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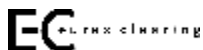
Response

CESR consultation

Guidelines on Risk Measurement and the Calculation of
Global Exposure and Counterparty Risk for UCITS

Ref: CESR 10-108, 19 April 2010

Frankfurt, 31 May 2010



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A. Introduction

Eurex Clearing AG welcomes the opportunity to comment on the CESR consultation "Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS." In particular, we wish to highlight an important inconsistency between the guidelines and overall EU as well as global policy aims.

Eurex is one of the world's largest derivatives exchanges. Eurex Clearing is a subsidiary of Eurex and the largest European Central Counterparty (CCP). Eurex provides an extensive range of products, including some of the world's most heavily traded derivative contracts. Eurex has always been at the forefront of electronic trading and serves the derivatives industry globally with access to the benchmark futures and options market for European derivatives. With clearing services for derivatives, equities, bonds and repos, customers benefit from a high-quality, cost-efficient and comprehensive trading and clearing value chain.

Eurex Clearing provides central clearing services for cash and derivatives markets both for listed as well as certain over-the-counter (OTC) financial instruments. Eurex and Eurex Clearing actively contribute to market safety and integrity with state-of-the-art market infrastructure both in trading and clearing services as well as with leading risk management processes for the derivatives industry. Especially central counterparty clearing has proven its value proposition as a stabilizing element for financial markets during market turmoil. Based on comprehensive risk management processes it effectively reduces systemic risk and improves both transparency and operational efficiency for centrally cleared products and markets.

B. Comments

Among other topics, the proposed CESR guidelines cover treatment of CCP-cleared OTC derivatives in the context of counterparty thresholds.¹ The UCITS directive (2009/65/EC) defines that:

"Article 52 (1): ... The risk exposure to a counterparty of the UCITS in an OTC derivative transaction shall not exceed either:

- (a) 10 % of its assets when the counterparty is a credit institution referred to in Article 50 (1) (f); or
- (b) 5 % of its assets, in other cases."²

The CESR consultation paper seeks to specify these thresholds further:

"...The following exposure must also be calculated within the OTC counterparty limits specified in Article 52 (1): Any exposure with a central clearing house whereby exposure with the OTC counterparty is novated to the clearing house. In

¹ This includes also securities lending transactions and stock repurchase agreements.

² See UCITS directive text available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0032:0096:EN:PDF>.

this case **the risk exposure is with the clearing house and not the OTC counterparty. ...**"³

The CESR guidance appears to imply that UCITS will be subject to a 5% (or in some cases 10%) counterparty limit to a single CCP for OTC derivatives exposures, therefore apparently **working against the current political and regulatory aim to encourage increased use of centralized clearing for OTC derivatives as a means to enhance the safety and stability of financial markets**. This policy goal was highlighted most prominently in the G20 Leaders' Statement from September 2009: "All standardized OTC derivative contracts should be ... cleared through central counterparties by end-2012 at the latest."⁴

The G20 commitment recognizes the benefits of central clearing over bilateral risk management arrangements. **Mitigation of counterparty risk** is achieved through contract novation, i.e. the process through which a CCP acts as a buyer to all sellers, and vice versa, which allows the CCP to assume the counterparty risk of all trading parties and ensure sufficient collateralization through (intraday) margin calls. Complexity in counterparty relations and monitoring costs are thus substantially reduced. The CCP is well protected against default by the collateralization of open risk positions and by its ability to close out positions and by its several lines of defence. Additionally, the CCP nets all offsetting open derivatives contracts of each trading party across all other trading parties. Such **multilateral netting decreases the gross risk exposure** to a much higher degree than through bilateral netting. Furthermore, a CCP is in a better position than any counterparty of a bilateral transaction to **absorb the failure of a clearing member**. By specifying the requirements for clearing members' margining and collateral, CCPs are able to reduce the risk of a failing member affecting others.

Implementation of the G20 commitment is underway in both the European Union and the United States: The European Commission in its October 2009 Communication on ensuring efficient, safe and sound derivatives markets remarked: "the Commission has identified CCP-clearing as the main tool to manage counterparty risks"⁵; the United States continues to work toward G20 commitments with financial reform bills from the House of Representatives and Senate (soon to be merged into a single bill) both requiring CCP clearing of eligible derivatives.

Furthermore, in the UK implementation of the UCITS directive, the benefits of central clearing are acknowledged in that listed derivatives are exempted from the concentration rules if the clearing house is considered to meet certain criteria:

³ As outlined on page 45, box 26, 4.2 (1) in the consultation document, available at: http://www.cesr.eu/index.php?page=consultation_details&id=162.

⁴ See Leaders' Statement, Pittsburgh G20 Meeting, available at: http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

⁵ See page 4, "Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Central Bank: Ensuring efficient, safe and sound derivatives markets: Future policy actions," October 20, 2009, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0563:FIN:EN:PDF>.

“(14) In applying this rule, all derivatives transactions are deemed to be free of counterparty risk if they are performed on an exchange where the clearing house meets each of the following conditions:

- (a) it is backed by an appropriate performance guarantee; and
- (b) it is characterised by a daily mark-to-market valuation of the derivative positions and an at least daily margining.”⁶

OTC derivatives that are centrally cleared will be subject to the same criteria and it would seem logical that the same conditions on exposure thresholds would apply.

C. Conclusion

Eurex Clearing would suggest that the CESR guidance be adjusted to recognize the benefits of central clearing of OTC derivatives. Specifically, CCPs should be excluded from the limits on risk exposure to a counterparty in an OTC derivatives transaction. This adjustment would serve to avoid the situation that the UCITS fund management industry would be prohibited from adoption of CCP clearing for a significant portion of OTC derivatives, including also in the context of securities lending and stock repurchase agreements.

We hope that you have found these comments useful and remain at your disposal for further discussion.

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⁶ See COLL 5.2.11 R (14) of FSA, “Collective Investment Schemes Sourcebook (Use Of Financial Derivative Instruments For UCITS) Instrument 2005,” available at: http://fsahandbook.info/FSA/handbook/LI/2005/2005_8.pdf; <http://fsahandbook.info/FSA/html/handbook/COLL/5/2>.