, markets have formed alternative approaches to resolve the immediacy issue of retrieving cash and non-cash collateral by offering multilateral trading platforms for standardized and centrally cleared General Collateral (GC) baskets offering four distinct features: Firstly, the liquidity of such platforms with a large potential number of counterparties together with the CCP-enabled multilateral netting allows for the immediate closing out of repo and reverse repo positions by means of entering into counter trades for the remaining term. Hence, there is no need for recall or immediate cancellation provisions in the repo and reverse repo arrangement itself. Secondly, maintaining repo and reverse repo positions in GC baskets provides for efficient collateral substitution, i.e., the non-cash collateral provider has the right for substitution of the corresponding collateral securities at any time and within one day (overnight). Thirdly, in being centrally cleared counterparty diversification and limits on bilateral

counterparty exposures are subject to the functioning and effective risk management of the CCP. Fourthly, centralised clearing of repos and securities lending transactions through a CCP greatly increases transparency and reporting for regulators and participants as well as supports standardisation.

Finally, similar to the beneficial treatment given to centrally cleared OTC derivatives under EMIR, we would recommend to establish a similar incentive to clear repo and securities lending transactions centrally, particularly with regards to counterparty limits, restrictions of eligible collateral and reusability of cash receipts from repo transactions.

D. Closing

Let us please conclude by asking ESMA to take into consideration the general and specific remarks made in section B. and C. above. We are convinced that it would be in the best interest of well functioning markets when the close interactions and dependencies between derivatives and collateral markets are adequately and consistently addressed across different legislative and regulatory reform initiatives.

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