



## **Eurex Clearing**

### **Response to**

Joint CFTC – SEC request for comment on  
international swap and clearinghouse  
regulation

CFTC Release No. 34-64926; SEC File No. 4-635

Frankfurt am Main, 26 September 2011

Eurex Clearing AG wishes to thank the Securities and Exchange Commission (“SEC”) and Commodity Futures Trading Commission (“CFTC”), (and, together, “Commissions”), for the opportunity to provide comments on this important subject of international swap regulation, as required of the Commissions by Section 719(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).

Formed in 1997, Eurex Clearing currently provides clearing services for Eurex Exchange, Eurex Bonds, Eurex Repo, the Frankfurt Stock Exchange, the Irish Stock Exchange, and the European Energy Exchange, as well as, via Eurex Credit Clear, for credit default swaps traded off exchange. With around 110 clearing members in 10 countries, it manages a collateral pool of approximately 45 billion euros and processes gross risks valued at almost 9 trillion euros per month.

Eurex Clearing is fully owned by Eurex Frankfurt AG, which in turn is fully owned by Eurex Zürich AG. Eurex Zürich AG is fully owned in equal shares by Deutsche Börse AG, a publicly traded company listed on the Frankfurt Stock Exchange, and SIX Swiss Exchange.<sup>1</sup>

Under the German regulatory framework, Eurex Clearing is supervised by BaFin (the German Federal Financial Supervisory Authority), cooperatively with the Deutsche Bundesbank (the German central bank). Eurex Clearing is also subject to regulation in various capacities in several other jurisdictions:

- With respect to regulation by the CFTC, the CFTC’s first no-action letter granted to a foreign board of trade (“FBOT”) was issued to Deutsche Terminbörse, the predecessor of Eurex AG, in 1996.<sup>2</sup> It allowed the FBOT to provide access to its trading system from within the US by US customers. Eurex has received over 20 No-Action Letters for access to its stock index products.<sup>3</sup> On July 31, 2009, Eurex Clearing was granted an Order by the CFTC under Section 409(b)(3) of the Federal Deposit Insurance Company (“FDIC”) Improvement Act of 1991, so that it may act as a multilateral clearing organization with respect to certain over-the-counter contracts, agreements or transactions.
- With respect to securities regulation by the SEC, the International Securities Exchange, the operator of a U.S. securities market, is owned by US Exchange Holdings, Inc., a fully-owned subsidiary of Eurex Frankfurt. Also with respect to regulation by the SEC, Eurex Clearing received an exemption from the SEC on July 29, 2009 to admit certain US persons for the purpose of clearing credit default swaps. This exemption was renewed in April, 2010 and was included in the SEC’s proposed rules respecting further exemptions for security-based swaps by certain clearing agencies.<sup>4</sup>

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<sup>1</sup> SIX will transfer its legal and economic interests in Eurex Clearing to Deutsche Börse AG (DBAG) such that as of 1 January 2012, DBAG will own Eurex Clearing fully.

<sup>2</sup> See CFTC Letter No. 96-28 (Feb. 29, 1996).

<sup>3</sup> See <http://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=ForeignOrganizationProducts&implicit=true&type=DCM&status=No-Action+Letter+Issued&CustomColumnDisplay=TTTTTTTT>

<sup>4</sup> See SEC Exemptive Order: Order Pursuant to Sections 15F(b)(6) and 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New

- On January 16, 2007, Eurex Clearing was recognized by the UK Financial Services Authority (“FSA”) as a Recognized Overseas Clearing House (“ROCH”), on the basis that the regulatory framework and oversight of Eurex Clearing in its home jurisdiction was comparable to that of the UK FSA.
- In addition, Eurex Clearing adheres to the internationally recognized standards of the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO), as recognized in a 2011 audit of the International Monetary Fund.<sup>5</sup>

Eurex Clearing has been following legislative and regulatory developments closely, particularly in Germany, the European Union, and the United States in response to September 2009 G20 commitments on OTC derivatives.<sup>6</sup> As an entity that could potentially be adversely impacted by inconsistent regulation across countries, Eurex Clearing agrees that international coordination is critical to ensure that the international regulatory structure for swaps is clear as to regulatory jurisdiction and legally consistent across national borders.

#### **Responses to questions:**

The Commissions’ request for comment notes that items A-E are most appropriately answered by regulators; item F targets a wider range of commenters; and item G requests information that exchanges and clearinghouses can provide. Eurex Clearing accordingly responds to items F and G. Please note that our comments apply to jurisdictions as specified.

#### **Item F. Regulatory Comparison**

We focus our answers on those aspects of OTC derivatives regulation covered by the September 2009 G20 commitment on OTC derivatives. This includes: clearing obligations, trading obligations, reporting obligations to trade repositories, and differential capital requirements between CCP cleared and non-CCP cleared transactions. As most of these aspects are not covered under existing laws or regulations within the European Union or individual member states of the European Union, in the EU context our answers relate for the most part to emerging legislation and regulation.

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Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, and Request for Comment, at <http://www.sec.gov/rules/exorders/2011/34-64678fr.pdf>; also SEC Release Nos. 33-9222; 34-64639; also 39-2474; File No. S7-22-11, available at: <http://www.sec.gov/rules/exorders/2011/34-64678fr.pdf>

5 International Monetary Fund, “Germany: Report on the Observance of Standards and Codes (ROSC),” 12 July 2011. See: <http://www.imf.org/external/pubs/cat/longres.aspx?sk=25032.0>.

6 G20 Leaders, “G20 Leaders Statement: The Pittsburgh Summit,” 24-25 September 2009. See: <http://www.g20.utoronto.ca/2009/2009communique0925.html>. “All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements.”

1. *Across jurisdictions, for any or all items listed above, which areas of regulation are similar and which areas are different?*

It is difficult to assess definitively similarities and differences between the US and EU approaches to swap and CCP regulation at this point. In the US, rulemakings implementing the Dodd-Frank Act (DFA) are not yet complete. In the EU, swap and CCP regulation will be covered under several different pieces of legislation. The proposed legislation on OTC derivatives, central counterparties and trade repositories, also known as European Market Infrastructure Regulation (EMIR), is still being finalized and will be subject to the development of technical standards by the European Securities and Markets Authority (ESMA) by mid-2012. Proposals for changes to the Markets in Financial Instruments Directive (MiFID) and Capital Requirements Directive (CRD) are in an even earlier stage of development. Even so, in some cases broad tendencies on similarities and differences between the approaches being followed in the US and EU can be identified:

- *Clearing obligation:* In both the US and the EU, certain OTC transacted derivatives will be subject to central counterparty clearing requirements. There are identifiable similarities and differences in exemptions for certain products and entities.
  - *Product exemptions:*
    - § Because the DFA exempts certain SEC-regulated products, OTC-traded equity and equity index options may not be subject to the clearing obligation in the US. In the EU there is no similar exemption.
    - § The US Treasury has proposed to exempt certain FX swaps and FX forwards (but not FX options and many currency swaps) from the clearing and trading mandates. Although discussed in the EU, a similar explicit exemption does not appear in the current versions of EMIR.
    - § Further differences in product coverage of clearing obligations are likely to emerge as a result of the separate processes in the US and EU for determining which classes of OTC derivatives will be covered by a clearing obligation.
  - *Entity exemptions:*
    - § In both the US and EU, transactions by non-financial entities are excluded from a clearing obligation if such transactions are used to hedge against business risk. The EU will provide a further exemption for non-financial entities for their non-hedging transactions falling beneath a threshold to be defined by ESMA.
    - § In the EU, it is likely that pension funds will be excluded from clearing obligations for OTC derivatives for at least a period of three to five years. Similar exemptions have recently also been the topic of discussion in the US.

- § In the EU, it is likely that intra-group—including financial as well as non-financial or mixed groups—transactions will be exempted from clearing obligations. In the US, in many comments submitted to the Commissions, it has been proposed that swap transactions between affiliates be exempted because, most of the time, the purpose of such swaps is to hedge against business risk. It has been argued that mandated clearing for such swaps would not reduce systemic risk.
- *Trading obligation:* In the EU an organised trading obligation for OTC derivatives will be addressed by the MiFID Review. In the US, such an obligation is included in the DFA.
    - *Mandatory trading of OTC derivatives:* In a December 2010 public consultation on the MiFID Review<sup>7</sup>, the EC sought views on “introduction of a requirement that all clearing eligible and sufficiently liquid derivatives should trade exclusively on regulated markets, MTFs, or organised trading facilities.” The current inter-services consultation MiFID Review draft legal texts<sup>8</sup> confirm that the EU Commission intends to propose a trading obligation for classes of OTC derivatives which will be further defined in a subsequent procedure. Similarly, the DFA requires that: “With respect to transactions involving swaps subject to the clearing requirement ... counterparties shall ... execute the transaction on a board of trade designated as a contract market ... or ... execute the transaction on a swap execution facility...”<sup>9</sup>
    - *Trade transparency and market structure:* The December 2010 MiFID Review consultation proposed that pre- and post-trade transparency be introduced for a broad range of equity-like and non-equity financial instruments including OTC derivatives. The available MiFID Review draft legal texts reveal that:
      - § Pre- and post-trade transparency will be introduced for a broad range of non-equity (including OTC derivatives) and equity-like financial instruments.
      - § All organised trading shall be conducted on regulated venues and shall be fully transparent. Trading venues include Regulated Markets (RMs), Multilateral Trading Facilities (MTFs) and Organised Trading Facilities (OTFs).
      - § All venues will be subject to the same pre- and post-trade transparency. The transparency requirements will be calibrated for different types of instruments and different market models.

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<sup>7</sup> European Commission, “Public Consultation Review of the Markets in Financial Instruments Directive (MiFID),” 8 December 2010. See: [http://ec.europa.eu/internal\\_market/consultations/docs/2010/mifid/consultation\\_paper\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf).

<sup>8</sup> Leaked documents were published at: <http://graphics.thomsonreuters.com/11/09/MiFIDISCDraft0911.pdf>.

<sup>9</sup> See Section 723 of the DFA.

§ As regards OTFs, an extensive framework on organisational requirements, conduct of business and corporate governance will be introduced, in analogy to the rules applicable to RMs and MTFs.

§ The difference between OTFs on the one hand and RMs and MTFs on the other hand is that the former are allowed to perform discretionary execution and to choose to whom they will grant access.<sup>10</sup>

These requirements are in general similar to those proposed in the DFA. However, it remains to be seen how aligned the details of the US and EU approaches will be as the Commissions continue to develop final requirements implementing the DFA and as the MiFID Review is finalised.

- *Reporting obligation:* The approaches in the US and EU include an important difference in that the EU mandate to report to trade repositories will cover all derivatives including also exchange-traded derivatives whereas the US approach includes swaps only. Another important difference is that a CCP in the EU would face a cumbersome process to register as a trade repository, which is not foreseen under the US approach. The approaches are, however, similar in that in both jurisdictions, all OTC derivative transactions will likely be covered, including those of non-financial entities even if those transactions are intended to hedge against business risk.
  - *Capital requirements:* Within the EU, the topic of capital requirements to be imposed on non-CCP cleared transactions is being addressed within the Capital Requirements Directive, which seeks to implement the global approach to be defined by the Basel Committee on Banking Supervision. Under the “Basel III” approach and in line with the G20 commitment, non-CCP cleared OTC derivatives would be subject to higher capital charges than CCP-cleared OTC derivatives. It is hoped that the US and EU will implement the globally agreed approach consistently.
2. *In viewing the existing laws, institutions, and enforcement mechanisms of each respective jurisdiction as a whole, are such similarities and differences appropriate and desirable for regulatory purposes, or do certain aspects of a particular jurisdiction's Swap market warrant a different regulatory approach?*

We are confident that current forms of law and market regulation in effect across jurisdictions today form a solid basis for effective regulation. The growth of global swap markets, which are characterized by high levels of cross-border trading, have been designed to function in various legal settlings. In the EU, ESMA promises to streamline and rationalize cross-border regulation across the EU member countries.

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<sup>10</sup> RMs and MTFs are required to provide systems for non-discretionary execution and must grant access to their platform on a non-discriminatory basis to any party who fulfills certain criteria.

At the same time, there may be important differences in banking, custody, and insolvency law across jurisdictions. These differences require the development of varied customer solutions at clearinghouses, such as the requirements on customer asset protection, in order to provide the necessary level of protection with the highest level of certainty in that jurisdiction. Eurex Clearing believes that regulators should be flexible when confronted with differences in non-domestic financial, legal and regulatory infrastructures.

Eurex Clearing believes that the optimal global regulatory model is one in which minimum standards across jurisdictions (such as the principles outlined in the G20 Accord) are reflected, while retaining the flexibility for trading venues and clearing houses to adopt innovative, efficient and robust risk management solutions. With respect to customer protections, we believe that market infrastructure in different jurisdictions should be allowed to offer solutions that exceed these principles.

- 3. What are the potential costs and benefits (in terms of investor protection, market efficiency, competition, or other factors) that may arise from further consistency/harmonization of regulations across borders?*

The DFA and upcoming EU legislation including EMIR, MiFID, and CRD are similar in their general requirements and in their intended effects, but they are not identical. We believe consistency is required in order to avoid regulatory arbitrage, but that some degree of regulatory flexibility will encourage various trading venues and clearinghouses to develop superior solutions to the types of treatment that will be most likely to satisfy customer demand.

Furthermore, we welcome efforts to ensure that any extraterritorial effects of US and EU legislation are clear to market participants as well as market infrastructures and do not lead to possible irresolvable inconsistencies. We note upcoming SEC and CFTC clarifications in this regard as well as ongoing changes to the text of EMIR, for example to reflect cases of cross-border transactions. In this context, recognition requirements of third-country CCPs in the two jurisdictions should be similar in terms of safeguarding financial stability while ensuring global capital flows are supported as required.

- 4. How should consistency in regulation across jurisdictions be measured and are there factors other than the harmonized text of a regulation that should be taken into consideration when assessing the degree to which cross-border regulatory harmonization has been implemented in practice?*

As stated above, Eurex Clearing supports the adoption of regulatory frameworks across jurisdictions that implement the G20 principles, while allowing for innovation by market participants. While we believe that regulators are mandated to meet certain minimum standards, we also believe there should be consistency in monitoring and enforcement. As part of its mandate to review progress in implementation of G20 objectives, the Financial Stability Board (FSB) should be charged with not only reviewing developed regulations but also reviewing implementation of measures across jurisdictions. National regulators should be encouraged to modify regulations as required on the basis of FSB observations.

5. *Assuming that a theoretically “optimal” set of regulations for a particular jurisdiction might take into consideration elements unique to a specific market in ways that might make cross-border harmonization difficult, to what extent do the benefits of greater regulatory harmonization across borders outweigh the costs associated with having regulations that might be less tailored to a particular market's circumstances? In what areas do you believe the benefits of harmonization most outweigh any potential downsides? (In particular, please identify any potential opportunities for regulatory arbitrage or impediments to the achievement of consistent regulatory standards across jurisdictions.) Are there any areas where you believe the likely benefits of “optimal” market-specific regulation outweigh the likely benefits of harmonization?*

As stated in response to F2 above, in the view of Eurex Clearing, there are likely to be differences among jurisdictions that in some cases warrant development of different regulatory treatment of OTC derivatives. For instance, there are many existing legal regimes, such as bankruptcy law, which are not harmonized across jurisdictions. These differences require the development of differing solutions, including requirements on segregation and portability.

6. *In the United States, what steps should or could be taken to better harmonize statutory requirements under the Dodd-Frank Act with statutory requirements implemented in other jurisdictions?*

EU officials, including Internal Market and Services Commissioner Michel Barnier, have stressed their commitment to ensuring consistent approaches with the US: “We must make sure our rules are the same on important issues. Scope and conditions for clearing. Collateral and capital requirements. And – importantly – the recognition of each other’s central counterparties and trade repositories.”<sup>11</sup>

Transatlantic working groups have been set up to ensure that EU policymakers and regulators are in close contact with US counterparts as EU legislation is being drafted. We believe this is a useful exercise that will contribute to close alignment on the most critical issues.

In addition to engagement in such working groups, the US can leverage participation in global forums to further promote harmonization where possible, for example via the Basel Committee on Banking Supervision, the Financial Stability Board, and various CPSS and IOSCO groups.

7. *In the United States, what steps could be taken to harmonize CFTC or SEC regulations with regulations promulgated by authorities in other jurisdictions?*

As above, to our understanding, EU and EU member state regulators are in close contact with the CFTC and SEC in the context of transatlantic working groups as well as within global initiatives, such as the drafting of the CPSS-IOSCO Principles

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<sup>11</sup> Michel Barnier, “Time for delivery: Making the Reforms of the Financial System in Europe and in the United States a reality,” 3 June 2011. See: [http://ec.europa.eu/commission\\_2010-2014/barnier/docs/speeches/20110603/speech\\_en.pdf](http://ec.europa.eu/commission_2010-2014/barnier/docs/speeches/20110603/speech_en.pdf).



for Financial Market Infrastructures or IOSCO work on organized trading of OTC derivatives.

#### *G. Swap Market Information*

1. *Please identify major organized markets and electronic execution facilities (and the Swaps-related regulator(s) for each) for the trading of Swaps.*
  - a. *For each market or facility, provide a listing and description of the major contract classes and subclasses, such as credit default swaps (CDS), equity swaps, currency swaps, interest rate swaps (IRS), and commodity swaps;*
  - b. *For classes and subclasses of contracts identified in paragraph a above, please provide:*
    - i. *The trading volumes in 2009, 2010, and year-to-date; and*
    - ii. *The outstanding notional values at year-end 2008, 2009, 2010, and the most recent available.*

Eurex offers several services supporting the off-exchange trading of derivatives products and subsequent clearing of those products. For example: the Block Trade facility supports the bilateral, off-exchange trading of standard Eurex products; the Vola Trade facility allows authorized members to clear futures and options transactions through Eurex Clearing resulting from bilaterally agreed volatility trades; and Flexible Contracts facilities support off-exchange trading of tailor-made futures and options contracts.

To our understanding, the derivatives traded under these services would not be considered Swaps in the context of the DFA and this request for comment. Therefore, we leave these questions to be answered by other respondents.

2. *Please identify major dealers participating in Swap markets (and the Swap-related regulator(s) for each).*

As noted above, Eurex offers several services supporting the off-exchange trading of derivatives products, but not Swaps in particular. We therefore leave this question to be answered by other respondents.

3. *Please identify major central counterparties (and the Swap-related regulator(s) for each) for the clearing of Swaps.*
  - a. *For each central counterparty, please provide a listing and description of the major classes and subclasses of cleared Swap contracts, such as CDS, equity swaps, currency swaps, IRS, and commodity swaps;*

In July 2009, Eurex Clearing launched Eurex Credit Clear in response to financial market turmoil culminating in summer 2008 in the bankruptcy of Lehman Brothers. Eurex Credit Clear offers clearing services for CDSs, covering the European CDS product suite of iTraxx® indices and selected single name iTraxx® index constituents.

In addition to its current CDS clearing service offering, Eurex Clearing is developing the capacity to clear other swaps and security-based swaps for clearing members (none of which is a US entity) and their non-US customers. Full implementation of these new services in Europe is currently planned for early 2012.

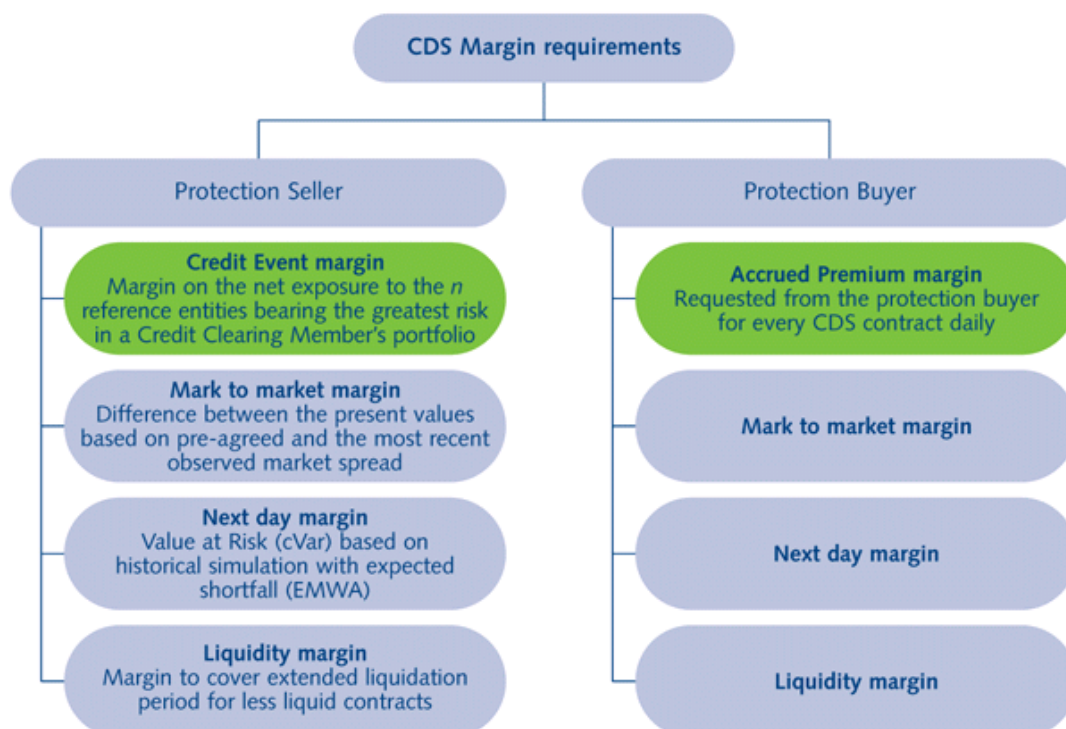
- b. For classes and subclasses of contracts identified in paragraph a above, please provide:
- i. The clearing volumes for 2009, 2010, and year-to-date; and
  - ii. The outstanding notional values at year-end 2008, 2009, 2010, and the most recent available;

Class / subclass of contract	Clearing volume in mn EUR			Outstanding notional values in mn EUR			
	2009	2010	Ytd 2011	Year-end 2008	Year-end 2009	Year-end 2010	Year-to-date 2011
CDS, Index ITRAXX-EUROPES11V1-5Y, ITRAXX-XOVERS11V2-5Y	85	0	0	0	85	85	85
CDS – Single name, RWE Aktiengesellschaft	10	0	0	0	10	10	10

c. For each central counterparty, please provide:

- i. A description of the method used to clear Swaps;

Credit Default Swaps are challenging for CCP risk management due to their event-driven binary nature, asymmetric risk position and discontinuous pay-off structure. Eurex Credit Clear's risk model addresses the specific risk profile of credit derivatives and covers the life cycle of a Credit Clearing Member. First, the risk model requires a separate clearing license as well as a separate clearing fund dedicated for clearing OTC CDS. Second, margin requirement at Eurex Credit Clear vary for protection seller and buyer to reflect asymmetric risk characteristics:



*ii. A description of the systems used to establish margin on individual Swaps and on Swap portfolios; and*

The Eurex Credit Clear service is based on a system licensed from Calypso. This system was embedded into the system infrastructure used by Eurex Clearing for its other business.

In applying for an order from the SEC to admit US entities as clearing members for the purpose of clearing CDS, Eurex Clearing provided complete details of its margin methodology to the SEC on a confidential basis. We would likewise be pleased to share with both Commissions additional information about the margin methodologies that we foresee implementing for swaps and security-based swaps on a confidential basis.

*iii. The name of each major clearing member of the central counterparty (and the Swap-related regulator(s) for each).*

<i>Clearing member</i>	<i>Regulator</i>
UniCredit Bank AG	BaFin, Deutsche Bundesbank
Nomura International plc.	FSA

We hope that you have found these comments useful and remain at your disposal for further discussion. If you have any questions please do not hesitate to contact:

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