

**Application to the Commodity Futures Trading Commission  
for an Order pursuant to Section 409(b)(3) of the  
Federal Deposit Insurance Corporation Improvement Act of 1991  
determining the appropriateness of the standards of the German  
Bundesanstalt für Finanzdienstleistungsaufsicht  
in the Oversight and Supervision of  
Eurex Clearing AG,  
a Multilateral Clearing Organization**

**Eurex Clearing AG**

**March 27, 2009**

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**Selected Abbreviations**

<b>AktG</b>	<i>Aktiengesetz, German Stock Corporation Act</i>
<b>BaFin</b>	<i>Bundesanstalt für Finanzdienstleistungsaufsicht, German Federal Financial Supervisory Authority</i>
<b>CEA</b>	<i>Commodity Exchange Act, as amended, 7 U.S.C section 1 et seq.</i>
<b>CCP</b>	<i>Central Counterparty</i>
<b>CDS</b>	<i>Over-the-Counter Credit Default Swaps</i>
<b>DBAG</b>	<i>Deutsche Börse AG</i>
<b>DBG</b>	<i>Deutsche Börse Group</i>
<b>Eurex</b>	<i>Eurex Deutschland</i>
<b>Eurex Clearing</b>	<i>Eurex Clearing AG</i>
<b>Exchange look-alike contract</b>	<i>Over-the-Counter contracts that trade off of the Eurex Deutschland Exchange, but that share common terms and conditions with contracts listed for trading on the exchange.</i>
<b>FDICIA</b>	<i>Federal Deposit Insurance Corporation Improvement Act</i>
<b>FSE</b>	<i>Frankfurter Wertpapier Börse, Frankfurt Stock Exchange</i>
<b>GEA</b>	<i>Börsengesetz, German Exchange Act</i>
<b>HGB</b>	<i>Handelsgesetzbuch, German Commercial Code</i>
<b>KWG</b>	<i>Gesetz über das Kreditwesen, German Banking Act</i>
<b>MCO</b>	<i>Multilateral Clearing Organization</i>
<b>WpHG</b>	<i>Wertpapierhandelsgesetz, Securities Trading Act</i>

## I. Introduction

*Request for Order under section 409 Federal Deposit Insurance Corp. Improvement Act*

Eurex Clearing AG (“Eurex Clearing”) hereby requests that the U.S. Commodity Futures Trading Commission (“CFTC” or “Commission”) grant an Order under section 409(b)(3) of the Federal Deposit Insurance Corporation Improvement Act (“FDICIA”) determining the appropriateness of standards of Germany’s *Bundesanstalt für Finanzdienstleistungsaufsicht* (“BaFin”) for oversight and supervision of Eurex Clearing, a multilateral clearing organization (“MCO”). Such a determination would permit Eurex Clearing to operate as an MCO consistent with the requirements of section 409 of FDICIA for the clearing of over-the-counter (“OTC”) contracts in the United States.

Eurex Clearing intends as an MCO to facilitate the clearing of two categories of OTC contracts. The first, “exchange look-alike” OTC contracts are contracts that trade off of the Eurex Deutschland Exchange (“Eurex”), but that share common terms and conditions with futures contracts and options on futures listed for trading on the exchange. This would include exchange of futures for physicals (“EFPs”), exchange of futures for swaps (“EFSs”), block trades, volatility trades and flexible options and futures. In addition, Eurex Clearing also contemplates clearing as an MCO OTC contracts that do not share common terms and conditions with contracts traded on Eurex. Specifically, Eurex Clearing is planning to offer clearing services for OTC Credit Default Swaps (“CDS”) and in the future, to extend its clearing services to OTC transactions in other asset classes, such as interest rate products. Mechanics, processes and certain of the rules governing these two distinct types of OTC instruments may differ. This application will distinguish between the two where relevant.

Eurex Clearing believes that BaFin meets appropriate standards within the meaning of section 409 FDICIA and the criteria that the Commission has applied in considering past section 409 orders. In this regard, this request is based upon the German legal and regulatory regime that applies to the licensing and oversight of clearing houses and how those requirements are applied to Eurex Clearing. This includes, in particular, the German Banking Act (*Gesetz über das Kreditwesen*, “KWG”), the German Securities Trading Act (*Wertpapierhandelsgesetz* “WpHG”), and other provisions that are discussed in greater detail below. In this regard, it should be noted that the U.K. Financial Services Authority in connection with its granting Eurex Clearing the status of a Recognized Overseas Clearing House has analyzed the German regulatory framework which applies to Eurex Clearing and found it to be comparable and that the Commission has found that the U.K. regulatory framework meets appropriate standards under section 409 FDICIA.<sup>1</sup>

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<sup>1</sup> “Determination of Appropriateness of Standards of the United Kingdom’s Financial Services Authority for Oversight and Supervision of ICE Clear Europe Limited, a Multilateral Clearing Organization,” 73 *Fed. Reg.* 44706 (July 31, 2008) (“FSA/ICE Order”).

In support of its request for a section 409 Order, Eurex Clearing is providing the Commission with:

- a. A description of Eurex Clearing;
- b. A summary of the German legal framework that applies to the licensing and supervision of central counterparties in Germany;
- c. A comparative analysis of the Core Principles for registration as a U.S. Derivatives Clearing Organization to the legal framework that applies to the licensing and supervision of central counterparties in Germany; and
- d. A comparative analysis of the Core Principles for registration as a U.S. Derivatives Clearing Organization to the German legal and regulatory regime as applied to Eurex Clearing.

Eurex Clearing's analysis is supported by the following documents which are attached to this request:

1. German Banking Act, plus relevant recent amendments
2. German Securities Trading Act
3. 21 Feb. 08 Guideline by BaFin
4. Eurex Clearing's license from BaFin
5. Eurex Clearing Articles of Incorporation
6. DBAG Compliance Policy
7. DBAG Group Risk Policy
8. Clearing Conditions of Eurex Clearing
9. Risk Based Margining System of Eurex Clearing
10. Order of the FSA, recognizing Eurex Clearing AG as a Recognized Overseas Clearing House.
11. Conditions for Utilization for the OTC Trade Entry (General Conditions for Participation)
12. BaFin Circular 5/2007: "Minimum Requirements for Risk Management"
13. Surveillance organizational handbook
14. Deutsche Börse Group ("DBG") Policy on Retention of Documents
15. "Minimum Requirements for Risk Management" (MaRisk) Circular of Deutsche Bundesbank
16. Guidelines for Granting Clearing License for ECAG
17. Capital Requirements—Own Funds
18. German Insolvency Statute and Extract

## **II. Description of Eurex Clearing**

### *Overview*

Eurex Clearing was formed in 1997 to function as the clearinghouse for the Eurex exchanges.<sup>2</sup> Eurex Clearing acts as the central counterparty (“CCP”) for all Eurex transactions and guarantees the fulfillment of all transactions in futures and options on futures traded on Eurex. Eurex Clearing also acts as the central counterparty for and guarantees transactions on Eurex Bonds (a cash market for bonds), Eurex Repo (repurchase agreements), for equities on the Frankfurt Stock Exchange and the Irish Stock Exchange and for certain contracts executed on the European Energy Exchange. Eurex Clearing is directly connected with various national and international central securities depositories, thereby simplifying the settlement processes for its clearing members. When a trade is executed on one of the above-mentioned markets, Eurex Clearing stands between the buyer and seller as clearing house for, and counterparty of, both contractual partners. Cleared transactions on Eurex are made between Eurex Clearing and the member firm that holds a clearing license.

Eurex Clearing also has an agreement with the Clearing Corporation relating to the operation of a clearing link between Germany and the United States. Eurex Clearing currently has no clearing members in the United States. However, it is possible that upon receiving MCO status, Eurex Clearing may permit U.S. entities to become members with respect to its CDS clearing facility and to hold a Eurex Clearing License solely to clear CDS contracts.<sup>3</sup> Eurex is not contemplating permitting U.S. entities to become Clearing Members with respect to the clearance of OTC look-alike contracts.

With respect to clearing exchange-traded and OTC look alike contracts members of Eurex Clearing are categorized as either direct clearing members (“DCMs”) or general clearing members (“GCMs”). GCMs are the only clearing members who may clear transactions on behalf of non-clearing members (“NCMs”). Credit institutions, banks, and other financial institutions that are regulated by a member country of the European Union or Switzerland may become members (as may the branch offices of those entities if the branch office is comprehensively regulated by a European Union member state or Switzerland). GCMs must have at least €125 million (approximately \$156 million)<sup>4</sup> in regulatory equity capital.

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<sup>2</sup> Eurex Clearing was formed when Eurex was established by the predecessor organization of SIX Exchange and Deutsche Boerse AG. For all intents and purposes, Eurex Clearing succeeded the clearinghouse of DTB.

<sup>3</sup> As discussed in greater detail, *infra*, Clearing Members are qualified and authorized by Eurex Clearing to clear on an instrument-specific basis. Permission to clear a specific category of instrument is termed to be “Eurex Clearing License.” Eurex Clearing contemplates granting U.S. members a clearing license only with respect to its CDS clearing facility.

<sup>4</sup> The exchange rate on November 20, 2008, was €1 equals \$1.2513.

Eurex Clearing is considering admitting U.S. Clearing Members with respect to the clearing of CDS. If Eurex Clearing decides to do so, it will establish similar requirements for such U.S. entities as would apply to non-U.S. entities holding a CDS Clearing License. These would include regulation, licensing or supervision of the entity by a U.S. regulatory authority and an enhanced regulatory equity capital requirement.

Eurex Clearing is licensed as a CCP by the German Federal Financial Supervisory Authority (“BaFin”). Its license was granted by BaFin on December 12, 2006. A copy of Eurex Clearing’s license, translated into English, is appended as Attachment 4. As discussed in greater detail below beginning on page 16, the German Federal Bank (“Deutsche Bundesbank”) cooperates with BaFin in the supervision of Eurex Clearing. BaFin and Deutsche Bundesbank coordinate and cooperate in the exercise of their supervisory functions. In addition, on January 16, 2007, Eurex Clearing was recognized by the U.K. 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 U.K. FSA. A copy of the FSA Recognition Order is appended as Attachment 10.

Every enterprise wishing to participate in the clearing processes of Eurex Clearing must obtain a clearing license from Eurex Clearing (“Clearing Membership”) (Chapter I section Chapter I, 1.1.1 (1) Clearing Conditions). The clearing license is granted when the applicant satisfies the prerequisites for clearing membership (Chapter I, section 1.1.2 Clearing Conditions) and executes the appropriate Clearing Agreement. Members of Eurex Deutschland or Eurex Zürich that are not clearing members – NCMs – must enter into a Clearing Agreement with a clearing member in the exact form specified by Eurex Clearing, to which Eurex Clearing also becomes a party. Only GCMs may clear transactions on behalf of NCMs and their customers (Chapter I, section 1.1.1 (2) 3 Clearing Conditions). Clearing licenses with respect to exchange look-alike contracts and the relationship between Clearing Members and NCMs will be similar in nature to those discussed above. The clearing license which will be applicable to CDS clearing will differ somewhat from that described above. The framework that will apply with respect to clearing CDS is discussed in greater detail below.

Every clearing member is required by Eurex Clearing to maintain sufficient margin to cover all of its contractual obligations (Chapter I section 1.3.1 Clearing Conditions). In addition, each clearing member is required to make a contribution to the Clearing Fund, which may be used to cover its and other defaulting Clearing Members’ contractual obligations in the event of default (Chapter I sections 1.6.1.1 (1), and 1.1.6.2 (1) Clearing Conditions). A separate Clearing Fund, established through the contributions of those Clearing Members with Licenses to clear CDS, will be established to cover a possible default of a CDS Clearing License holder.<sup>5</sup> Eurex Clearing also serves as the central

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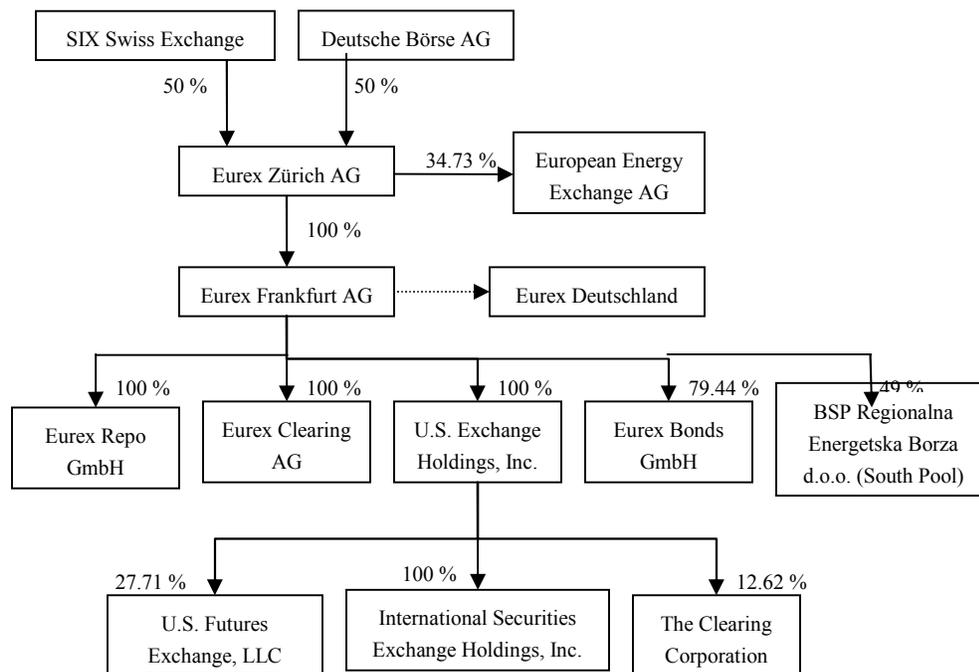
<sup>5</sup> The fund will maintain adequate, liquid resources to enable it to handle a default in which the margin requirement (pledged collaterals) of a defaulted entity is insufficient to cover losses. CDS Clearing Members will contribute a minimum amount to the fund plus a dynamic amount determined by the volume of each

counterparty for each clearing member transaction that takes place on the above-mentioned Regulated Markets and Multilateral Trading Systems. Germany has implemented the Collateral Directive (Directive 2002/47/EC) (the "Collateral Directive") and the Settlement Finality Directive (Directive 98/26/EC).

*Legal organization and governance*

Eurex Clearing is a stock corporation (*Aktiengesellschaft*) formed and incorporated under the laws of Germany. It is a wholly owned subsidiary of Eurex Frankfurt AG ("Eurex Frankfurt"), a German stock corporation which is itself wholly owned by Eurex Zürich AG ("Eurex Zürich"), a Swiss stock corporation. Eurex Zürich has two 50% parents, Deutsche Börse AG ("DBAG"), a German stock corporation listed at the FSE, and the SIX Swiss Exchange ("SIX"). SIX is the operator of a market of Swiss shares, bonds, warrants and structured products. Affiliates of Eurex Clearing include Eurex Zürich and the trading platforms Eurex Bonds GmbH and Eurex Repo GmbH. Eurex Zürich operates the Eurex Zürich exchange under the Swiss Exchange Act. Eurex Frankfurt operates the Eurex Deutschland exchange, which is authorized by and under the supervision of the competent highest state authority State of Hesse, Germany in accordance with the Exchange Act (*Börsengesetz*). A structure chart is set out below:

**Eurex Companies Structure**



clearing member's open positions. The initial payment into the guaranty fund is due upon granting of the CDS Clearing License by Eurex Clearing.

Under German corporate law, Eurex Clearing exists as a separate legal entity, notwithstanding its relationships with affiliates. Accordingly, Eurex Clearing has its own two boards of director (a “Supervisory Board (Aufsichtsrat)” and an “Executive Board (Vorstand)”), which must vote on any matter relevant to the group that would require implementation at Eurex Clearing.

Eurex Clearing, together with other group entities, formulates group-wide policies relevant to it, such as its anti-money-laundering policy. However, Eurex Clearing's board members consider any such policy independently.

Eurex Clearing, pursuant to a formal outsourcing agreement, relies on group functions of DBAG for the performance of the business of Eurex Clearing. However, because it is a separate legal entity, Eurex Clearing's business is ring-fenced from the business activities of the rest of DBG. All DBG companies have a dual board structure including a Supervisory Board and an Executive Board wherein members of the Supervisory Boards do not perform executive functions.

Under the Articles of Association of Eurex Clearing, the Supervisory Board has 12 members, elected for three-year terms by the shareholders. The most important functions and duties of the Supervisory Board are to supervise the work of the Executive Board, approve corporate decisions with a substantial financial or economic impact, approve company planning, appoint the Executive Board and decide on the remuneration of the Executive Board. A shareholders' meeting (“the Shareholders’ Meeting”) must be held at least once a year where the shareholders approve the Annual Financial Statements and the work of the Executive and Supervisory Boards during the financial year. They also annually appoint the auditor of the company as well as the Supervisory Board members and decide on their remuneration. Transactions which have an impact on shareholders' rights, e.g. any dilution of their shareholding or amendments to the Articles of Association, also must normally be approved at the Shareholders’ Meeting. The quorum required depends on the nature of the transaction to be approved.

The Executive Board is responsible for day-to-day management and operations of Eurex Clearing pursuant to sections 76 to 78 of the German Stock Corporation Act, the *Aktiengesetz* (“AktG”). These sections of the AktG stipulate that Eurex Clearing be managed by the Executive Board at its sole discretion except in relation to transactions which need the approval of the Supervisory Board in accordance with the Articles of Association or the Executive Board's rules of procedure.

Two members of the Supervisory Board are representatives of companies admitted to Eurex Clearing. Moreover, Eurex Clearing has established three user committees for the discussion of matters relating to the clearing infrastructure and clearing processes with a particular focus on: (i) derivatives clearing, (ii) equity and (iii) fixed income clearing activities. These user committees are a discussion forum for members and are a sounding board to Eurex Clearing and a means for mutual communication between Eurex Clearing and its members with respect to its clearing policies and operations. It is intended to

provide a separate mechanism with respect to decision-making input with respect to CDS clearing.

In light of its status as a non-listed company, Eurex Clearing is not required to comply with the Deutsche Corporate Governance Kodex (the "German Governance Code"). DBAG, an indirect parent of Eurex Clearing, however, seeks to comply with the German Governance Code due to its status as a listed company. The German Governance Code's aims are to make the corporate governance of German listed companies more transparent and understandable and to promote the trust of investors as well as the general public in the management and supervision of German listed companies. While these rules are not legally binding, listed companies failing to comply with the Code's recommendations must disclose publicly how their practices differ from those recommended by the Code. As a general rule, the Code is reviewed annually and amended if necessary to reflect international governance developments. Some of the Code's recommendations are also directed at ensuring independence of supervisory board members.

The Code contains three types of provisions: (1) it describes and summarizes the existing statutory framework; (2) it gives a set of recommendations (that requires stock corporation companies to issue annual compliance reports, pursuant to Article 161 Stock Corporation Act); and (3) it makes suggestions that are left to the individual companies to choose whether to adopt. Specifically, the Code recommends that the supervisory board should take into account potential conflicts of interest when nominating candidates for election to the supervisory board. Similarly, if a material conflict of interest arises during the term of a member of the supervisory board, the Code recommends that the term of that member be terminated. The Code further recommends that any conflicts of interest that have occurred be reported by the supervisory board at the annual shareholders' meeting, together with the action taken. At any given time not more than two former members of the management board should serve on the supervisory board. For nominations for members of the Supervisory Board, care must be taken that the supervisory board, at all times, is composed of members who have the required knowledge, abilities and expert experience to properly complete their tasks. The Code recommends that the supervisory board establish an audit committee, which would handle the formal engagement of the company's independent auditors once they have been approved by the general meeting of shareholders. The audit committee would also address issues of accounting, risk management and auditor independence. Although Eurex Clearing does not meet all the requirements of the German Governance Code (in particular, not having established committees for those matters that are administrated centrally in its group, such as audit), it nonetheless regards this as a useful set of standards for corporate governance and seeks, where possible, to maintain good standards of corporate governance, including those broadly in line with the German Governance Code.

## *Compliance*

Section 25a (1)1 of the KWG provides that Eurex Clearing must have an adequate business organization to ensure Eurex Clearing's compliance with applicable statutory provisions. This includes both domestic German law and, where Eurex Clearing is acting abroad, foreign law applicable to Eurex Clearing. BaFin supervision focuses not only on compliance with German regulatory law but also takes into account adequate compliance with applicable foreign law such as US recognition requirements. The managers of Eurex Clearing, the Executive Board, are directly responsible for ensuring compliance with this provision, thereby requiring direct access of the regulatory department to Eurex Clearing's Executive Board.

Eurex Clearing is required to satisfy BaFin requirements independently. The ability of Eurex Clearing to act independently of its affiliates was one of the major issues considered (and found satisfactory) by BaFin in granting regulatory authorization to Eurex Clearing. This finding is based mainly on the independence of the members of the Executive Board responsible for an adequate business organization of Eurex Clearing. In relation to third party service provision, section 25a(2) KWG provides that any outsourcing by Eurex Clearing must not impair (i) the proper functioning of the business of Eurex Clearing, (ii) the ability of the Executive Board to manage and control or (iii) the ability of BaFin to pursue audits and its ability to control or supervise Eurex Clearing.

The Executive Board is also required to establish an independent compliance office for carrying out supervisory tasks. It is required to perform its functions independently of the business, trade and settlement operations of Eurex Clearing. The compliance office is answerable to the management but otherwise not bound by instructions in the course of its activities.<sup>6</sup> The compliance office reports to the Executive Board regularly, at least once a year. The duties conferred to the compliance office in accordance with these guidelines must not be adversely affected by other business activities. The activity of Group Compliance is focused on (i) the prevention of money laundering and terrorist financing, (ii) professional and banking secrecy, (iii) the prevention of insider dealing, (iv) prevention of market manipulation, (v) prevention of fraud, (vi) prevention of conflicts of interest and corruption and (vii) data protection and its reporting.

The compliance function is centrally established and organized for all entities of the DBG by DBAG's Group Compliance. Eurex Clearing has delegated the compliance function in accordance with the requirements of section 25a(2) KWG to Group Compliance. Eurex Clearing's business practices and procedures in this regard are set out in the Compliance Policy, which is binding on all employees, including members of the

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<sup>6</sup> See Section 4.2 of the "*Guideline on the details concerning the organizational duties of investment services enterprises pursuant to section 33 paragraph (1) of the Securities Trading Act*" at [http://www.bafin.de/cln\\_116/mn\\_720784/sid\\_103020E83530D0F4EE20FD0D23DF0014/nsc\\_true/SharedDocs/Veroeffentlichungen/EN/Service/Proclamations/bek00\\_\\_01e.html#doc727146bodyText8](http://www.bafin.de/cln_116/mn_720784/sid_103020E83530D0F4EE20FD0D23DF0014/nsc_true/SharedDocs/Veroeffentlichungen/EN/Service/Proclamations/bek00__01e.html#doc727146bodyText8)

Executive Board, and is attached as Exhibit 6. According to section 1.1 of the Compliance Policy, the compliance function has a direct reporting line to executive management, including the Executive Board of Eurex Clearing in relation to compliance matters concerning Eurex Clearing.

*Instruments that may be cleared by Eurex Clearing acting as MCO*

*Exchange look-alike contracts*

Various types of off-market transactions, such as EFPs, EFSs, block trades, volatility trades and flexible options and futures are transacted exclusively under the rules of Eurex Clearing.<sup>7</sup> These OTC exchange look-alike transactions are agreed upon by the parties to these transactions and are not matched or executed at Eurex Deutschland. Once such OTC transactions are entered into by two counterparties directly with each other or on their behalf, the transaction is submitted directly to Eurex Clearing through the Eurex Clearing IT systems. Once Eurex Clearing accepts the transaction for clearing through novation,<sup>8</sup> it becomes the counterparty to each of the original counterparties to the transaction. Once accepted for clearing the transactions are included in the overall open interest of the central counterparty and are indistinguishable from open positions that result from transactions executed on Eurex Deutschland. If this Order is granted, Eurex Clearing, as MCO, will begin accepting for clearing such OTC transactions entered into by U.S. Eligible Contract Participants.

*CDS*

Eurex Clearing is also developing the capability of accepting for clearing OTC transactions that do not reflect the same terms and conditions as contracts traded on Eurex Deutschland. Specifically, Eurex Clearing is planning to offer clearing for CDS transactions as an MCO. Eurex Clearing will novate CDS transactions submitted to it by its CDS Clearing Members (or their Registered Customers that are cleared by their respective CDS Clearing Member), becoming the counterparty to new CDS transactions with its Clearing Members.

CDS Clearing Members will be required to meet a number of requirements in excess of, or in addition to, those required to be a Eurex Clearing Member. First, a license to clear CDS contracts requires the Clearing Member to meet enhanced and additional minimum equity capital requirements.

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<sup>7</sup> This is in contrast to the typical way such transactions are treated by U.S. markets where such transactions are typically governed as transactions subject to the rule of a contract market.

<sup>8</sup> The process of Eurex Clearing becoming the counterparty to these OTC transactions is through novation, which occurs at the time Eurex Clearing accepts the transaction for clearing. This legal process is distinct from the process by which Eurex Clearing becomes the counterparty to transactions executed on Eurex Deutschland or the other Regulated Markets or Multilateral Trading Systems mentioned above. For those transactions, Eurex Clearing uses the process of “open offer” and becomes counterparty to each side of the transaction at the moment it is executed.

As currently contemplated, Eurex Clearing will novate CDS transactions between two of its CDS Clearing Members or between a CDS Clearing Member and its “Registered Customer.” As contemplated, CDS Clearing Members may agree with another entity—a “Registered Customer”-- to act as the Clearing Member in respect of transactions in which the Registered Customer is a counterparty to the CDS Clearing Member or another Registered Customer. As a pre-condition, Eurex Clearing, the CDS Clearing Member and its Registered Customer must enter into a tripartite clearing agreement in the form specified by Eurex Clearing,

Eurex Clearing’s legal relationship, and its clearing guarantee, extends only to its CDS Clearing Members. At the time of novation, the original CDS transaction is replaced by CDS contracts between Eurex Clearing and each of the original counterparties. The terms of the substitute CDS contracts are set by Eurex Clearing’s Clearing Conditions.

It is expected that at least some CDS transactions may be between two Registered Customers or between a Registered Customer and its Clearing Member. In this case, the CDS transactions submitted for clearing by the two CDS Clearing Members will each have a mirror CDS between the respective Clearing Member and its Registered Customer. In this situation, at the same time that Eurex Clearing novates the CDS between its Clearing Members, pursuant to the tri-partite Clearing Agreement, a CDS with terms established by the Clearing Conditions will be substituted for the mirror CDS between the Clearing Member and its Registered Customer.

Operationally, in order for a transaction to be cleared, it must first be registered with DTCC Deriv/Serv. Thus, if a CDS Clearing Member is not a member of DTCC Deriv/Serv, its Registered Customer must be so that it can request that the transaction be forwarded from DTCC Deriv/Serv. Only confirmed CDS contracts as defined by DTCC Deriv/SERV may be submitted to Eurex Clearing for clearing. Eurex Clearing will accept for clearing only CDS that have full up-front margin coverage at the time of novation. At that time, Eurex Clearing will conduct a pre-risk evaluation and it must show no shortfall in collateral. Other pre-novation checks are conducted as well. These relate to member and product-specific requirements.<sup>9</sup> If all such pre-novation checks are satisfactory, Eurex Clearing will proceed to novate the contract. At the time of novation, new contracts the terms of which are established by the rules of Eurex Clearing that govern clearing of CDS transactions will replace the prior bi-laterally negotiated contracts.

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<sup>9</sup> For example, with respect to member checks, the member must be in good-standing and if a Registered Customer is involved there must be a tri-partite agreement in effect. Product-related checks include specific product-related criteria, such as duration to maturity, and position limits, if in effect.

### III. Summary of the German Legal Framework

#### *Overview*

Eurex Clearing is an entity incorporated in accordance with German corporate law. The legal relationship between Eurex Clearing and its members is based on contract law, and is governed by the Membership Agreement that clearing members enter into with Eurex Clearing. Eurex Clearing has not been granted any statutory immunity. The rules of Eurex Clearing consist of the Clearing Agreement between Eurex Clearing and its clearing member which incorporates the Clearing Conditions as the general terms of business for Eurex Clearing and the separate Conditions for Utilization for the OTC Trade Entry (General Conditions for Participation) (“Conditions for OTC Utilization”), appended hereto as Attachment 11, which constitute the terms of business for clearing of OTC look alike contracts. A separate chapter with respect to CDS transactions will be added to the Clearing Conditions (“CDS Chapter”). The Clearing Conditions and the Conditions for OTC Utilization (with respect to Exchange look-alike contracts) or CDS Chapter (with respect to CDS) constitute the set of legally binding rules of Eurex Clearing from the perspective of the clearing member. The Clearing Agreement, the Clearing Conditions, the Conditions for OTC Utilization, and the CDS Chapter as well as any amendments to those documents are not subject to regulatory approval but nevertheless are provided to BaFin as Eurex Clearing’s supervisory authority for its consideration and discussion. The Clearing Agreement, Clearing Conditions, Conditions for OTC Utilization and CDS Chapter are, as a contractual arrangement, enforceable and subject to principles of German civil law.

#### *European Directives implemented in the KWG*

Various Directives of the Commission of the European Union, as further discussed below, which are aimed at harmonizing banking supervision in all E.U. member states have been implemented through the German Banking Act (“KWG”). These include: the Conglomerates Directive (Directive 2002/87/EC), Banking Consolidation Directives (Directives 2000/12/EC and 2000/28/EC), Capital Adequacy Directive (Directive 93/6/EC), the second Capital Adequacy Directive (Directive 2004/155/EC, Investment Services Directive (Directive 93/22/EEC) and Markets in Financial Instruments Directive (Directive 2004/39/EC, "MiFID").

#### *Provisions in the KWG*

The KWG provides the legal basis for the supervision of banking business, financial services and the services of a CCP. An objective of the KWG is to safeguard the viability of the financial sector, within the context of free market principles, such as the responsibility for business decisions resting with the managers of credit and financial services institutions ("institutions"). The activity of institutions is restricted by qualitative and quantitative general provisions. These are broad, general obligations, similar in nature to the Core Principles of the Commodity Exchange Act which apply to U.S. Derivatives

Clearing Organizations (“DCOs”). A fundamental principle of the KWG is that supervised entities must maintain complete books and records of their activities and keep them open to supervisory authorities. BaFin approaches its supervisory role using a risk-based philosophy, adjusting the intensity of supervision to various financial services institutions depending on the type and scale of the financial services provided. BaFin generally does not intervene directly in institutions' individual operations.

*KWG expressly recognizes Eurex Clearing as carrying out a banking business*

Providing central counterparty services in Germany is explicitly treated in the KWG as a banking activity pursuant to section 1 (1) 2 Nos. 1 to 12 KWG. Operating as a CCP accordingly requires prior written authorization from BaFin (section 32 (1) 1 KWG). Such authorization is granted where the requirements of section 33 KWG are met on an ongoing basis pursuant to the KWG, as described in further detail below.<sup>10</sup>

In its relation to its members, Eurex Clearing operates under the provisions of the German Civil Code. That code, among other things, requires any debtor of an obligation to perform in good faith. This provides the way in which contractual performance must be rendered and gives rise to a number of ancillary or supplementary duties: for example duties of information, cooperation, protection and fairness. Moreover, this provision serves to limit the exercise of contractual rights, a concept commonly referred to as inadmissible exercise of rights. This principle in particular applies where a party to a contract uses standard terms of business, such as the Eurex Membership Agreement and Clearing Conditions. Section 307 (1) 1 German Civil Code provides that provisions of general terms and conditions are void in the event that they operate to the detriment of the counterparty. Consequently, Eurex Clearing is strictly bound by the principle of good faith in its relationship to the clearing members.

Taken as a whole, these provisions act to promote and maintain standards of integrity and fair dealing by Eurex Clearing. The high standards of integrity of Eurex Clearing are further evidenced by its compliance with all financial and organizational duties, which are currently audited annually by Eurex Clearing's external auditors.

*BaFin and Deutsche Bundesbank Oversight*

Under section 7(1) BaFin collaborates with Deutsche Bundesbank in the supervision of Eurex Clearing. As noted above, Eurex Clearing's principal regulator is BaFin. BaFin, as the successor to the Federal Banking Supervisory Office, is responsible for all sovereign measures. These tasks include licensing, monitoring and - if necessary - closing individual institutions. BaFin can also issue general instructions which lay down

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<sup>10</sup> As noted above, Eurex Clearing has been licensed by BaFin to operate as a CCP. The KWG was amended in 2007 to refer explicitly to operation as a CCPs as a distinct category of registrant. Prior to being licensed as a CCP under the current version of the KWG, Eurex Clearing was required by BaFin to be licensed as a credit institution (*Kreditinstitut*) for the conduct of banking business and financial services.

rules for carrying out banking business and providing financial services and for limiting risks. It can do this by issuing principles and regulations.

BaFin's duties also include solving problems in the banking and financial services sector that could jeopardise the safety of the assets entrusted to institutions, impair the orderly conduct of banking business or the orderly provision of financial services or bring about considerable disadvantages for the economy as a whole.

In order to operate as a CCP in Germany, an institution must first apply to BaFin for issuance of a written license. BaFin has licensed Eurex Clearing pursuant to section 32 (1) 1 and (2) and section 1(1)2 No. 12 KWG to operate as a CCP. A copy of the BaFin authorization and an English translation of it are appended as Attachment 4. The application for the license must contain the following, among other things:

- suitable evidence of the resources needed for business operations;
- the names of the managers (e.g. the members of the "Executive Board");
- the information which is necessary for assessing the professional qualifications, as required for managing the institution, of the proprietors and of the persons specified; and
- a viable business plan showing the nature of the planned business, the organizational structure and the planned internal monitoring procedures of the institution.

BaFin may make the granting of the license subject to conditions consistent with the purpose and intent of the KWG. For instance, in the case of applications for a banking or financial services license, it may limit the scope of the license to certain types of banking businesses or financial services. Plus, before granting the license, BaFin determines whether the guarantee scheme is appropriate for the institution. When licensing an institution, BaFin issues guidelines with respect to capital adequacy and risk management. Subsequently, it monitors compliance with the conditions for granting the license.

Section 25a of the KWG requires that an institution, including a CCP must have in place suitable arrangements for managing, monitoring and controlling risks and appropriate arrangements by means of which its financial situation can be accurately gauged at all times.<sup>11</sup> In addition, the institution must have a proper business organization, an appropriate internal control system and adequate security precautions for the deployment of electronic

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<sup>11</sup> The guidelines BaFin issued with respect to capital adequacy and risk management of institutions, like Eurex Clearing AG, pursuant to the German Banking Act are in set forth in BaFin Circular 5/2007, entitled, "Minimum Requirements for Risk Management" (see Attachment 12).

This Circular provides, among other things, a flexible, framework for risk management at institutions based on section 25a (1) of the German Banking Act (Kreditwesengesetz). Further-more it refines the requirements placed on a proper business organisation for the outsourced activities and processes pursuant to section 25a (2) German Banking Act. Within the meaning of this Circular, risk management – taking into account the institution's risk-bearing capacity – includes in particular the determination of appropriate strategies, as well as the establishment of appropriate internal surveillance procedures. The internal surveillance procedures comprise the internal control system and internal audit.

data processing. Lastly, the institution must ensure that the records of executed business transactions permit full and unbroken supervision by BaFin for its area of responsibility. Records must be retained for six years.

If the institution chooses to outsource an operation to another enterprise that is essential for conducting banking business or providing financial services, it must ensure that such outsourcing arrangement neither impairs the orderliness of such business or services nor the managers' ability to manage and monitor them nor BaFin's right to audit and ability to monitor them. In particular, the institution must ensure by contractual means that it has the required powers to give instructions to the contractor in question and include the outsourced areas in its internal monitoring procedures. The institution must immediately report its intention to outsource operations as well as the realization of such intention to BaFin and Deutsche Bundesbank immediately. BaFin forwards a copy of the report to the Federal Supervisory Office for Securities Trading.

BaFin may impose sanctions in accordance with the provisions of the Administration Enforcement Act (Verwaltungsvollstrecktmgsgesetz) to enforce compliance with the orders it issues. It also may issue sanctions.

#### *Deutsche Bundesbank's Role in "continuing supervision"*

Section 7 of the KWG provides for cooperation and collaboration between BaFin and Deutsche Bundesbank relating to banking supervision. Deutsche Bundesbank's involvement in banking supervision is based both on its historic evolution and on the nature of its duties. Although the Bundesbank's objectives and tasks as a central bank are not identical to those of banking supervisors, monetary policy and prudential supervisory aims and activities often overlap or complement one another in the financial sector.

The German Parliament provided for the Bundesbank's involvement in banking supervision in section 7 KWG based upon Deutsche Bundesbank's business relationships with credit institutions, its local presence, its general proximity to the market, and knowledgeable staff qualified to deal with issues relating to the financial market and its stability. As a consequence, Deutsche Bundesbank plays an important role in virtually all areas of banking supervision.

These are:

- the issuing of general rules (such as principles and regulations)
- the process of ongoing supervision, with the exception of (sovereign) individual regulatory measures vis-à-vis institutions, which are reserved for BaFin
- prudential audits and
- international cooperation/coordination in the prudential field.

Section 7 (1) 2 KWG provides that the cooperation between the two authorities includes the continuing supervision ("*laufende Überwachung*") of institutions by Deutsche Bundesbank. Pursuant to section 7(1)3 KWG, this continuing supervision includes

evaluating documents submitted by institutions, including auditors' reports pursuant to section 26 KWG and annual financial statements as well as performing and evaluating audits of banking operations with a view to assessing the adequacy of institutions' capital and risk management procedures as well as appraising audit findings. Generally, Deutsche Bundesbank conducts such supervision in adherence to the guidelines (*Richtlinien*) issued by BaFin. These guidelines are issued by BaFin with the concurrence of Deutsche Bundesbank. Deutsche Bundesbank also plays an important role in crisis management.

### *The Supervision Directive*

Deutsche Bundesbank and BaFin have set out the details of their respective roles in continuing supervision in a Supervision Directive, dated 21 February 2008 (“Supervision Directive”), a copy of which is appended as Attachment 3.<sup>12</sup> The 2008 Supervision Directive is the current authority governing the assignment of regulatory responsibilities between the two regulators. It has provided the basis for supplementing the organisational structure within the Central Office Department of Banking and Financial Supervision of Deutsche Bundesbank as well as clarifying the activities of the banking supervisors based at the Bundesbank's Regional Offices. The agreement is designed to avoid duplication of work and boost cost-effectiveness. It does not differentiate oversight responsibilities with respect to ECAG from that which applies to the other financial institutions.

Under the Supervision Directive, the Deutsche Bundesbank is assigned most of the operational tasks in banking supervision. The functional effectiveness of the supervisory system is optimally supported, in particular, by the Deutsche Bundesbank's many years of experience in the field of financial markets and payment operations. The Deutsche Bundesbank's responsibilities notably include evaluating the documents, reports, annual accounts and auditors' reports submitted by the institutions as well as regular audits of banking operations. It holds both routine and ad hoc prudential discussions with the institutions. Only in exceptional cases will BaFin carry out audits of banking operations, either together with the Bundesbank or on its own.

### *Risk oriented approach to supervision*

The Supervision Directive incorporates a risk-oriented approach to banking supervision. This approach was laid out in Article 124 of the Directive 2006/48/EG of the European Parliament and the Council of 14 June 2006 on the commencement and exercise of the activity of the credit institutions (Banking Directive) and the implementing guidelines of the Committee of the European Banking Supervisory Authorities (CEBS). Article 124 of the Banking Directive implements the Supervisory Review Process (SRP; banking supervising examination process) which comprises the SREP (supervisory review and evaluation process, banking supervision and evaluation process). This is the review and monitoring process which applies to ECAG as a financial institution.

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<sup>12</sup> For a general discussion of these matters, including the banking supervision process, see: [http://www.bundesbank.de/bankenaufsicht/bankenaufsicht\\_bafin.en.php](http://www.bundesbank.de/bankenaufsicht/bankenaufsicht_bafin.en.php)

SREP commits the supervisory authority to review the risk management of the institutions at least once per year, thereby assessing present and potential risks and to make allowance for the extent and relevance of the risks for the institution and for the importance of the institution for the financial system. ECAG is considered to be an important institution for the financial system.

The Supervision Directive sets forth the tasks that must be undertaken in the supervisory review and evaluation process as:

- (i) investigation of the facts
- (ii) analysis and assessment of present and potential risks based on the investigated facts
- (iii) a summarizing and future-oriented evaluation of all information
- (iv) evaluation-based decisions on supervisory measures and their implementation, and
- (v) risk-oriented supervision planning.

Within this framework, the Deutsche Bundesbank assumes the duties of current supervision according to section 7 Paragraph 1 *KWG*. Current supervision comprises, in particular, the investigation of facts, the analysis of the incoming information to be raised and the resulting assessment of present and potential risks.

The results and assessments of the current supervision is provided immediately by the Deutsche Bundesbank to BaFin, so that the latter can make a final evaluation and decision on the facts. Any discrepancies regarding the documents which have to be submitted regularly by the supervised institution is independently clarified by Deutsche Bundesbank with the institutions. In this respect, Deutsche Bundesbank, under section 44 Paragraph 1 *KWG* has been granted a right of access of supervised institutions.

In carrying out its current supervision responsibilities, Deutsche Bundesbank analyses and assesses the information included in the documents submitted by the institutions, in the audit reports submitted under section 26 *KWG* and the institutions' annual financial statements. It also analyzes and assesses information developed during banking business examinations. The information developed by Deutsche Bundesbank is summarized, processed, analyzed and evaluated with regard to its significance to supervision of the banking institution, creating for each institution a risk profile. The risk profile comprises, in particular, an evaluation of the risks of the institution, its organization and internal control procedures as well as an estimate of its risk capacity.

As detailed in Article 9 of the Supervision Directive, an institution's risk profile is composed of an evaluation of all risks of the institution. This includes its organization and internal control procedures as well as its risk capacity, which includes financial risk. This risk profile is developed by the supervisory authorities at least once per year, and is updated intra-year in response to changes in essential information. The evaluation of the

risk profile must enable BaFin to determine whether further action on the part of the supervisors is necessary.

#### *Internal audit reports*

As noted, the supervisors rely, in part, on internal risk management reports of the supervised institutions. BaFin has issued Circular 18/2005 (“MaRisk”), appended as Attachment 15, which sets forth the minimum requirements that must be met in conducting this internal audit. MaRisk requires that all manner of risks to the organization be addressed. Of special note, MaRisk, section AT 4 requires the institution to assess its risk bearing capacity. This includes defining all material risks, including liquidity risk, in determining their over-all risk-capacity. The financial institution is responsible for selecting the method used for determining its risk-bearing capacity and this methodology has to be reviewed yearly to determine that it remains suitable. Managers are responsible for ensuring at all times that the institution does not take on greater risk than its risk-bearing capacity.

#### *Supervisory Process*

The supervisory process is detailed in the Supervision Directive. As discussed above, the supervisory process administered by both authorities is focused on analysis, evaluation and oversight of the institution’s risk profile. Both supervisors engage in joint planning for carrying out their risk-oriented supervision. Each year the two authorities agree on which institutions should be the focus of banking examinations and of the supervision strategy with respect to such institutions generally.

Current supervision is carried out by Deutsche Bundesbank using the SREP model. See Article 2 Supervision Directive. Article 3 details that BaFin has a future oriented role, determining whether the institutions are covered by current regulation and risk management requirements and determining the capital adequacy of the supervised institutions. The typical supervisory oversight is conducted on the basis of the required reports, including the internal audit discussed above, audited financial statements, and annual banking examinations.

Based upon the development of the facts and evaluation discussed above, BaFin will determine whether an institution is in, or out of, compliance with the regulations and make appropriate determinations. As discussed below, this includes ordering an institution to correct shortcomings. The supervision of an institution’s response to such orders is carried out by the Deutsche Bundesbank as part of its current supervision responsibilities. The supervisors may have event-driven or routine discussions with an institution with respect to the institution’s risk profile and compliance efforts. See, Article 11, Supervision Directive.

Intensive supervision is implemented for institutions where significant developments raise issues. In these instances, under Article 7, Deutsche Bundesbank will conduct current supervision and provide the information developed to BaFin. Detailed

cooperation between the two supervisors occurs to ensure that the necessary information is developed and actions taken.

As noted above, ECAG is considered to be a system-relevant institution under Article 6 of the Supervision Directive and is accordingly accorded closer supervision than a non-system relevant institution would be. BaFin and the Deutsche Bundesbank cooperate very closely in achieving a final supervisory evaluation of system-relevant institutions, like ECAG, and in preparing and implementing any necessary supervisory measures.

#### *Information sharing between Deutsche Bundesbank and BaFin*

Under Article 8 of the Supervision directive, BaFin and Deutsche Bundesbank are required to provide the other with information needed by each to carry out its duties. Accordingly, BaFin must immediately inform Deutsche Bundesbank about all supervisory decisions made by it. Each authority is required to provide the other with copies of all letters they create during the current supervision. The shared documentation must allow each authority to process the individual facts related to a supervised institution at any time.

In addition, the annual work plan for audits and projects are coordinated by the two authorities. Moreover, each regulatory authority consults with the other with respect to the information to be requested when inquiries are made to any supervised institution. The rule on informational inquiries follows the general pattern that, other than in exceptional circumstances, Deutsche Bundesbank, in consultation with BaFin, requests and analyzes the information and each supervisory authority makes the information known to the other. Deutsche Bundesbank retains the authority to require information with regard to its responsibility in the area of financial stability.

The supervisory authorities share the data developed, including personal data which is needed by the receiving party for performing its functions. With regard to such personal data, BaFin and the Deutsche Bundesbank grant each other automated access to their respective database for the purpose of performing their functions under the Banking Act.<sup>13</sup> They may also set up joint data files.<sup>14</sup> At the time of setting up a joint data file, a decision shall be made as to which party is required to take the technical and organizational measures pursuant to data protection requirements of German law.

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<sup>13</sup> Under the procedures, every tenth time that BaFin retrieves personal data from the Deutsche Bundesbank's database, the Deutsche Bundesbank logs the time, details with respect to the data retrieved and the identity of the retriever.

<sup>14</sup> With respect to joint data files, each party may change, deny access to or delete only the data which it itself has entered and is the responsible agency within the meaning of the Federal Data Protection Act only with regard to those data which it has entered. If either party has grounds for suspecting that the data entered by the other party may be incorrect, it notifies the other party. The other party shall verify the correctness of the data without delay and if necessary correct, deny access to or delete the data without delay.

### *Summary*

In summary, supervisory audits include examination of market risk models and systems. BaFin in consultation with Bundesbank issued the Supervision Directive (Attachment 3) which provides for a risk-based approach to supervisory oversight. Under this risk-based supervision, which implements the EC Banking Directive (Directive 2006/48/EC of the European Parliament and of the Council of June 14, 2006) and the guidelines based on it issued by the Committee of European Banking Supervisors (CEBS), the supervisory authority must review the supervised institutions' risk management at least once a year, to evaluate current and potential risks and, in so doing, to take account of the scale and importance of the risks for the institution and of the importance of the institution for the financial system.

Institutions of systemic importance are institutions which, because of their size, the depth of their interbank relationships and their close integration into the international economy, might trigger considerable follow-on effects on other credit institutions and lead to instability of the financial system if their continued existence is threatened. BaFin and Deutsche Bundesbank jointly decide whether an institution is classified as being of systemic importance. Eurex Clearing has been so classified. Such institutions are subject to intensified supervision by both supervisory authorities. In order to avoid duplication of effort, BaFin and Deutsche Bundesbank coordinate their supervisory oversight, with Deutsche Bundesbank conducting “current supervision” and BaFin taking sovereign actions.<sup>15</sup>

### *BaFin's regulatory powers*

As noted above, BaFin, as Eurex Clearing's principal regulator, exercises authority to carry out all sovereign measures. BaFin is authorized to request information from Eurex Clearing and can order audits under section 44(1)1 KWG. Moreover, BaFin may issue orders applying to Eurex Clearing and its Executive Board that are appropriate and necessary to stop and prevent breaches of regulatory provisions or to prevent or overcome undesirable developments at Eurex Clearing which could endanger the safety of the assets operated by Eurex Clearing or could impair the proper conduct of its banking business or provision of financial services (section 6 (2) KWG). BaFin may dismiss members of the Executive Board of Eurex Clearing under section 36 (1) 1 KWG or may ultimately withdraw the authorization granted to Eurex Clearing in accordance with section 35 (2) KWG. Section 6 (3) KWG provides that BaFin may issue orders to Eurex Clearing and its Executive Board that are appropriate and necessary to stop and prevent violations of regulatory provisions or to prevent or overcome undesirable developments which could

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<sup>15</sup> As noted above, BaFin is Eurex Clearing's primary regulator with the cooperation and assistance of Deutsche Bundesbank. The Exchange Supervisory Authority of the State of Hesse does not have a direct supervisory role over Eurex Clearing, although Eurex Clearing does submit its audited annual report as a consequence of the Exchange Supervisory Authority's role as regulator of FSE and Eurex Deutschland and Eurex Clearing's role with respect to settlement of transactions executed on those two exchanges.

endanger the safety of the assets entrusted to the institution or could impair the proper conduct of its banking business or provision of financial services.

BaFin can, on the basis of the KWG or other statutory instruments, take various sovereign measures vis-à-vis individual institutions. For instance, BaFin can issue general measures which lay down rules for carrying out banking business and providing financial services and for limiting risks.

Pursuant to section 46 (1) KWG, if the discharge of Eurex Clearing's obligations to its creditors and, especially, the safety of the assets entrusted to it are endangered or if there are grounds for suspecting that effective supervision of Eurex Clearing is not possible (section 33 (3) numbers 1 to 3), BaFin may take temporary measures to avert the danger. In particular, it may (i) issue instructions on the management of Eurex Clearing's business, (ii) prohibit the taking of deposits or funds or securities of clearing members and the granting of loans, and (iii) prohibit proprietors and the Executive Board from carrying out their activities or limit such activities.

Pursuant to section 44(1)1 KWG, an institution and the members of its governing bodies, as well as its employees, shall upon request provide information about all business activities and submit documentation to BaFin. This information would be provided to both BaFin and to Deutsche Bundesbank. Pursuant to section 44 (1) 2 KWG, BaFin may perform audits at the institutions, even without cause, and may entrust Deutsche Bundesbank with the task of carrying out such audits; including enterprises to which an institution has outsourced major operational units within the meaning of section 25a(2) KWG. The staff of BaFin, the staff of Deutsche Bundesbank, and any other persons whom BaFin uses to perform the audits, may enter and inspect the institution's business premises during customary office and business hours. Pursuant to section 44 (4) KWG, BaFin may send representatives to shareholders' meetings, general meetings or partners' meetings, as well as to meetings of the supervisory bodies of institutions organized in the form of a legal person. BaFin representatives may address these meetings.

BaFin may issue orders to stop and prevent breach of regulatory provisions, enforce compliance with its orders by imposing sanctions, and levy fines for non-compliance. It may withdraw an institution's license if the institution has persistently contravened provisions of the KWG, of the WpHG or the regulations or orders issued to implement these Acts, or instead of revoking the institution's licence, may demand the dismissal of the responsible managers or may prohibit these managers from carrying out their activities.

Pursuant to section 46a(1) KWG, BaFin may, if the conditions specified in section 46(1)1 KWG are met and in order to avert insolvency proceedings temporarily:

- issue a ban on transfers and payments by the institution;
- order the institution to be closed for business with customers; and
- prohibit the acceptance of payments not intended for the discharge of debts to the institution, unless in the appropriate deposit guarantee

scheme or investor compensation scheme the institution undertakes to satisfy in full all those entitled to satisfaction.

Pursuant to section 47(1) KWG, if there is reason to fear that credit institutions may encounter financial difficulties which are likely to pose grave dangers to the national economy, and particularly to the proper functioning of the general payments system, BaFin may by regulation:

- grant a credit institution an extension of time to discharge its obligations, and order that judicial enforcements, seizures and temporary injunctions against the credit institution, as well as the initiation of insolvency proceedings over the credit institution's assets, are impermissible for the duration of the extension;
- order that credit institutions be temporarily closed for business with customers and that they may neither make nor accept payments and credit transfers connected with such business; it may limit this order to certain types or categories of credit institutions and to particular types of banking business;
- order that stock exchanges within the meaning of the German Stock Exchange Act (Börsengesetz) be temporarily closed.

Moreover, Eurex Clearing acts as a "Designated Payment & Security Settlement System" under the Settlement Finality Directive (Directive 98/26/EC) ("SFD") and has been notified as such to the European Commission by Deutsche Bundesbank. Pursuant to section 46b KWG, if insolvency proceedings are initiated in respect of an institution which is a participant in a system in accordance with Article 2 a of the SFD, BaFin must without delay notify the appropriate agencies of the other states of the European Economic Area.

In addition, trades entered into Eurex Clearing's system benefit from specific insolvency protection under the German Insolvency Act ("InsO"). As explained in greater detail below, this means that such trades can be executed even where Eurex Clearing or a Clearing Member becomes insolvent and permits continued trade processing and clearing of existing orders despite the initiation of an insolvency proceeding. Under section 46b KWG, the relevant insolvency procedure can only be initiated at the request of BaFin. In that event, it would be more than likely that BaFin would first announce a so-called "Moratorium" under section 46 KWG in order to ensure the orderly closure of Eurex Clearing's business activities.

#### **IV. Comparative Analysis of German Framework to U.S. Core Principle Requirements and of Core Principles to the German Requirements as Applied to Eurex Clearing.**

As noted above, section 409 of FDICIA provides that a non-U.S. MCO for over-the-counter derivatives may operate in the United States if the Commission (or one of several other U.S. financial regulators) has determined that the MCO is supervised by a foreign financial regulator that satisfies appropriate standards. Eurex Clearing by this Application for an Order is requesting that the Commission determine that BaFin's supervision of Eurex Clearing's clearing activities satisfies appropriate standards.

In reviewing such a request, the Commission considers the foreign legal and regulatory scheme and how that scheme has been applied to the requesting clearing organization. Central to this consideration is an analysis of the correspondence between the foreign regulatory scheme and the Core Principles applicable to U.S. DCOs as set forth in section 5b of the Act.<sup>16</sup> The following analysis sets forth the Core Principles applicable to U.S. DCOs and the Application Guidance and Compliance with Core Principles issued by the Commission, with which applicants for registration as a DCO must comply initially and on a continuing basis.<sup>17</sup> It then sets forth the corresponding or equivalent German regulatory requirements and how that requirement has been applied to Eurex Clearing.

Section 5b(c) of the Act provides:

## **REGISTRATION OF DERIVATIVES CLEARING ORGANIZATION**

(1) APPLICATION-- A person desiring to register as a derivatives clearing organization shall submit to the Commission an application in such form and containing such information as the Commission may require for the purpose of making the determinations required for approval under paragraph (2).

***Core Principle A: IN GENERAL—To be registered and to maintain registration as a derivatives clearing organization, an applicant shall demonstrate to the Commission that the applicant complies with the core principles specified in this paragraph. The applicant shall have reasonable discretion in establishing the manner in which it complies with the core principles.***

An entity preparing to submit to the Commission an application to operate as a derivatives clearing organization is encouraged to contact Commission staff for guidance and assistance in preparing its application. Applicants may submit a draft application for review prior to the submission of an actual application without triggering the application review procedures of section 39.3 of the Commission's regulations. The Commission also may require a derivatives clearing organization to demonstrate to the Commission that it is operating in compliance with one or more core principles.

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<sup>16</sup> See, "Determination of Appropriateness of Standards of the United Kingdom's Financial Services Authority for Oversight and Supervision of ICE Clear Europe, Limited, a Multilateral Clearing Organization," 73 *Fed. Reg.* 44706, 44707 (July 31, 2008).

<sup>17</sup> Appendix A to Part 39, 17 C.F.R. §39, Part A.

## **Corresponding German Requirements:**

Supervision and oversight by BaFin of CCPs in Germany, like that by the Commission, is based upon a licensing scheme. As in the U.S., any entity that functions as a CCP must apply for and maintain a license or registration. Section 32 of the KWG requires that an entity must obtain a license in order to “conduct a banking business or to provide financial services in Germany commercially or on a scale which requires a commercially organized business undertaking.”<sup>18</sup> Providing the services of a CCP falls under this provision of the KWG and the activities of Eurex Clearing thus are viewed as falling within its meaning.

The materials that must be provided in support of an application for a license are found in section 32(1) KWG. They include the following:

- suitable evidence of the resources needed for business operations;
- the names of the managers;
- the information which is necessary for assessing the trustworthiness of the applicants;
- the information which is necessary for assessing the professional qualifications, as required for managing the institution, of the proprietors and of the principals;
- a viable business plan showing the nature of the planned business, the organizational structure and the planned internal monitoring procedures of the institution;
- information regarding qualified participating interests if qualified participating interests are held in the institution; and
- the facts indicating a close relationship between the institution and other natural persons or other enterprises.

The demonstration required to obtain a license encompasses several of the substantive requirements that are contained in the U.S. Core Principles. For example, Core Principle B requires that an applicant have adequate Financial Resources. An applicant under section 32 KWG must provide evidence of the resources needed for its business operations. Accordingly, section 32 KWG establishes both the process for applying for a CCP license in addition to a number of substantive requirements analogous to those contained in various Core Principles.

As under the Core Principles, the application under section 32 KWG leaves a degree of flexibility with respect to how the institution meets the requirements. For example, section 32 KWG requires that the application include a viable business plan showing the nature of the planned business, the organizational structure and planned internal monitoring procedures. BaFin would judge whether the plan as submitted is viable and a license should therefore be granted. Accordingly, the regulatory framework and means of oversight and supervision closely correspond to the Commission’s.

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<sup>18</sup> Part III, Section 32(1) KWG.

BaFin, in implementing this requirement requires sufficiently detailed information to satisfy itself that the applicant has carried its burden of demonstrating that it can be appropriately licensed under the KWG. In this regard, BaFin requires a significant amount of information and number of documents in support of an application. These include among others:

- a specific business and operational plan
- an overview of participations held in the institution, and
- year-end audited financial statements.

BaFin is empowered to refuse a license if the application does not contain adequate information or documentation.<sup>19</sup> Under section 33 of the KWG, BaFin may also refuse to grant authorization if:

- the entity is insufficiently capitalized
- the members of management are not fit or suitable in terms of their experience and expertise
- the principals are not fit
- the institution has not undertaken adequate organizational steps to enable it to effectively carry out the transactions conducted thereon or to conduct its business properly, or
- supervision of the institution would be impaired.

BaFin may withdraw the authorization if any reason comes to light which would support the withholding of authorization; the institution becomes, or is in danger of becoming insolvent, or the institution repeatedly violates the provisions of the KWG.

***Core Principle B: FINANCIAL RESOURCES—The applicant shall demonstrate that the applicant has adequate financial, operational, and managerial resources to discharge the responsibilities of a derivatives clearing organization.***

In addressing Core Principle B, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. The resources dedicated to supporting the clearing function:
  - a. The level of resources available to the clearing organization and the sufficiency of those resources to assure that no material adverse break in clearing operations will occur in a variety of market conditions; and
  - b. The level of member/participant default such resources could support as demonstrated through use of hypothetical default scenarios that explain assumptions and variables factored into the illustrations.
2. The nature of resources dedicated to supporting the clearing function:

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<sup>19</sup> Section 33(3) KWG.

- a. The type of the resources, including their liquidity, and how they could be accessed and applied by the clearing organization promptly;
- b. How financial and other material information will be updated and reported to members, the public, if and when appropriate, and to the Commission on an ongoing basis; and
- c. Any legal or operational impediments or conditions to access.

### **Corresponding German Requirements:**

The applicant for a CCP license is required to detail “suitable evidence of the resources needed for business operations.” section 32(1)1 KWG. This requirement, like Core Principle B, encompasses financial, operational and managerial resources. Accordingly, the application to be licensed as a CCP must provide evidence that it in fact has such financial, operational and managerial resources.

In addition to section 32(1)1 KWG’s broad, open-ended mandate, there are more specific requirements in the KWG that also apply with respect to the adequacy of financial, operational and managerial resources.

#### *Financial resources*

Section 10 of the KWG provides that institutions, which include CCPs, must have adequate funds “in order to meet their obligations to their creditors, and particularly to safeguard the assets entrusted to them.” Accordingly, the CCP must have adequate capital to carry out its functions. Under this provision, institutions (including CCPs) are required to provide BaFin (and Deutsche Bundesbank) data on a monthly basis demonstrating the adequacy of the institution’s capital. This capital is intended to be available to ensure the safety of customer funds committed to the institution and therefore must be readily accessible by the CCP. Under this provision, funds must actually have been transferred to the institution in order to be included among the institution’s own funds. Illiquid assets, which are defined in the law as including tangible assets, long-dated loans and non-marketable securities, may not be counted as part of the entity’s own funds.<sup>20</sup> Haircuts are also prescribed for the value of listed and non-listed securities. *See* section 10(2b)7 KWG. In determining the value of such securities, the entity must deduct declines in their average market value from their book value. Section 10(4c) KWG. Reserves are those amounts that were so identified in the last approved annual accounts.

BaFin, in its supervisory role may require the institution (which includes CCPs) to make interim adjustments to the computation of the institution’s “own” funds to take into account losses that have not yet affected the balance sheet. These adjustments may remain in effect until year-end financial reports are approved. The institution may request BaFin to rescind an interim adjustment if the circumstances giving rise to the adjustment no longer apply. section 10(3b) KWG. Section 11 KWG requires institutions to invest in such a manner so as to ensure their liquidity and their ability to make payments as

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<sup>20</sup> See section 10(2c)2.

required. BaFin, acting with Deutsche Bundesbank determines whether an institution's liquidity is adequate. Data is required to be submitted monthly to BaFin and Deutsche Bundesbank to support this finding on an on-going basis.

Eurex Clearing is further required to calculate its own capital in accordance with German statutory provisions. Despite its qualification as a securities trading firm according to section 1(3d) 2 KWG,, Eurex Clearing is also regarded as a credit institution under section 1 (1) 2 KWG and must calculate its capital requirements accordingly. The German laws that apply to Eurex Clearing have implemented the E.U. Capital Adequacy Directive, which has been amended to implement the third Capital Adequacy Directive and the Markets in Financial Instruments Directive (Directive 2004/39/EC) ("MiFID").

There are also certain German legislative provisions to which Eurex Clearing is subject which relate to the financial resources of the DBG. For instance, Germany's rules on regulatory capital are based upon the Basel Accords and Capital Adequacy Directive. In addition, Germany also implemented into its national law the rules in the Investment Services Directive regarding regulatory approval and security over controllers of regulated financial institutions and persons with "close links." BaFin is therefore able to consider the financial benefits, liabilities, risks and exposures arising from Eurex Clearing's connection with any persons, including any undertaking in the same group, any other person with a significant shareholding or stake, any person who has made a significant investment in Eurex Clearing whether in the form of equity, debt, by means of guarantee or otherwise, and any person with whom the exchange has a significant contractual relationship. The 2007 consolidated financial statements for the Deutsche Börse Group can be found at: [http://deutsche-boerse.com/dbag/dispatch/en/kir/gdb\\_navigation/investor\\_relations/30\\_Reports\\_and\\_Figures/30\\_Annual\\_Reports/10\\_Annual\\_Report\\_2007](http://deutsche-boerse.com/dbag/dispatch/en/kir/gdb_navigation/investor_relations/30_Reports_and_Figures/30_Annual_Reports/10_Annual_Report_2007).

#### *Operational and management resources*

Section 25a KWG also requires the supervised entity to have in place adequate organizational resources. Specifically, section 25a(1) requires that an institution, e.g. a CCP, have in place "suitable arrangements for managing, monitoring and controlling risks." It also requires the institution to have in place "appropriate arrangements by means of which the institution's financial situation can be gauged with sufficient accuracy at all times." Section 25a(1)3 further requires that the institution have in place "a proper business organization." This open-ended requirement requires that the business organization be appropriate to the nature of the business conducted. In this regard, a CCP must ensure that its business organization is appropriate to meet the demands of operating a CCP. This would include the requirement that the CCP have the necessary infrastructure, both financial and operationally, to operate during all market conditions. This provision also requires that the institution have in place the necessary information systems to assess its risks and its financial situation at all times.

Section 25a(2) KWG also addresses an institution's operational and management resources by establishing requirements with respect to outsourcing of its functions. This is

parallel to and consistent with Core Principle B's requirement that the CCP demonstrate that it have adequate financial, operational and management resources to discharge its responsibilities. In this regard, Section 5c(b) of the CEA provides that a contract market or derivatives transaction execution facility can comply with core principles through delegation of any functions to another registered entity. As the Commission made clear, functions can be outsourced to comply with Core Principles as long as the outsourcing entity remains responsible for compliance with the Core Principle, the entity maintains a sufficient degree of control over the persons under contract and the contractor has "no conflict of interest." It remains the institution's responsibility to ensure that its obligations under the Act are met irrespective of contracting out for services.<sup>21</sup> The KWG requires that outsourcing of "operational areas that are essential for conducting banking business or providing financial services [which include the services of a CCP] must impair neither the orderliness of such business or services nor the managers' ability to manage and monitor them nor [BaFin's] right to audit and ability to monitor them." The institution must ensure that it has retained sufficient power in its outsourcing contract and must include the outsourced areas of operations in its internal reviews and audits. Moreover, BaFin requires that an institution's intent to outsource operational areas be reported to it.

With respect to management resources, section 32(1)4 KWG provides that the managers of an institution (e.g. a CCP) must have the professional qualifications to enable the institution to discharge its responsibilities. Specifically, the names and qualifications of managers must be included in a license application. If the institution does not properly fulfill its obligations under the KWG such that its license could be revoked, BaFin may instead take the step of demanding that the institution's managers be dismissed. Thus sections 32 and 36 taken together, require that the institution have adequate managerial resources and give BaFin the ability to discipline the institution through the dismissal of inadequate management. These dual authorities are powerful tools for oversight of the adequacy of managerial resources.

#### **As applied to Eurex Clearing:**

Eurex Clearing maintains adequate financial resources to assure no material adverse break in operations would occur in varying market conditions. As CCP for the Eurex exchange and for other regulated markets as well as Multilateral Trading Systems, Eurex Clearing is responsible for guaranteeing the financial performance of the contracts traded on several trading venues. OTC look alike contracts will be included in a unified open interest with instruments executed on the Eurex Deutschland exchange. Accordingly, the same Guaranty Fund, margining and default rules will apply to OTC look alike contracts as to exchange-traded contracts. Eurex Clearing relies on various safeguards to reduce the likelihood of default. It has also created a multilevel system of defenses to cover any shortfalls in the case of default. An initial level of protection is provided by a

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<sup>21</sup> See, "Trading Facilities, Intermediaries and Clearing Organizations; New Regulatory Framework; Final Rule," 66 *Fed. Reg.* 42256, 42266 (August 10, 2001). Although the Commission's discussion is focused on exchanges and derivative transaction execution facilities, its reasoning would apply equally to derivatives clearing organizations.

sophisticated system of collateral margining, which is described in greater detail below. Eurex Clearing calculates margin coverage based on both current and future price risks. The daily provision of margin is supplemented by: (1) mandatory contributions to Eurex Clearing Fund by Clearing Members; (2) reserves maintained by Eurex Clearing; and (3) the contractual commitments of DBAG and the SIX, Eurex Clearing's parents.

The amount of the contribution to the Clearing Fund is determined by Eurex Clearing for each Clearing Member and depends on the status of the Clearing Member as well as the extent of its clearing activities as reflected by the margin required to be posted by the Member with Eurex Clearing. Currently, General Clearing Members pay to the Clearing Fund an amount equal to 2% of their margin requirement, subject to a minimum of €5 million for GCMs and €1 million for Direct Clearing Members.<sup>22</sup> Clearing Members provide their contribution to the Clearing Fund in the form of (third party) bank guarantees and/or cash or securities collateral. The bank guarantee must contain the bank's unconditional obligation to provide for the payment of the guaranteed amount indicated by Eurex Clearing upon demand. Each Clearing Member's contribution to the Clearing Fund may be used to cover the financial consequences of default by the Clearing Member itself or by any other Clearing Member.<sup>23</sup> In addition to the member-funded Clearing Fund, Eurex Clearing also maintains a reserve fund by setting aside annual surpluses for contributions to the fulfillment of obligations of any Clearing Member that may have defaulted in its obligations.<sup>24</sup>

At the end of the third quarter of 2008, Eurex Clearing had the following capital and liquid financial assets.

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<sup>22</sup> See Eurex Capital Requirements and Fund Contributions, available at: <http://www.eurexchange.com/clearing/membership/requirements.html>.

<sup>23</sup> The Current General Guarantee Fund is valued at over \$120 million.

<sup>24</sup> The Reserve Fund is valued at approximately €5 million.

<b><u>Capital</u></b>	
Subscribed capital	€ 5,112,918.81
Statutory reserve	€ 511,291.88
Capital Reserve	€ 60,199,926.71
Other retained earnings	€ 4,978,006.09
Total	€ 70,802,143.49
<b><u>Liquid financial assets</u></b>	
Cash and bank balances (including cash margins)	€ 9,965,458,755.29

According to Chapter I section 6.1.3 of the Clearing Conditions, Eurex Clearing uses funds from its annual surplus to set aside reserves for the Clearing Fund in order to contribute to the fulfillment of the obligations of any Clearing Member that may default on its obligations. As of the end of the third quarter of 2008, the amount reserved by Eurex Clearing amounted to €5 million. Under Chapter I section 6.2)2) of the Clearing Conditions, such amount is used in case of default in the following order of priority:

- collateral of the General or Direct Clearing Member obliged to perform other than that indicated in Chapter I sections 6.1.1 and section 1.6.1.2;
- the contribution to the Clearing Fund of the Clearing Member obliged to perform pursuant to Chapter I sections 1.6.1.1 and 1.6.1.2;
- the reserves of Eurex Clearing pursuant to Chapter I section 6.1.3; and
- the contributions of all other General or Direct Clearing Members to the Clearing Fund which shall be realised on a pro rata basis (and additional contributions may be required).

In the event that the aforementioned measures are still not sufficient to cover the default of a Clearing Member, any realised contribution to the Clearing Fund shall be raised by the Clearing Member to its original amount within ten Business days in accordance with Chapter I section 6.3 (“Replenishment of Contributions to the Clearing Fund”). This requirement shall not apply to any Clearing Member that has terminated its Clearing License by means of a written statement to Eurex Clearing AG no later than on the fifth Business day following such realisation.

With respect to clearing of CDS transactions, as noted above, Eurex Clearing will establish a separate clearing fund to guarantee these transactions. CDS Clearing Members will contribute a minimum amount to the fund plus a dynamic amount determined by the volume of each clearing member’s open positions. Specifically, CDS Clearing Members will contribute 3-7% of their Margin Requirement to the CDS Guarantee Fund, subject to a minimum of €50 million. Because of its dynamic component, the exact level of contribution cannot now be determined. However, the fund will maintain adequate, liquid

resources to enable it to handle a default in which the margin requirement (pledged collaterals) of a defaulted entity is insufficient to cover losses. The initial payment into the guaranty fund is due upon granting of the CDS Clearing License by Eurex Clearing.

Each CDS Clearing Member must pledge collateral as required by Eurex Clearing's margin calculation. That calculation is based on a dynamic VaR (Value at Risk) model relating to the clearing member's risk exposure to cleared CDS contracts.

In addition to the requisite financial resources, Eurex Clearing, as discussed in greater detail below, has the requisite operational, managerial and staff resources to ensure that it can carry out its functions as a CCP with no break in function.

***Core Principle C: PARTICIPANT AND PRODUCT ELIGIBILITY—The applicant shall establish (i) appropriate admission and continuing eligibility standards (including appropriate minimum financial requirements) for members of and participants in the organization; and (ii) appropriate standards for determining eligibility of agreements, contracts, or transactions submitted to the applicant.***

In addressing Core Principle C, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. Member/participant admission criteria:
  - a. How admission standards for its clearing members/participants would contribute to the soundness and integrity of operations; and
  - b. Matters such as whether these criteria would be in the form of organization rules that apply to all clearing members/participants, whether different levels of membership/participation would relate to different levels of net worth, income, and creditworthiness of members/participants, and whether margin levels, position limits and other controls would vary in accordance with these levels.
2. Member/participant continuing eligibility criteria:
  - a. A program for monitoring the financial status of its members/participants; and
  - b. Whether and how the clearing organization would be able to change continuing eligibility criteria in accordance with changes in a member's/participant's financial status.
3. Criteria for instruments acceptable for clearing:
  - a. The criteria, and the factors considered in establishing the criteria, for the types of agreements, contracts, or transactions it will clear; and
  - b. How those criteria take into account the different risks inherent in clearing different agreements, contracts, or transactions and how they affect maintenance of assets to support the guarantee function in varying risk environments.
4. The clearing function for each instrument the organization undertakes to clear.

## **Corresponding German Requirements:**

The activities of a clearing member fall within the scope of the KWG. *See* section 1 KWG. Accordingly, to be a clearing member of Eurex Clearing, an institution must in the first instance meet the licensing and supervision requirements that apply to financial institutions under the KWG (or an equivalent permitted regulatory framework). These requirements are reflected in Eurex Clearing's Clearing Conditions, and with respect to CDS Clearing Members, in the CDS Chapter of the Clearing Conditions. Both the Eurex Clearing Conditions and the CDS Chapter require that a clearing member, in order to gain a clearing license from Eurex Clearing, must be licensed in its home jurisdiction within the European Union or Switzerland to conduct safe custody business, lending operations and the receipt of collateral. Both further provide that the clearing member applicant must be supervised by a responsible regulatory authority of the European Union or by the Swiss Banking Commission. *See e.g.* Chapter I, Clearing conditions section 2.(3)a. This requirement, that clearing members be licensed as a financial institution subject to supervision by an appropriate European Union or Swiss regulatory authority establishes a very high threshold that Eurex Clearing clearing members must meet with respect to their fitness, financial prudence and operational soundness. As discussed above, in addition, U.S. entities may become CDS Clearing Members. Such entities will be subject to the enhanced requirements that will be applicable generally to CDS Clearing Members.

BaFin, in its supervision of Eurex Clearing clearing members requires that such institutions maintain a sufficiently high net worth and have adequate operational capabilities to carry out the line of business which they operate. Thus, in order for a BaFin-supervised entity to undertake clearing business, it must satisfy BaFin of its ability to prudently undertake this line of business activity. Not only does BaFin in its supervisory role scrutinize the ability of the financial institution to undertake such business, but as Eurex Clearing's supervisor, it also examines whether Eurex Clearing's membership criteria and its requirements of clearing members for conducting clearing processes with Eurex Clearing are prudent and sound.

Specifically, section 25a KWG requires an institution to have a proper business organization. In the case of a CCP, where the risk of transactions is mutualized, this requirement logically includes appropriate and sound requirements on what entities may act as clearing members/participants. It further would require the CCP to have appropriate risk parameters with respect to the amount and type of clearing business particular members can undertake and also to have in place robust risk management systems. In fulfillment of this general requirement, Eurex Clearing has established specific requirements in its Clearing Conditions and CDS Chapter for member admission. These include, for example, minimum required levels of equity capital as provided under the KWG. *See* Chapter I, section 2.2(a)(a) Clearing Conditions.

Section 25a KWG also subjects Eurex Clearing to BaFin's supervision with respect to the types of clearing businesses in which Eurex Clearing engages. Thus, as Eurex Clearing undertakes to clear for additional markets or types of transactions, its business

organization must be proper and adequate for prudently carrying out that line of clearing business. Eurex Clearing is required by section 25a KWG to ensure that its business organization is proper and adequate and that it has in place suitable arrangements for managing, monitoring and controlling the risks attendant to its undertaking to clear a particular type of transaction. Thus, Eurex Clearing must ensure under section 25a KWG that it appropriately manages, monitors and controls for the risks attendant to any type of contracts or transactions that it clears.

This requirement of the Banking Act is explained and reinforced by BaFin Circular 5/2007: “Minimum Requirements for Risk Management,” [http://www.bafin.de/cln\\_109/nn\\_720494/SharedDocs/Veroeffentlichungen/EN/Service/Circulars/rs\\_0705\\_en\\_ba.html?nnn=true](http://www.bafin.de/cln_109/nn_720494/SharedDocs/Veroeffentlichungen/EN/Service/Circulars/rs_0705_en_ba.html?nnn=true). This Circular, which is appended as Attachment 12, requires that pursuant to section 25a KWG, an institution prior to commencing business with respect to a new product or other new business activity must draw up a plan. This plan must include a risk analysis and analysis of the consequences of the new activities on risk management. The Circular also requires that the introduction of new products include a test phase prior to introduction of continuous trading. The Circular further requires that the plan and the commencement of new products and the introduction of new business activities must be approved by the responsible professional Executive Board member, in cooperation with the Executive Board member responsible for monitoring the activities in question.

#### **As applied to Eurex Clearing:**

As noted above, Eurex Clearing accepts a number of different types of instruments for clearing from a number of different markets, including derivatives (Eurex), cash equities (Frankfurt and Irish stock exchanges), bonds (Eurex Bonds), repos (Eurex Repos) and emission rights (EEX). Each product is accepted for clearing through the incorporation in the Clearing Conditions of a new chapter governing that particular product.

Eurex Clearing has established stringent admission and continuing eligibility standards for clearing members as well as appropriate standards for the submission of contracts to Eurex Clearing.<sup>25</sup> First, Eurex Clearing members must be domiciled in a country of the European Union or Switzerland and must be licensed by the financial regulatory authorities of their home jurisdiction. The license of the Clearing Member must include permission to conduct safe custody business, lending operations and the receipt of collateral in the form of cash or securities. (Chapter I section 1.1.1 of the Clearing Conditions). Branches of the aforementioned institutions can be admitted provided additional financial guarantees are given. In order to verify the legal validity of guarantees, Eurex Clearing may demand from the institution a legal opinion (Chapter I section 1.1.4 Clearing Conditions).

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<sup>25</sup> Attachment 16 is the Guidelines for Eurex Derivatives Clearing Members.

The Clearing Conditions include additional admission requirements for clearing members relating to their economic, technical and functional ability to operate in that capacity. Chief among these is the requirement that any Clearing Member maintain minimum equity capital in an amount determined by Eurex Clearing, (Chapter I section 1.1.2 (1) Clearing Conditions). CDS Clearing Members will be subject to a separate equity capital requirement.

Moreover, the Clearing Member must maintain appropriate technical equipment (back-office facilities) to ensure the orderly recording, booking and supervision of all transactions, as well as the provision of margin and the calculation of margin requirements with respect to customers. The Clearing Conditions further require that an applicant for clearing membership have at least one sufficiently qualified member of staff in the back-office for the orderly fulfillment of clearing obligations present at all times during the business day by telephone and fax. Chapter I, section 1.2.3 (3) (g) Clearing Conditions. This includes the requirement that staff demonstrate proficiency through formal testing. CDS Clearing Members will instead be required to provide a written confirmation of proficiency.

Depending on the market concerned, the Clearing Conditions include certain technical requirements for Clearing Members, such as for telecommunication lines and connectivity to required systems, which must be met at the time of admission and kept current.

The Eurex Clearing's membership section verifies that an applicant meets the membership qualifications. The requirement of sufficient equity capital must be evidenced on an annual basis.

With respect to the eligibility of new products, Eurex Clearing must adhere to the BaFin requirements of detailing the new product's introduction in a plan and conducting a program of testing before the new product is eligible for clearing.

***Core Principle D: RISK MANAGEMENT—The applicant shall have the ability to manage the risks associated with discharging the responsibilities of a derivatives clearing organization through the use of appropriate tools and procedures.***

In addressing Core Principle D, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. Use of risk analysis tools and procedures:
  - a. How the adequacy of the overall level of financial resources would be tested on an ongoing periodic basis in a variety of market conditions;
  - b. How the organization would use specific risk management tools such as stress testing and value at risk calculations; and
  - c. What contingency plans the applicant has for managing extreme market events.
2. Use of collateral:
  - a. What forms and levels of collateral would be established and collected;

- b. How amounts would be adequate to secure prudentially obligations arising from clearing transactions and, where applicable, performing as a central counterparty;
  - c. The factors considered in determining appropriate margin levels for an instrument cleared and for clearing members/participants;
  - d. The appropriateness of required or allowed forms of margin given the liquidity and related requirements of the clearing organization;
  - e. How the clearing organization would value open positions and collateral assets;
- and
- f. The proposed margin collection schedule and how it would relate to changes in the value of market positions and collateral values.
3. Use of credit limits:
- If systems would be implemented that would prevent members/participants and other market participants from exceeding credit limits and how they would operate.

### **Corresponding German Requirements:**

Section 25a(a)(1) KWG requires that an institution subject to the KWG must “have in place suitable arrangements for managing, monitoring and controlling risks and appropriate arrangements by means of which the institutions financial situation can be gauged with sufficient accuracy at all times.”

This general requirement is given force and effect through the supervision process. In this regard, the Supervision Directive specifically notes that the regulatory authorities shall implement a “risk-oriented approach” to supervision. BaFin carries out the Supervisory Review and Evaluation Process as a mechanism for monitoring and evaluating risks of the enterprise, including the institution’s capacity for financial risk. The Banking Business Audits required by Article 17 of the Supervision Directive are subject to MaRisk and include an evaluation of the adequacy of the institution’s own risk management systems. Thus, as with the implementation of the Core Principle, it is the clearing house’s responsibility in the first instance to establish a system that satisfies the requirements that it have in place “suitable” arrangements to manage, monitor and control risks. The suitability of these arrangements is analyzed and tested by the regulators in their continuing and on-going supervisory review of the CCP.

### **As applied to Eurex Clearing:**

The risk management requirement of section 25a(a)(1) KWG is applied by Eurex Clearing to ensure the greatest level of confidence in its program of risk management and analysis, including frequent assessment of the overall risk to the CCP using frequent stress testing and value-at-risk calculations. The form and level of collateral collected ensures Eurex Clearing’s ability to secure prudentially obligations arising from its role as a CCP. Eurex Clearing analyzes risk and applies sophisticated tools for the analysis of risk and takes measures to manage risk at all phases of the clearing life-cycle, beginning prior to the submission of orders to the matching engine and extending until a position is closed. Its

wide variety of robust risk management tools includes a trailblazing system of pre-trade risk tools.

#### *Pre-trade risk management tools*

In this regard, Eurex Clearing has a number of complementary pre-trade risk measures in place with respect to the clearing of exchange traded and exchange look-alike OTC instruments that build on each other to create a multi-level security system that provides clearing members with effective tools to proactively manage and to avoid certain types of risks. Specifically, clearing members may establish risk limits for each trading member on a product specific basis, for both exchange-traded and OTC products by establishing a maximum order size that can be input to the trading engine for exchange traded products and/or a maximum wholesale trade size that can be submitted for clearing of OTC products. The clearing member in its discretion can impose risk limits of any size on trading members including blocking the trading or clearing of particular products by a trading member by setting the risk parameter at zero.

Pre-trade risk controls operate by limiting by product the number of orders entered into the trading system or wholesale trades accepted for clearing within a specified time frame. The limits can be set both by number of order/quotes or the accumulated lot-quantity of orders. Thus these limits have been designed to prevent excessive entry of orders/quotes caused by computer malfunctions. In addition, a limit can be set on the number of accumulated unmatched orders, thereby limiting the risk of order execution. If either level is exceeded, trading activity is disabled. In addition, clearing members have a stop button that can be used by Clearing Members in emergency situations to disconnect the trading member from the Eurex market.

With regard to CDS, such transactions will be required to have full up-front margin coverage at the time of acceptance for novation.

#### *Stress testing*

Eurex Clearing conducts routine stress testing to ensure that it can meet its obligations as a CCP in both normal and under the most extreme market conditions. Eurex's stress testing stipulates that margin requirements and available post-default financial resources should be adequate to cover at least 999 out of 1,000 events. Post-default resources include the collateral and the Clearing Fund contribution of a defaulting member, the reserve fund of Eurex Clearing and clearing fund contributions of non-defaulting members, in that order. Eurex conducts stress testing periodically through out the trading day.

Each clearing member's risk exposure is stress tested against a comprehensive set of scenarios for all the product groups that it clears. Scenarios include the worst historical observations that have been experienced in each of the product groups as well as executive management's expectations on worst potential future price movements. Scenarios based on historical observations include both price movements across all product groups on specific crisis days as well as the historically largest moves for each product group. Potential losses based on stress scenarios are compared to each member's additional margin. Losses

beyond additional margin are then compared to the Clearing Fund. How much of the Clearing Fund is consumed by the theoretical stress-test calculations is identified and analyzed on a daily basis. Intraday stress tests are performed by Eurex Clearing in extraordinary market situations.

As soon as the consumption of the clearing fund by any clearing member - irrespective of its credit quality - breaches a defined threshold, the Eurex Clearing board takes risk mitigating actions. These include member-specific actions, such as extra margin requirements or generalized requirements, such as calling for additional contributions by Members to increase the size of the Clearing Fund.

Stress testing will, of course, be conducted with respect to CDS clearing. The stress test scenarios and procedure are reviewed regularly.

### *Margining system*

Eurex establishes required margin levels through its Risk-based Margining system. Risk-based Margining, like SPAN® margining, uses scenario matrix simulations to calculate margins. Where it differs from SPAN® is that SPAN® calculates underlying price and volatility combinations in three self-designated levels (three up and, three down), Risk-based Margining uses price levels that are based on the strike prices of listed equity options and calculates a much greater number of underlying price levels (up and down). A brochure explaining the Risk-based Margining System of Eurex Clearing is appended here to as Attachment 9.

### *Original Margin*

Pursuant to Chapter I section 3.1 (1) Clearing Conditions, each Clearing Member is required to maintain margin in the amount determined by Eurex Clearing to cover all of its contractual obligations.<sup>26</sup> The amount of required margin is calculated daily subsequent to the post-trading period or each trading day for the combined proprietary and agent positions of each Clearing Member. Margin must be provided prior to the commencement of the next trading day. Each Clearing Member is required to maintain original margin in the amount determined by Eurex Clearing to cover all of its contractual obligations regarding its proprietary and client positions. The margin requirements for Non-Clearing Members are set by the Clearing Member who has agreed to clear trades for such Non-Clearing Member in accordance with Eurex Clearing's minimum margin requirements pursuant to Chapter I section 3.1 (5) Clearing Conditions. The amount of original margin to be deposited by the Clearing Members is determined using the Risk Based Margining method, discussed above.

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<sup>26</sup> The following description gives an outline of the general provisions of the Clearing Condition for the calculation and collection of margin. These general provisions are applicable for the clearing of all trades at Eurex Deutschland and Eurex Zürich. These general provisions are also applicable by way of reference for all cleared transactions in specific products cleared by Eurex Clearing unless specific provisions for the Clearing Conditions with respect to such products determine otherwise.

Under Chapter I section 3.1.2 Clearing Conditions, the required coverage of possible liquidation costs of futures positions until the end of the next trading day are determined separately for each trading participant's proprietary and agent accounts. Under the margin calculation process, long and short positions of a given delivery month of the same underlying instrument held in an account will be netted; spread margin is applied to each spread pair with varying maturities; and original margin will be applied to the still remaining non-spread positions which carry the full risk of liquidation losses through the end of the next trading day. Intra-day margin calls may be made if necessary on the basis of the risk assessment made in the course the trading day (under Chapter I section 3.2 Clearing Conditions). Such supplementary margin must be transferred immediately in the appropriate currency to the account at a branch of Bundesbank or the Swiss National Bank or with other commercial banks for such purpose, or to the pledged securities account with Clearstream. Options on futures are subject to futures-style margining.

Once total margin is calculated for each Clearing Member, all products with the same risk potential may be categorized in collective margin classes and several margin classes with a similar risk structure may be grouped together in margin groups resulting in the elimination of offsetting risks from the calculation of original margin (cross-margining). Therefore, margins can be collectively calculated for all product segments for which Eurex Clearing is a central counterparty.

#### *Variation margin*

Open positions are marked to market daily and the resulting daily profits and losses for futures contracts and options on futures are offset in cash daily. Chapter I section 1.4 Clearing Conditions (netting procedure). Variation margin is calculated once a day at the end of the post-trading period separately with regard to transactions on proprietary position accounts and agent position accounts of each Clearing Member. Settlement call takes place the following morning. The net pays or collects are debited/credited from/to the internal cash clearing accounts maintained for each Clearing Member by Eurex Clearing. Where Eurex Clearing does not claim any credit balance on a cash clearing account of a Clearing Member as cash margin, it will credit or debit the daily balance to the account of such Clearing Member with Bundesbank or the Swiss National Bank.

#### *CDS Margining*

The total margin requirement for CDS covers the market risk of the positions held by a clearing member so that, should a member default, the clearing house has, in all but the most extreme market circumstances, sufficient margin to cover default losses to at least the 99 % confidence interval without recourse to other financial resources at its disposal.

Positions will be revalued on an at least a daily basis using the reference market price. Pays and collects will be timely so that a clearing member's exposure to market risk in case of a default is both accurately measured and contained.

Collateral will be pledged at the approved collateral location. Eligible collateral is based on the current list of collateral which is approved by Eurex Clearing. All collateral is daily marked to market but specific limits for certain collateral to be pledged may apply. Only collateral owned by the CDS Clearing Member is accepted.

Eurex Clearing will calculate the amount of the up-front margin required for cleared CDS transactions based upon five components, which are discussed in greater detail below:

- Mark-to-market margin,
- Next day margin,
- Liquidity margin,
- Accrued premium margin (which applies only to the protection buyer), and
- Credit event margin (which applies only to the protection seller).

#### *Mark-to-market*

Eurex Clearing on a daily basis will determine the difference between the net present values based on the CDS spread in the agreement and the most recently observed market spread.

#### *Next day margin*

Next day margin accounts for the decay in value in liquidating outstanding positions of a defaulting member. The next day margin component is calculated based on the estimated time to unwind or cover positions. Eurex Clearing will use a VaR (Value at Risk) method such as historical simulation to determine the next day margin requirements.

#### *Liquidity Margin*

Liquidity margin is calculated by taking into account the next day margin and the time necessary to unwind a position that is in default.

#### *Accrued premium margin*

In a typical CDS, the protection buyer pays a fixed fee or premium to the seller for a period of time. This payment is often termed the “spread.” The premium margin component is based upon the value of these payments.

#### *Credit event margin*

In a typical CDS contract, a payment from the seller to the protection buyer is made when a credit event occurs. Eurex Clearing includes in its margin calculation a component relating to the potential occurrence of a credit event. Eurex Clearing determines this

amount by collecting from protection sellers the full credit event margin for the n net positions in a portfolio bearing the highest potential loss. It calculates this amount by

- taking the entire CDS (index) portfolio across all reference obligations;
- identifying the n most risky positions in a portfolio (in term of notional amounts issued by the same company);
- assuming a Recovery Rate for these positions; and
- collecting the full credit event margin for the identified positions.

The cleared CDS transaction is also valued on a daily basis. Eurex clearing will establish a price reflecting the true market conditions for a CDS based on a number of parameters, including quotes, traded prices and third-party market data providers. Specifically, Eurex Clearing will determine the valuation of cleared transactions on a daily basis based on the midpoint of bid-ask spreads determined according to the true market conditions of the respective contract and with regard to its risk assessment. Eurex Clearing will gather data from CDS Members with respect to quotes, traded levels and end-of-day pricing. It will extract data from various third-party data vendors and cross check data among different sources, against past time-series and against published benchmarks. If a satisfactory spread cannot be determined using this process, Eurex Clearing will calculate a value based on a theoretical model.

### *Acceptable Collateral*

Under Eurex Clearing's Clearing Conditions, the margin may be in cash, securities or book-entry securities acceptable to Eurex Clearing. Cash margin may be provided in the currencies determined by the Executive Board of Eurex Clearing, currently EUR, CHF, GBP and USD. Securities collateral may be deposited in the form of securities denominated in a number of currencies which include the aforementioned currencies. Margin in EUR is provided by a timely instruction of the Clearing Member of the respective branch of Bundesbank to honor the transfer instructions received from Eurex Clearing with respect to such Clearing Member's account at the branch and to transfer the amounts to the account of Eurex Clearing. Collateral in securities must be deposited by the Clearing Member in its pledged securities account at Clearstream or SegInterSettle Zurich (SIS), and the Clearing Member must grant a lien in favor of Eurex Clearing on all securities deposited in its pledge account. Once Eurex Clearing has received notice that the securities have been transferred to the pledge account, it will credit the value or the number of such securities to the collateral clearing account of the Clearing Member.

***Core Principle E: SETTLEMENT PROCEDURES—The applicant shall have the ability to (i) complete settlements on a timely basis under varying circumstances; (ii) maintain an adequate record of the flow of funds associated with each transaction that the applicant clears; and (iii) comply with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations.***

In addressing Core Principle E, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. Settlement timeframe:
  - a. Procedures for completing settlements on a timely basis during times of normal operating conditions; and
  - b. Procedures for completing settlements on a timely basis in varying market circumstances including during a period when one or more significant members/participants have defaulted.
2. Recordkeeping:
  - a. The nature and quality of the information collected concerning the flow of funds involved in clearing and settlement; and
  - b. How such information would be recorded, maintained and accessed.
3. Interfaces with other clearing organizations:

How compliance with the terms and conditions of netting or offset arrangements with other clearing organizations would be met, including, among others, common banking or common clearing programs.

### **Corresponding German Requirements:**

Section 25a(a)2 KWG requires that an institution have a “proper business organization.” Part of the CCP’s routine business for which it must have adequate procedures is the timely settlement of positions in all market conditions.

In addition, section 25a(a)3 requires that the institution “ensure that the records of executed business transactions permit full and unbroken supervision by the Federal Banking Supervisory Office.” This requirement that BaFin be able to have unbroken supervision of transactions through the records kept is highly analogous to Core Principle E’s requirement that records be maintained of the flow of funds. Both requirements have at their core the requirement that the regulator, through the record keeping system of the CCP, be able to follow the movement and distribution of funds throughout the life cycle of a transaction.

As a member of the European Union, Germany is bound by EU Directives. Thus, Germany was required to adopt in national law the terms of the *EU Settlement Finality Directive*. The SFD was intended to reduce the systemic risk associated with participation in payment and securities settlement systems ("systems"), and in particular the risk linked to the insolvency of a participant in such a system. To this end, it established common rules stipulating that transfer orders and netting must be legally enforceable, that transfer orders may not be revoked once they have been entered into the system, that the

insolvency of a participant may not have retroactive effects and that the insolvency law applicable is the law of the Member State whose system is involved. It further stipulated that collateral security provided to a system by a participant may not be affected by the opening of insolvency proceedings against that participant. Eurex Clearing is a financial institution covered by the terms of the directive.

The SFD establishes the finality of transfer orders and netting arrangements by providing that they are legally enforceable and binding on third parties, even in the event of insolvency proceedings against a participant, provided that transfer orders were entered into a system before the moment of opening of such insolvency proceedings. However, where transfer orders are entered into a system after the moment of opening of insolvency proceedings and are carried out on the day of opening of such proceedings, they are binding on third parties only if the settlement agent, the central counterparty or the clearing house can prove that they were not aware, nor should have been aware, of the opening of such proceedings.

The moment of entry of a transfer order into a system is defined by the rules of that system and a payment order may not be revoked by a direct participant or by a third party as from the moment defined by the rules of the system.

With respect to the effects of insolvency on collateral security, the SFD provides that the rights of a participant in a system to collateral security provided to them may not be affected by insolvency proceedings against the institution which provided the collateral security. Under the SFD, Member States of the European Union must inform the European Commission which systems are included in the scope of the Directive. Member States may also impose supervision or authorization requirements on the system.

Section 34(2) of the German Insolvency Code has incorporated the changes necessary to make effective the provisions of the EU Directive. Under this provision, the German Insolvency Code has special rules applicable to participants in a "System" which are consistent with the provisions of the SFD. Consistent with the effect of the SFD, trades entered into the CCP's system benefit from the specific insolvency protection under the German Insolvency Act. This means that such trades can be executed even where the CCP or another clearing member becomes insolvent. With respect to the insolvency of a CCP, under section 46b KWG, only BaFin is permitted to initiate an insolvency proceeding.<sup>27</sup>

### **As applied to Eurex Clearing:**

Eurex Clearing acts as a "Payment and Securities Settlement System" under the SFD and has been notified as such to the European Commission by Bundesbank. Thus, the finality and netting provisions discussed above apply to its clearing activities on behalf of its European Clearing Members, ensuring the finality of payments and netting of transactions for which Eurex Clearing acts as CCP.

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<sup>27</sup> However, it is more likely that BaFin would use its authority under §46KWG to announce a "Moratorium" of a clearing house in order to ensure the orderly closure its business activities.

### *Daily Settlement*

Under Eurex Clearing's rules, the daily settlement price corresponds to the exchange closing auction price. If it is not possible to determine a closing price within the closing auction or if the price so determined does not reflect true market conditions, the settlement price is based upon the price of a minimum number of transactions during the final 15 minutes of trading. (Chapter II section 2.1.2 (Daily Settlement)). If it is not possible to determine a price pursuant to the foregoing procedures, or if the price so determined does not reflect true market conditions, Eurex Clearing determines the settlement price. Eurex Clearing calculates the settlement prices for European Products once per day at 8:00 p.m. Central European Time ("CET") before the batch processing of cleared transactions begins. At that time the CCP calculates original and variation margin during the end-of-day batch processing and it applies a routine settlement call in the morning on the next trading day.

Daily margin pays and collects are calculated by Eurex Clearing using its Risk Based Margining IT System. Payments by Clearing Members of margins in form of cash are delivered by the Clearing Member to accounts of Eurex Clearing with the German Central Bank, the Swiss Banking Commission or with other settlement banks used for such purpose. Amounts are credited by Eurex Clearing to the Clearing Member's account at the same banking institutions. Cash margins of the Clearing Members are pooled in such accounts as agreed by the Clearing Member in accordance with Chapter I section 3.4 Clearing Conditions. Eurex Clearing holds adequate records of the cash margins so delivered to ensure complete and timely redelivery. With respect to margins in the form of securities, Eurex Clearing receives a pledge over securities held in pledge accounts of the Clearing Member.

### *Final settlement*

Generally, final settlement prices are determined through similar procedures. For cash settled contracts, however, CCP rules contain specific provisions on determination of the final settlement price (see e.g. Chapter II section 2.4.2 (Final Settlement Price)).

Eurex Clearing's Clearing Conditions provide that the delivery of cash or securities in settlement of obligations from one Clearing Member to Eurex Clearing and onward from Eurex Clearing to another Clearing Member occurs directly between the Clearing Members involved. In order to facilitate deliveries between Clearing Members, Eurex Clearing provides the functionality necessary to permit members to optimize their delivery management through the use of different settlement accounts on a product-specific basis at the different Central Securities Depositories that are supported by Eurex Clearing. Under this functionality, Clearing Members are able to use not only their own settlement accounts at the various supported CSDs, but are also able to use the accounts of custodian institutions that handle settlement instructions for the clearing member.

Settlement performance of the Clearing Member is monitored by Eurex Clearing by virtue of the IT systems used by it and is monitored by settlement service providers, who exchange information with Eurex Clearing, particularly in the event of settlement default. The Eurex Clearing members are obliged to notify Eurex Clearing immediately if they are unable to fulfil any obligation arising out of transactions at Eurex.

***Core Principle F: TREATMENT OF FUNDS—The applicant shall have standards and procedures designed to protect and ensure the safety of member and participant funds.***

In addressing Core Principle F, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. Safe custody:

- a. The safekeeping of funds, whether in accounts, in depositories, or with custodians, and how it would meet industry standards of safety;
- b. Any written terms regarding the legal status of the funds and the specific conditions or prerequisites for movement of the funds; and
- c. The extent to which the deposit of funds in accounts in depositories or with custodians would limit concentration of risk.

2. Segregation between customer and proprietary funds:

Requirements or restrictions regarding commingling customer funds with proprietary funds, obligating customer funds for any purpose other than to purchase, clear, and settle the products the clearing organization is clearing, or procedures regarding customer funds which are subject to cross-margin or similar agreements, and any other aspects of customer fund segregation.

3. Investment standards:

- a. How customer funds would be invested consistent with high standards of safety; and
- b. How the organization will gather and keep associated records and data regarding the details of such investments.

**Corresponding German Requirements:**

As discussed in greater detail below, Eurex Clearing does not accept customer funds to margin or guarantee positions. All collateral and funds deposited with Eurex Clearing must be the proprietary funds of the Clearing Member. Consequently, Eurex Clearing does not permit the commingling of customer and proprietary funds at the CCP level. Eurex Clearing itself is subject to the provisions of the KWG discussed below, which also apply to Clearing Members.

A number of requirements in German law provide protections to customer funds at the clearing member/participant level. By way of example, under the German Deposit Act customer collateral which is in the form of securities which are deposited with an intermediary that is a credit institution under the KWG are kept segregated and not commingled with the credit institution's proprietary assets. Although cash which is deposited by a customer with a credit institution generally is not segregated, if the customer deposits such funds into a trust account it will be segregated from the other funds

of the credit institution. However, such accounts typically are not used in connection with trading accounts because of operational complexity.

The German Banking Act has a number of additional requirements that provide for the protection for customer funds. Under the German Banking Act, in particular Section 10 KWG, institutions must have adequate proprietary funds “in order to safeguard the assets entrusted to them.” Thus, as financial and banking institutions, the KWG requires the institution that it covers to safeguard the assets entrusted to them.

Further to the requirements that institutions covered by the German Banking Act must meet, section 11 KWG requires that institutions “invest their funds in such a way as to ensure that adequate liquidity for payment purposes is guaranteed at all times.” That provision continues, providing that BaFin, “acting in agreement with Deutsche Bundesbank, draws up Principles by which it assesses in the normal case whether an institution’s liquidity is adequate . . .”

Section 25a requires that an institution have a proper business organization and section 32 requires that an applicant for a license to conduct business demonstrate a “viable business plan showing the nature of the planned business, the organizational structure and the planned internal monitoring procedures of the institution.”

In addition to the above, the WpHG applies to treatment of securities used as collateral for a trading account with an Investment services enterprise (“broker”). Under section 34a(1) WpHG, customer securities are segregated for the benefit of customers from the property of such a broker.<sup>28</sup> Accordingly, customer assets collateralizing trading accounts that are in the form of securities are required to be segregated from the property of the broker. Customers retain their property rights in such securities under this provision.

Moreover, also under section 34a WpHG, brokers that are not themselves licensed deposit-taking credit institutions are required to maintain customer funds in segregated accounts with credit institutions that are so licensed, either in Germany or in another jurisdiction.<sup>29</sup> Each broker must segregate each of its customer’s funds from the broker’s other assets and from the assets of other customers held with that depository and inform the depository credit institution that the money is being deposited for the account of a third party or parties. The broker must also inform the customer of the account and institution in which the funds are deposited and the extent to which the deposit is protected by applicable deposit protection schemes.<sup>30</sup> Thus, customer funds provided to a broker are treated as belonging to and for the benefit of the customer.

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<sup>28</sup> See, Section 34a WpHG , attachment 2.

<sup>29</sup> Securities Trading Act, section 34a.

<sup>30</sup> This is consistent with European Union legislation which requires investment firms to make arrangements to safeguard clients’ rights in financial instruments and to prevent use of such financial instruments for the broker’s own account unless the client consents in writing (see European Directive on markets in financial instruments - “MiFID” - Article 13 para. 7). Similar requirements apply with respect to

A somewhat different scheme applies to deposit-taking Institutions. Like non-deposit taking entities, deposit-taking institutions are required by the German Securities Deposit Act to treat client securities separately from their own. Although it does not require them to hold securities at external sources, the German Securities Deposit Act ensures that any client securities are held off-balance sheet and do not fall into the general asset pool of the institution (banks) in case of bankruptcy and/or insolvency. Furthermore, the German Securities Deposit Act does not allow a particular client security position to be utilised to cover a demand arising from another client, unless the owner of the securities has given special permission.

With respect to funds, institutions that are licensed as deposit taking institutions are required to hold customer funds in separate accounts from the property of the institution and from other customers, although they are not required to deposit such funds with a separate institution. As a consequence, and due to the nature of the banking business, although traceable to a particular customer, such funds are considered to be a general obligation of the Institution. Nevertheless, the German legal framework does provide two means of safeguarding such funds.

First, banks are subject to a number of capital requirements to ensure that they are able to meet all obligations to their customers/depositors. Section 10 of the German Banking Act sets forth the capital and liquid financial assets requirements which institutions must meet. These must be considered together with the specific provisions for the required proprietary risk capital according to Principle I (Grundsatz I) and the requirements for sound liquidity practice according to Principle II (Grundsatz II) which are based on principles set out in the Basel Accords and European Capital Adequacy Directive (Directive 93/6/EC). The Principle I and Principle II regulations are attached. These provisions together form the regulatory environment for German banking institutions subject to the supervision of the BaFin and the Bundesbank.

Secondly, customer funds deposited directly or indirectly with German credit institutions or financial services institutions are entitled to the benefits of several insurance and compensation schemes:

- Pursuant to the German Deposit Guarantee and Investor Compensation Act (*Einlagensicherungs- und Anlegerentschädigungsgesetz*), which implemented the EU Deposit Guarantee Directive and Investor Compensation Directive, credit institutions must participate in a deposit compensation scheme that provides deposit protection on an aggregate basis for each customer up to a maximum of 90% of a customer's funds on deposit and the equivalent of EUR 20.000,00 per depositor.

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funds, with two exceptions: (1) a client may not consent to the use of its cash by the investment firm (MiFID Article 13 para. 8; and (2) banks, which include Institutions" within the meaning of the German Banking Act, are exempt from this prohibition because this is the nature of the banking business under the European Banking Directive (European Directive 2000/12/EC).

- Financial services institutions and credit institutions are required to participate in an investor compensation scheme that provides equivalent levels of protection to customers if the institution is unable to repay funds owed to customers or to return securities that belong to customers and that the institution holds in safe custody on behalf of customers.

Compensation is payable under these schemes if BaFin determines that an institution, for reasons directly related to its financial circumstances, is unable to repay deposits or meet its liabilities from its investment business and that there is no prospect of repayment or such liabilities being met at a later date. In any such case, customers have a claim directly against the compensation scheme. Where funds are deposited in an institution on behalf of a third party, the third party is entitled to claim compensation directly from the scheme in the event of a failure of the depository institution so long as there is adequate evidence that the account is for the benefit of that third party. These statutory compensation schemes are not available to certain institutional investors acting for their own accounts or certain managers and affiliates of the failed depository institution.

The statutory compensation schemes are funded by required contributions from member institutions, which are set at levels overseen by BaFin and the German Federal Finance Ministry. The compensation schemes themselves are subject to supervision and audit by BaFin.

In addition to the statutory protection schemes outlined in this section, deposits in most German credit institutions are covered by voluntary private deposit protection arrangements, such as the Deposit Protection Fund for commercial banks established by the Association of German Banks. These arrangements are funded by contributions from member institutions, and generally safeguard liabilities to non-bank creditors (including creditors not covered by the statutory protection schemes) and cover amounts in excess of those covered by the statutory protection schemes. The Deposit Protection Fund, for example, covers liabilities of the failed institution, for each creditor, up to the level of 30% of the liable capital of the credit institution (as of its last published annual financial statements). The protection of the Deposit Protection Fund applies to deposits at participating German banks and their branches outside Germany, irrespective of the currency in which they are denominated, and also to both resident and non-resident depositors.

Section 23a KWG requires that the institution inform customers of the guarantee scheme that applies to its activities.

To avoid liquidity crises in connection with failures and potential failures of credit institutions, the Deutsche Bundesbank, together with German credit institutions, has established a Liquidity Consortium Bank. This institution is authorised to provide loans

and other liquidity assistance, when necessary, to credit institutions that meet certain safety and soundness requirements.

Based upon these provisions of German law, customer collateral in the form of securities can be, or is required to be subject to protection from the general creditors of the institution or broker, respectively and is treated as belonging to the customer. Brokers are required to deposit customer cash in a deposit taking institution and to treat such funds as customer funds. Funds held in a bank are not subject to segregation treatment. However, these funds are safeguarded through capital requirements, bank supervision and the funding of various guarantee funds and deposit protection arrangements. In this way, customer collateral is provided a level of protection comparable to that provided under the Commodity Exchange Act.

**As applied to Eurex Clearing:**

Margin and treatment of funds is provided in Chapter I, Part 3 of the Clearing Conditions of Eurex Clearing. Margins are accepted either in cash, securities or book-entry securities. Chapter I, section 3.4 Clearing Conditions. The Clearing Member must pay margin due to the CCP from its own funds. Chapter I section 3.4(1) Clearing Conditions. Thus, Eurex Clearing does not hold customer funds and holds only the proprietary funds of clearing members. Because Eurex Clearing holds no customer funds of its members, it effectively does not permit the commingling of customer and broker proprietary funds at the CCP level. Customer collateral at the Clearing Member level, as explained above, are subject to, or can be subject to separate treatment from that of the broker or institution, respectively, and is subject to a number of insurance and deposit protection arrangements.

Eurex Clearing holds a security interest in all securities held in collective safe custody. Chapter I, section 3.5 Eurex Clearing Clearing Conditions. As explained above, net payments of margins in the form of cash are delivered by the Clearing Member to accounts of Eurex Clearing with the German Central Bank, the Swiss Banking Commission or with other settlement banks used for such purposes. Cash margins of the Clearing Members are pooled in such accounts as agreed by the Clearing Member in accordance with Chapter 3, Clearing Conditions.

Generally, Eurex Clearing does not use any assets of the Clearing Member other than provided for in the Clearing Conditions. Deposits are maintained at Deutsche Bundesbank, the Swiss Banking Commission or other approved depositories.

The CCP is also subject to provisions of the KWG that restrict large exposures and extensions of credit. It must monitor daily for such large exposures/extensions of credit<sup>31</sup> and report quarterly on such large exposures. See, sections 13 (1) 1 and 2 KWG, section 13 (3) 2 KWG, section 13 (3) 6 KWG and section 14(1) KWG.

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<sup>31</sup> Large exposures are those exceeding €1.5 million

Eurex Clearing AG is required to calculate its own capital in accordance with these German legislative provisions. Eurex Clearing AG is regarded as a credit institution for these purposes according to Section 1 para. 1 KWG. This means that the Eurex Clearing is required to maintain sufficient own capital according to the general rules set out by the Capital Adequacy Directive.

***Core Principle G: DEFAULT RULES AND PROCEDURES—The applicant shall have rules and procedures designed to allow for efficient, fair, and safe management of events when members or participants become insolvent or otherwise default on their obligations to the derivatives clearing organization.***

In addressing Core Principle G, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. Definition of default:

- a. The events that will constitute member or participant default;
- b. What action the organization would take upon a default and how the organization would otherwise enforce the definition of default; and
- c. How the organization would address situations related to but which may not constitute an event of default, such as failure to comply with certain rules, failure to maintain eligibility standards, actions taken by other regulatory bodies, or other events.

2. Remedial action:

The authority pursuant to which, and how, the clearing organization may take appropriate action in the event of the default of a member/participant which may include, among other things, closing out positions, replacing positions, set-off, and applying margin.

3. Process to address shortfalls:

Procedures for the prompt application of clearing organization and/or member/participant financial resources to address monetary shortfalls resulting from a default.

4. Use of cross-margin programs:

How cross-margining programs would provide for clear, fair, and efficient means of covering losses in the event of a program participant default.

5. Customer priority rule:

Rules and procedures regarding priority of customer accounts over proprietary accounts of defaulting members/participants and, where applicable, in the context of specialized margin reduction programs such as cross-margining or trading links with other exchanges.

### **Corresponding German Requirements:**

There is no single, explicit requirement in the German Banking Act requiring a CCP to have default rules. However, this requirement can be inferred from a number of provisions which previously have been described. Most fundamentally, section 25a KWG requires the licensed institution to “have in place suitable arrangements for managing, monitoring and controlling risks” and that it have a “proper business organization.” Moreover as discussed above, Germany is bound by the EU Settlement Finality Directive. Clearing houses are explicitly included within the remit of the SFD. Germany has adopted

national legislation, such as its amendment to its insolvency laws to implement in national legislation the provisions of the SFD. This also includes section 24b KWG, which requires that an institution which is designated as a “System” under the directive, notify BaFin of its status. Finally, section 23a requires that an institution conducting a banking business inform customers of the applicable guarantee scheme that applies.

These provisions implicitly provide that a CCP have default rules. One of the purposes of the SFD is to clarify the effect of an insolvency of a member on the System that is the CCP. Thus the purpose of the SFD, in part, is to provide legal certainty for the default arrangements and provisions that are inherent to the operation of a CCP system. Moreover, the proper business organization of a CCP must include provisions establishing default rules and lines of defense in case of default.

### **As applied to Eurex Clearing:**

#### *Closing-out of Positions*

Pursuant to Chapter I section 1.7.1 Clearing Conditions, a Clearing Member of Eurex Clearing is in default where such Clearing Member (i) fails to provide the margin demanded by Eurex Clearing for any business day or fails to pay when due a daily settlement payment, any net premiums or other fees owed in a timely manner; (ii) fails to deliver the securities owed by it on the delivery date or fails to provide the payment owed for such securities; or (iii) fails to fulfil any other obligation to Eurex Clearing arising under the Clearing Conditions.

Upon a default, the defaulting Clearing Member may not itself conclude new transactions or open new positions. The Clearing Member must close out or transfer to another Clearing Member all existing transactions or positions carried by the defaulting Clearing Member. The defaulting Clearing Member closes transactions by concluding an inverse transaction with Eurex Clearing. If the closing or transfer of transactions or positions has not been concluded in a satisfactory period of time, Eurex Clearing may carry out the closing of the transactions or positions on behalf of the defaulting Member. See Chapter I sections 7.1(1), 7.1(5) and 8.1 Clearing Conditions. The CCP will close out positions and realize margin in accordance with the following priority schedule of Chapter I section 8.1 Clearing Conditions:

- Creation of a single net position by netting all open positions of all the accounts of the Clearing Member. Close-out of such net position by Eurex Clearing or a trading participant designated by it.
- Realization of all margin of the defaulting Clearing Member including its contribution to the Clearing Fund pursuant to Chapter I section 6.1 (1) Clearing Conditions.
- Refund of any surplus in the event that the proceeds from the realisation of margin of the defaulting Clearing Member exceed the amount

required to cover all obligations of such Clearing Member arising out of its transactions.

- Utilization of the funds maintained by Eurex Clearing pursuant to Chapter I section 6.1 (3) Clearing Conditions in the event that the proceeds from the realisation of margin and the enforcement of the contributions to the Clearing Fund as well as the collateral pursuant to Chapter I section 2.2(2) Clearing Conditions of the defaulting Clearing Member are insufficient to satisfy its obligations arising out of its transactions.

Typically, in response to a default, Eurex Clearing seeks to obtain securities of the same class by way of securities lending or buy-in subject to various deadlines depending on the class of securities. It is also able to initiate a securities auction involving other Clearing Members or determine cash settlement. The rights and obligations of Eurex Clearing, the defaulting Clearing Member and other Clearing Members and users in such situations are detailed in the sections of the rules referred to above.

In the case of a shortfall, the contributions of a Clearing Member to the Clearing Fund are used in accordance with the Clearing Conditions. In case of default of a Clearing Member, the default provisions apply. This includes the realization of all margin and all contributions to the Clearing Fund of the defaulting Clearing Member. Ultimately, in the event the utilization of funds maintained by Eurex Clearing is insufficient, a pro rata enforcement of contributions of non-defaulting clearing members, e.g. in form of cash or securities, can be made as described in Chapter I section 6.2 (2) and (4) Clearing Conditions. Lastly, if Eurex Clearing or a General Clearing Member or Direct Clearing Member terminates the Clearing Membership, Eurex Clearing will release the contribution of the General Clearing Member or Direct Clearing Member to the Clearing Fund one month after notice is given of such termination, but in any event not earlier than one month after the day upon which all contracts in the accounts for which the respective Clearing Member handles the Clearing have been cleared.

The defenses of the CCP that will be deployed in the face of a default are as follows: an initial level of protection is provided through the system of collateral margining described above. The daily provision of margin is supplemented by: (1) mandatory contributions to Eurex Clearing AG's Clearing Fund by Clearing Members and (2) reserves maintained by Eurex Clearing AG.

The amount of the contribution to the Clearing Fund is determined by Eurex Clearing for each Clearing Member and depends on the status of the Clearing Member as well as the extent of its clearing activities as reflected by the margin required to be posted by the Member with Eurex Clearing. Currently, General Clearing Members pay not less than an amount of €5 million and Direct Clearing Members not less than €1 million to the Clearing Fund. Clearing Members provide their contribution to the Clearing Fund in the form of (third party) bank guarantees and/or cash or securities collateral. The bank guarantee must contain the bank's unconditional obligation to provide for the payment

of the guaranteed amount indicated by Eurex Clearing upon demand. Each Clearing Member's contribution to the Clearing Fund may be used to cover the financial consequences of default by the Clearing Member itself or by any other Clearing Member. Eurex Clearing also continuously enhances its guarantee fund by setting aside annual surpluses for contributions to the fulfillment of obligations of any Clearing Member that may have defaulted in its obligations.

In addition, through contractual agreements, Deutsche Borse AG and SIX Swiss Exchange undertake to provide Eurex Clearing AG with the funds it needs (up to the limits set by the agreement) to meet its obligations as the central counterparty to settle derivatives contracts traded on Eurex in the event that other lines of defenses are exhausted.

### *CDS Clearing*

Moreover, the measures that Eurex Clearing may take in response to a default of a CDS Clearing Member are specific to the CDS clearing facility. In the event of a default by a CDS Clearing Member, Eurex Clearing has the right to close out and settle open positions of the defaulting CDS Clearing Member. Eurex Clearing has the right to transfer positions, including especially client positions, to another CDS Clearing Member within a specified time period. Eurex Clearing has the right to enter into, on behalf of the defaulting CDS Clearing Member new transactions to hedge the market risk of the defaulting member's position. Eurex Clearing may use a voluntary auction process to liquidate the defaulter's position as a whole or in meaningful amounts to the non-defaulting CDS Clearing Members. Finally, Eurex Clearing may assign the remaining positions to the non-defaulting CDS Clearing Members pro rata, or close out the entire defaulting member's portfolio by cash-settlement of the entire position on both sides.

Margins are set so as to cover any scenario of consecutive credit events of n reference entities a day, and the default of the Clearing Member. In the unlikely event that this margin is insufficient to cover the default, the clearing house would deploy the following layered defenses sequentially:

1. Utilize the collateral of the defaulting CDS Clearing Member;
2. Utilize the contribution to the CDS Clearing Fund of the defaulting CDS Clearing Member;
3. Utilize the reserve fund of Eurex Clearing;
4. Utilize the contributions to the CDS Clearing Fund of non-defaulting CDS Clearing Members; and
5. One assessment to CDS Clearing Members to replenish the CDS Clearing Fund.

***Core Principle H: RULE ENFORCEMENT—The applicant shall (i) maintain adequate arrangements and resources for the effective monitoring and enforcement of compliance with rules of the applicant and for resolution of disputes; and (ii) have the authority and ability to discipline, limit, suspend, or terminate a member's or participant's activities for violations of rules of the applicant.***

In addressing Core Principle H, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. Surveillance:

Arrangements and resources for the effective monitoring of compliance with rules relating to clearing practices and financial surveillance.

2. Enforcement:

Arrangements and resources for the effective enforcement of rules and authority and ability to discipline and limit or suspend a member's/participant's activities pursuant to clear and fair standards.

3. Dispute resolution:

Where applicable, arrangements and resources for resolution of disputes between customers and members/participants, and between members/participants.

**Corresponding German Requirements:**

Section 25a(1)3 KWG requires a supervised institution to have an adequate business organization, including adequate internal control systems, for the appropriate management and monitoring of the risk to which it is exposed. The content of this general requirement depends upon the nature of the institution to which it applies, and in that sense is similar to a Core Principle. In the case of a CCP, an internal control system that is appropriate to the management and monitoring of the risk to which the institution is exposed necessarily includes monitoring and surveillance capabilities with respect to the risk associated with each clearing member's total position, each clearing member's adherence to the Clearing Conditions, and enforcing compliance, as necessary, with respect to any breach of the foregoing by any clearing member. Further, proper business organization requires that the surveillance/compliance functions be administered separately from the business generation units of the organization.

Moreover, BaFin has the statutory authority to remove management or to revoke Eurex Clearing's license for failure to abide by the requirements of the Banking Act. Specifically, under section 36 KWG, BaFin may remove managers or prohibit managers from carrying out functions in a supervised institution if the manager has contravened the Banking Act or the WpHG or implementing regulations or orders. This has the effect of requiring management to enforce the Banking Act and to ensure that its operations are in compliance with the law, including enforcing the clearing conditions and other rules and requirements of Eurex Clearing, to avoid possible, direct adverse action from BaFin.

Ultimately, under section 35(2) KWG, BaFin is empowered to revoke Eurex Clearing's license if it learns of facts which would warrant refusal or the safety of assets entrusted to the institution are endangered. The safety of the assets entrusted to Eurex Clearing is derived in part through compliance by its members with the clearing conditions, and Eurex Clearing's failure to enforce its clearing conditions would therefore be grounds for possible license revocation.

As noted above, Eurex Clearing is not established as a German public law entity. Thus, the CCP's compliance powers are not bestowed through statute, but rather derive through the Membership Agreement that each Clearing Member enters into with Eurex Clearing. Thus, the applicable German statutory provision that empowers Eurex Clearing to ensure compliance, discipline Clearing Members and issue penalties are section 311(1) and 339 of the German Civil Code. These provisions allow for parties to an agreement to agree upon contractual penalties as damages in accordance with the general limitation prescribed by the law. These statutory provisions therefore provide the legal force behind the provisions of the Clearing Conditions that provide for the sanctioning and discipline of members.

#### **As applied to Eurex Clearing:**

Eurex Clearing enforces compliance with and through its Clearing Conditions under which Eurex Clearing can discipline a member by revoking its Eurex Clearing clearing license and refusing access to a clearing member or terminating a non-clearing member's access agreement (Chapter I, section 9.3 Clearing Conditions) or by imposing money penalties in connection with breach of a default rule. *See* Chapter I section 7.1(4) Clearing Conditions. This will be equally true for the clearing of OTC look alike contracts as for CDS transactions, each which will be subject to a separate clearing license. Enforcement and investigation staff are given effective powers of investigation, monitoring and oversight with respect to compliance with Eurex Clearing's rules, particularly as they relate to the CCP's risk management and market supervision functions.

The main market surveillance and oversight function is performed by Eurex Clearing's market supervision personnel. The processes and procedures that they follow are described in the Surveillance organizational handbook, which is appended hereto as Attachment 13. In addition, the membership department verifies the compliance of applicants with the requirements for admission to Clearing Membership and of the Clearing Member's on-going compliance with the CCP's capital requirements. The membership department verifies Clearing Members' on-going compliance with capital adequacy requirements through the review of each member's audited financial statements. Non-compliance by a Clearing Member with this review process may result in suspension of the member's Eurex Clearing clearing license.

In addition, Eurex Clearing monitors clearing members by performing a quarterly rating based on a quantitative model which is presented to the CCP's Executive Board.

Based on this approach, the intraday margin call limit can be reduced by a decision of the Executive Board of Eurex Clearing based on the recommendation of Clearing Supervision. Further measurements are to undertake senior management visits of the corresponding clearing member in order to investigate risk management systems and methods, internal and external audit of these systems and methods. Such monitoring and on-going oversight may result in restrictions of the amount of clearing business that the member is able to do by establishing clearing limits. Or, if the overall risk level of the CCP, as the aggregated risk scores of its Clearing Members, increases, the Executive Board may determine to increase contribution factors to the Clearing Funds.

In addition to the clearing review, the CCP supervision department conducts daily monitoring of clearing members using a proprietary search engine with an intelligent search algorithm in order to detect news and rumors relating to members.

With regard to dispute resolution, the Clearing Agreement between the CCP and the clearing member provides that disputes are governed by German law. The Clearing Conditions provide that any dispute arising out of the Clearing Conditions would be held in the courts of Frankfurt am Main, Germany. However, the link clearing agreement with The Clearing Corporation is governed by New York law and disputes arising thereunder would be adjudicated in the New York courts.

***Core Principle I: SYSTEM SAFEGUARDS—The applicant shall demonstrate that the applicant (i) has established and will maintain a program of oversight and risk analysis to ensure that the automated systems of the applicant function properly and have adequate capacity and security; and (ii) has established and will maintain emergency procedures and a plan for disaster recovery, and will periodically test backup facilities sufficient to ensure daily processing, clearing, and settlement of transactions.***

In addressing Core Principle I, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. Oversight/risk analysis program:
  - a. Whether a program addresses appropriate principles and procedures for the oversight of automated systems to ensure that its clearing systems function properly and have adequate capacity and security. The Commission believes that the guidelines issued by the International Organization of Securities Commissions (IOSCO) in 1990 and adopted by the Commission on November 21, 1990 (55 FR 48670), as supplemented in October 2000, are appropriate guidelines for an automated clearing system to apply.
  - b. Emergency procedures and a plan for disaster recovery; and
  - c. Periodic testing of back-up facilities and ability to provide timely processing, clearing, and settlement of transactions.
2. Appropriate periodic objective system reviews/testing:
  - a. Any program for the periodic objective testing and review of the system, including tests conducted and results; and
  - b. Confirmation that such testing and review would be performed or assessed by a qualified independent professional.

## **Corresponding German Requirements:**

Section 25a(1)2 provides that an institution subject to the Banking Act must have in place “a proper business organization, an appropriate internal control system and adequate security precautions for the deployment of electronic data processing. This provision includes the concept of adequate disaster recovery arrangements.

Section 25a(2) further provides that any outsourcing arrangements must not impair orderliness of business operations nor the manager’s ability to control those functions. It requires that the entity to which functions are outsourced be subject to the internal audit functions of the outsourcing entity and that BaFin be provided prior notice of any outsourcing arrangements.

The requirements of section 25a(1)2 of the KWG are further explained and reinforced by BaFin Circular 5/2007: “Minimum Requirements for Risk Management,” [http://www.bafin.de/cln\\_109/nn\\_720494/SharedDocs/Veroeffentlichungen/EN/Service/Circulars/rs\\_0705\\_en\\_ba.html?\\_\\_nnn=true](http://www.bafin.de/cln_109/nn_720494/SharedDocs/Veroeffentlichungen/EN/Service/Circulars/rs_0705_en_ba.html?__nnn=true). BaFin Circular 5/2007, which is appended as Attachment 12, provides guidance with respect to IT system requirements and safeguards. This Circular provides that the institution must base the scope and quality of its IT processes on its operational needs, business activities and risk situation. It requires that the institution’s IT systems meet be based on and meet established standards, and requires that the suitability of an institution’s IT systems be assessed on a regular basis by technically competent employees. The Circular also mandates minimum requirements, such as testing of new or amended systems prior to deployment.

The Circular also requires that the institution have in place contingency and disaster recovery plans. These include the requirement that the institution periodically test the effectiveness and suitability of the contingency plan. It also requires that outsourced functions be included in an integrated contingency plan. The contingency plan has to provide for both business continuity and recovery plans. A prior Circular required that there be at least one off-site disaster recovery facility.<sup>32</sup>

BaFin is a member of the International Organization of Securities Commissions (IOSCO) and recognizes that the IOSCO Principles for the Oversight of Screen-based Trading Systems for Derivative Products issued in 1990 and supplemented in 2000 is the appropriate guideline for an automated clearing system to meet.

## **As applied to Eurex Clearing:**

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<sup>32</sup> See, “Bundesaufsichtsamt Pronouncement on the Employment of Cross-Border Electronic Data Processing Facilities (hereinafter referred to as “EDP facilities”) for Bank Accounting Purposes,” [http://www.bafin.de/cln\\_109/nn\\_720494/SharedDocs/Veroeffentlichungen/EN/Service/Proclamations/gren\\_\\_dvb\\_\\_en.html?\\_\\_nnn=true](http://www.bafin.de/cln_109/nn_720494/SharedDocs/Veroeffentlichungen/EN/Service/Proclamations/gren__dvb__en.html?__nnn=true)

Eurex, by letter dated August 10, 1999, was permitted under a no-action letter of the CFTC's Division of Trading and Markets, to install trading terminals in the U.S. and to list for trading thereon specified contracts. See, [http://www.cftc.gov/tm/letters/99letters/tmeurex\\_no-action.htm](http://www.cftc.gov/tm/letters/99letters/tmeurex_no-action.htm) ("Eurex Terminals Letter"). In connection with that letter, Eurex provided the Commission with a full explanation of the development, operation, security and oversight of the Eurex IT systems. Moreover, Eurex in requesting the Eurex Terminals Letter represented that in developing and operating its IT systems it adhered to, and would continue to adhere to the IOSCO Principles for the Oversight of Screen-based Trading Systems for Derivative Products. See Eurex Terminals Letter at page 7. Eurex continues to adhere to, and to meet the IOSCO policies in connection with the development and operation of its automated clearing systems.

Eurex Clearing has established and maintains a risk analysis and oversight program with respect to its IT Systems. As discussed above, under German law, IT-systems (hardware and software components) and the relevant IT-processes must be capable of ensuring the integrity, the availability, the authenticity and the confidentiality of data. For these purposes IT systems and relevant IT processes must utilise established standards. The adequacy of these standards must be revised regularly by competent and technically responsible staff. IT systems must be tested before initial use and after major modifications and must be approved by competent and technically responsible staff. Business IT and IT used for testing procedures must in principle be kept separate. The development and modification of guidelines concerning programming measures (e.g. parameter adjustments) must be carried out by technically competent and responsible staff.

Eurex Clearing has outsourced its information technology function to Deutsche Börse Systems AG ("DBS"). As noted above, the arrangements for controlling and documenting the design, development, implementation and use of information technology systems, are subject to section 25a (1) 3 KWG.<sup>33</sup> The following contains a brief description of the practices of Eurex Clearing in this respect.

DBS has the task of overseeing the continued acceptability of the functioning of the IT System. As such, it conducts a formal program of testing and evaluation of the IT Systems. The IT Systems are regularly upgraded and improved to introduce desired enhancements and to keep pace with any necessary improvements through the periodic release of new versions of the Eurex Clearing systems..

Additional modifications can be made as needed in response to specific issues that may come to the attention of DBS or in response to changes in the business, such as listing a new product.

Continuing changes and necessary updates to the IT systems are made through the change request process. Every change request must be in writing, and only after an impact

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<sup>33</sup> See also, MaRisk a circular of Deutsche Bundesbank that specifically addresses IT systems requirements. It is included as Attachment 15.

analysis has been made by project personnel, if the change is part of a large project, or for smaller changes, by central functions. The change request must include:

- customer impact analysis;
- functional and technical impact analysis;
- change request sign off; and
- implementation plan.

In this way, the IT systems are subject to continuing monitoring and testing and are susceptible to major periodic upgrades as well as continuing enhancements, and is subject to monitoring and evaluation to ensure data security (availability and integrity) and operational continuity.

#### *Business continuity and disaster recovery*

AT 7.3 MaRisk requires that Eurex Clearing have in place practices that relate to its critical activities and processes that can be implemented in response to an emergency, the "emergency concept." The effectiveness and adequacy of the emergency concept is subject to regular, periodic testing. The emergency concept must include business continuity plans in the event of an emergency. Business continuity plans must include a range of possible alternative solutions to be available depending upon the nature of the emergency and must ensure that regular business operations can be reassumed within an acceptable period of time.

As part of its business continuity planning, The IT system of Eurex Clearing is set up with automatic failover by hot standby. The business relevant data on all remote systems (user device or member server) are recoverable and can be re-requested from the backend in case of failure. Therefore, the data on the backend system must be reliable. Thus the backend cluster is to be built as a fault and (due to criticality of the trading data) disaster tolerant system.

The backend system is built as an OpenVMS cluster consisting of 2 times 1, 2 or 3 systems (each can be a multi processor server) located at two independent, sites distant from each other, plus a quorum system at a 3<sup>rd</sup> site. The cluster interconnect is implemented using fast network switches over dark fibers, which use two completely different routes.

1. Redundancy: The Eurex Clearing, Risk Engine and Data Warehouse backed systems are all actively used. In case one of them fails, the transaction load of the failed one is distributed among the surviving systems - in flight transactions are retransmitted. On the IT backend system one site is active and the other site application is standby but does not attach to database. If one site fails an automatic failover takes part with the possibility to switch back after the failed side is up and running again.

2. Data integrity and durability: All data is safe on disk, disks are built as host based shadow sets, where shadowing is done over the sites. Archiving to tape is done twice; one copy is written in the first data center, the second is written at the quorum site.

In the event of a failure or a disaster, because all systems are equal (no master exists), a failure of a system or even an entire site, is transparent to the member system. The cluster would reconfigure within 15-60s without any manual interaction, assuring a consistent disk and database state (roll back of incomplete transactions). The communication server would reroute the non processed transaction to a survived host system and the exchange member would get the results slightly delayed but complete and guaranteed. There would be no further impact on the exchange operation except that the total system CPU performance is reduced. A symmetric sizing of the servers at both sites would lead to a about 60% residual processing capacity (>505 because less cluster communication is necessary in a reduced system).

Repair of the failed system/site is possible and proven intra day. As soon as the system/site is available again, it will join the cluster, the transaction routing will reconfigure itself and the load will be balanced across all systems again.

To guarantee data security (availability and integrity), data is simultaneously stored on several discs (shadowing) and backups are repeated in predefined cycles.

Failure security of back end and communication servers is realized through multiple lay-out of the hardware involved (computers, discs, controllers, routers and lines) and software engineering measures. Access to hardware and software is restricted by authorizing certain participants and members of staff only.

Operating system software, exchange software, member and security data are subject to permanent data back up. One trading day's data stock (master data as well as transaction data) is stored temporarily on data discs before end-of-day processing (pre-batch backup) takes place. Afterwards, the data is stored permanently on a suitable data carrier (tape drives/CD).

During end-of-day processing, data is updated and prepared for the next trading day. After the end of the processing, another data back up is generated (post-batch backup). Again, data is stored temporarily first, before being stored permanently.

Protocol data of an entire trading day is stored additionally (review backup). Protocol data contains detailed information about the concluded trading day, from which details about data processing can be derived. Central storage of member data guarantees at any time quick availability of information.

***Core Principle J: REPORTING—The applicant shall provide to the Commission all information necessary for the Commission to conduct the oversight function of the applicant with respect to the activities of the derivatives clearing organization.***

In addressing Core Principle J, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. Information available to or generated by the clearing organization that will be made routinely available to the Commission, upon request and/or as appropriate, to enable the Commission to perform properly its oversight function, including information regarding counterparties and their positions, stress test results, internal governance, legal proceedings, and other clearing activities;

2. Information the clearing organization will make available to the Commission on a non-routine basis and the circumstances which would trigger such action;

3. The information the organization intends to make routinely available to members/participants and/or the general public; and

4. Provision of information:

a. The manner in which all relevant routine or non-routine information will be provided to the Commission, whether by electronic or other means; and

b. The manner in which any information will be made available to members/participants and/or the general public.

### **Corresponding German Requirements:**

Eurex Clearing is required to provide financial information both on a routine and non-routine basis about itself and its activities to BaFin and Deutsche Bundesbank. Eurex Clearing must routinely report to BaFin whenever Eurex Clearing has a change in its ongoing business. Specifically, section 24 (1) 1-14 KWG requires Eurex Clearing to report immediately to BaFin changes in circumstances regarding its active and passive participations, branches, constitutional provisions (legal form, firm name, change of registered seat) and organizational and economic status (including appointment or removal of executive board members, loss of 25% of own funds, intention of merger with another institution, discontinuation of banking activity, commencement or termination of a business not related to its license, and the failure of a counterparty to discharge a repo or securities lending agreement. Changes to the Clearing Conditions are not required to be approved by BaFin under this provision, but significant rules nevertheless are provided to BaFin for discussion and comment in its general supervisory role.

Eurex Clearing is further subject to routine, periodic reporting with respect to its financial condition, large exposures and the financial condition of its members. These are detailed reports required by BaFin and Bundesbank. The most important reporting of these reports are: (i) daily monitoring and monthly reporting of the adequacy of own funds under section 10(1)5 KWG (which is based on the Capital Adequacy Directive); (ii) quarterly reporting of own funds of securities trading firms pursuant to section 10(9)5 KWG; (iii) daily monitoring and quarterly reporting of large exposures pursuant to section 13(1)1 and

2, section 13(3)2, and 6, section 14(1), and section 6 KWG; (iv) quarterly reporting of any exposure/extensions of credit exceeding €1.5 million; (v) monthly reporting of the monthly return including the status of the assets and the profit and loss account balance; and (vi) monthly reporting of the adequacy of the institution's liquidity pursuant to section 25 KWG.

Additionally, Eurex Clearing is required, pursuant to the WpHG to report to BaFin all transactions in securities and derivatives traded on an organised market to which Eurex Clearing acts as CCP. See section 9(1)3 WpHG, The reporting is made via an automated reporting tool pursuant to section 9(2) WpHG. The same applies to any trading member or Clearing Members as counterparty to such transactions pursuant to section 9 (1)1 WpHG.

Eurex Clearing must also provide annual reports to BaFin which include certified financials, a management report and auditor's reports. Auditors are required to audit for compliance by Eurex Clearing with BaFin's other reporting requirements. Auditors must also determine whether Eurex Clearing has complied with its anti-money laundering obligations. See section 29 KWG.

With respect to non-routine reporting and information requests, BaFin may investigate any action of Eurex Clearing within BaFin's jurisdiction. Specifically, BaFin may request information and pursue on-site audits and inspections at any time in accordance with section 44 *et seq.* KWG. Moreover, in order to enforce its inspection authority, BaFin is empowered to issue instructions to Eurex Clearing, and its appropriate Executive Board member, that are appropriate and necessary to prevent breaches of regulatory provisions. See section 6(3) KWG.

In addition to the reports from Eurex Clearing, BaFin and Deutsche Bundesbank have authority over Eurex Clearing's clearing members and may obtain information and reports directly from them as well.

In addition, Eurex Clearing has an obligation under the German anti-money laundering law to notify appropriate law enforcement authorities of transactions that may constitute money laundering.

#### **As applied to Eurex Clearing:**

Eurex Clearing has constructed the necessary systems to comply with the above BaFin and Bundesbank reporting requirements. The processes for the frequent, routine reports, such as calculation of proprietary capital are largely automated. Other reports, such as an annual report that includes a report by management, because of their nature, are not automated.

Reports under section 9(1)3 WpHG, of all securities and derivatives transactions executed on the regulated market to which Eurex Clearing acts as CCP are made via an automated reporting tool pursuant to section 9(2) WpHG.

Eurex Clearing stands ready to provide any information requested by BaFin or Bundesbank on a non-routine basis. Moreover, as discussed in the section on information sharing, Eurex Clearing is authorized by Part 10 of its Clearing Conditions to provide information in response to requests from foreign regulators, such as the CFTC, SEC and FSA and from self-regulatory organizations and exchanges.

Eurex Clearing's compliance with the various reporting requirements is the subject of internal audit/compliance as well as verification of compliance by outside auditors.

***Core Principle K: RECORDKEEPING—The applicant shall maintain records of all activities related to the business of the applicant as a derivatives clearing organization in a form and manner acceptable to the Commission for a period of 5 years.***

**In addressing Core Principle K, applicants and registered derivatives clearing organizations may describe or otherwise document:**

1. The different activities related to the entity as a clearing organization for which it must maintain records; and

2. How the entity would satisfy the performance standards of Commission regulation 1.31 (17 CFR 1.31), reserved in this part 39 and applicable to derivatives clearing organizations, including:

a. What “full” or “complete” would encompass with respect to each type of book or record that would be maintained;

b. The form and manner in which books or records would be compiled and maintained with respect to each type of activity for which such books or records would be kept;

c. Confirmation that books and records would be open to inspection by any representative of the Commission or of the U.S. Department of Justice;

d. How long books and records would be readily available and how they would be made readily available during the first two years; and

e. How long books and records would be maintained (and confirmation that, in any event, they would be maintained for at least five years).

### **Corresponding German Requirements:**

There are a number of German statutory requirements that require the keeping of books and records relating to the clearing operations of Eurex Clearing and to its business operations. Most significantly, section 25a(1)3 KWG provides that a licensed institution (i.e., CCPs) must “ensure that the records of executed business transactions permit full and unbroken supervision” by BaFin. That section further provides that the requisite records must be retained for six years. It further explicitly preserves the applicability of section 257(3) and (5) of the German Commercial Code (“HGB”).

The retention of the provisions of the HGB is significant because the HGB and German General Fiscal Law (*Abgabenordnung*, "AO"), which also applies, provide additional, explicit requirements with respect to the audit trail/recordkeeping requirements. Section 257 HGB provides that Eurex Clearing has the duty to keep business books, inventories, and annual financial statements at least ten years and business letters at least six years.

These Acts also apply specifically with respect to electronic recordkeeping systems. These Acts require the keeping of clear and complete audit trails of all uses of information technology systems and to reconcile (where appropriate) the audit trails with equivalent information held by system users and other interested parties. These principles are included within German generally accepted accounting principles. In order to comply with these accounting principles, the IT based records system must ensure the following functionalities:

- documentation of the originating records,
- journal function (complete recording of transactions), and
- accounting function (logical recording of accounting records).

#### **As applied to Eurex Clearing:**

Eurex Clearing's business practices, procedures and rules in this regard are compliant with the relevant German legislative provisions. Compliance is audited regularly by Eurex Clearing's external auditors. Furthermore, Eurex Clearing has in force written policies defining the key legal requirements in force regarding the retention of documents, appended as Attachment 14 .

Electronically generated documents which constitute evidence of customer transactions, including the complete audit trail of transactions and a complete post execution history of positions are subject to this policy unless the data is stored in another safe way (section 3.2 of the Policy on Retention of Documents).

Section 3.4 of the Policy on Retention of Documents provides that documents or information may be kept in micrographs or on IT supported media provided that the reproduction or recording of the original document or information at the origin of the recording is faithful, long lasting, readable and reproducible. The types of information and details of transactions which are recorded include daily positions, margins and deliveries of the Clearing Member.

***Core Principle L: PUBLIC INFORMATION—The applicant shall make information concerning the rules and operating procedures governing the clearing and settlement systems (including default procedures) available to market participants.***

In addressing Core Principle L, applicants and registered derivatives clearing organizations may describe or otherwise document:

Disclosure of information regarding rules and operating procedures governing clearing and settlement systems:

a. Which rules and operating procedures governing clearing and settlement systems should be disclosed to the public, to whom they would be disclosed, and how they would be disclosed;

b. What other information would be available regarding the operation, purpose and effect of the clearing organization's rules;

c. How members/participants may become familiar with such procedures before participating in operations; and

d. How members/participants will be informed of their specific rights and obligations preceding a default and upon a default, and of the specific rights, options and obligations of the clearing organization preceding and upon the member's/participant's default.

### **Corresponding German Requirements:**

Section 24b KWG provides that an institution that operates as a system within the Directive on Settlement Finality must “provide information on the systems . . . in which it is involved and on the basic rules governing their mode of operation to all parties which can demonstrate that they have a legitimate interest in the matter.”

### **As applied to Eurex Clearing:**

As noted above, Eurex Clearing acts as a " Designated Payment & Security Settlement System" under the SFD and has been notified as such to the European Commission by Bundesbank. Accordingly, section 24b KWG requires Eurex Clearing to provide information on the systems and the rules governing the CCP's mode of operation.

Eurex Clearing's clearing conditions are found in both German and English on its website. The English version is found at: [http://www.eurexchange.com/documents/regulations/clearing\\_conditions\\_en.html](http://www.eurexchange.com/documents/regulations/clearing_conditions_en.html). Also included in the website are clearing circulars, found at: [http://www.eurexchange.com/documents/clearing\\_circulars\\_en.html](http://www.eurexchange.com/documents/clearing_circulars_en.html); and a number of plain language guides and other publications explaining the operation, purpose and effect of the clearing organization rules, procedures and operations. These include a general guide to the CCP operations, a guide to the risk-based margining system, a guide to business continuity and other helpful and informative publications. These can be found at: [http://www.eurexchange.com/documents/publications/clearing\\_en.html](http://www.eurexchange.com/documents/publications/clearing_en.html).

In addition, management also communicates directly with Clearing Members with respect to their specific rights and obligations through Circulars, Advisories and other notices.

***Core Principle M: INFORMATION SHARING—The applicant shall (i) enter into and abide by the terms of all appropriate and applicable domestic and international information-sharing agreements; and (ii) use relevant information obtained from the agreements in carrying out the clearing organization's risk management program.***

In addressing Core Principle M, applicants and registered derivatives clearing organizations may describe or otherwise document:

1. Applicable appropriate domestic and international information-sharing agreements and arrangements including the different types of domestic and international information-sharing arrangements, both formal and informal, which the clearing organization views as appropriate and applicable to its operations.

2. How information obtained from information-sharing arrangements would be used to carry out risk management and surveillance programs:

a. How information obtained from any information-sharing arrangements would be used to further the objectives of the clearing organization's risk management program and any of its surveillance programs including financial surveillance and continuing eligibility of its members/participants;

b. How accurate information is expected to be obtained and the mechanisms or procedures which would make timely use and application of all information; and

c. The types of information expected to be shared and how that information would be shared.

### **Corresponding German Requirements:**

There is no requirement in German law or BaFin administrative provisions requiring that CCPs enter into information sharing arrangements with their counterparts. However, there is a clear mechanism for the exchange of CCP data using regulator-to-regulator information sharing arrangements. Moreover, the Clearing Conditions also provide that Eurex Clearing is authorized to share information as provided in the Clearing Conditions with responsible domestic or foreign supervisory authorities that are subject to confidentiality requirements with respect to such information.<sup>34</sup>

Pursuant to the section 7 WpHG BaFin has the authority to cooperate with competent authorities of other countries in connection with the supervision of securities and derivatives markets, trading activity thereon, and in connection with their supervision of credit institutions and financial services institutions. As noted above, BaFin is a member of IOSCO, which promotes cooperation among more than 150 regulators of stock (and derivatives) exchanges all over the world.

BaFin and its predecessor, the BAWe, have entered into memoranda of understanding ("MOUs") as well as various other information-sharing arrangements with the Commission. Moreover, BaFin is a signatory to the May 2002, IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the

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<sup>34</sup> See footnote 36, *infra*.

Exchange of Information.<sup>35</sup> BaFin, as a member of Forum of European Securities Commissions, entered into a Multilateral Memorandum of Understanding on the Exchange of Information and Surveillance Activities (the "FESCO MOU") that provides for sharing of certain market surveillance data among FESCO members, including as to the ultimate customer in a transaction.<sup>36</sup> BaFin and its predecessor, the BAWe, have also entered into bilateral MOUs with regulators in Argentina, Australia, Brazil, China, the Czech Republic, France, Hong Kong, Hungary, Italy, Japan, Poland, Portugal, Russia, Singapore, Spain, Switzerland, Taiwan and, as noted above, the United States.<sup>37</sup>

### **As applied to Eurex Clearing:**

Although BaFin does not require CCPs to enter into information sharing agreements, Eurex Clearing's clearing conditions require clearing members to provide Eurex Clearing with information as requested. The Clearing Conditions also provide that Eurex Clearing is authorized to share information as provided in the Clearing Conditions with responsible supervisory authorities that are subject to confidentiality requirements with respect to such information.<sup>38</sup> See Chapter I, section 10.1(1) Clearing Conditions. Eurex Clearing may, under this authority, provide requested information the release of which is authorized by its rules directly to a foreign regulatory authority, like the Commission.<sup>39</sup> Based on this authority, Eurex Clearing confirms that it is willing and able

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<sup>35</sup> <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf> . This is an agreement among the signatories, which as noted above includes BaFin, to share information relating to enforcement investigations on an equal basis with all other signatories.

<sup>36</sup> The functions of the Forum of European Securities Commissions have since been assumed by the Committee of European Securities Regulators. The multilateral MOU remains in effect.

<sup>37</sup> In addition, Eurex's Trading Surveillance Office is authorized under the German Exchange Act to obtain information directly from, and share information directly with, similar trading surveillance offices of other exchanges or regulators outside of Germany. Eurex may also request that the BaFin obtain information from other regulators pursuant to the arrangements described above, as necessary.

<sup>38</sup> Part 10 Section 10.1 of the Clearing Conditions of Eurex Clearing reads as follows:

- (1) Eurex Clearing AG treats all data and information which relate to its Clearing Members, Non-Clearing Members and Link Clearing Houses confidentially. Eurex Clearing AG shall be authorized – within the provisions it is subject to - to transfer data and information to responsible supervisory authorities or other authorized third parties domestic or abroad which are subject to non-disclosure regulations comparable to those of Eurex Clearing AG.

Customer-related informations may only be passed on by Eurex Clearing AG if they are already publicly available or if they are legally required or if the Clearing Member, Non-Clearing Member or the Link Clearing House has agreed to it.

<sup>39</sup> Although such requests and responses may be made directly between Eurex Clearing and a foreign regulatory authority, as a matter of comity, Eurex Clearing would inform its home country regulators of such a request from the Commission and of its intended response.

to cooperate through information sharing and other means with the Commission in its role as a Multilateral Clearing Organization in relation to its clearing operations.

More importantly, BaFin has entered into information sharing arrangements with other regulators. BaFin is a signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (“IOSCO MMOU”). Paragraph 10(a)(ii) of the the IOSCO MMOU provides that signatories will share information as requested with respect to possible violations of regulatory requirements concerning “markets, exchange, and clearing and settlement entities.” As part of the IOSCO MMOU, signatories in Paragraph 6(b) represent that, “no domestic secrecy or blocking law or regulation should prevent the collection or provision of the information set forth in 7(b) to the Requesting Authority.”

BaFin is also an adherent to the [Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations](#) (“Boca Declaration”). BaFin’s predecessor agency, BaWE, was a signatory to the Boca Declaration, signing the agreement on October 17, 1997. The Boca Declaration constitutes a multilateral mechanism for sharing information on a bilateral basis between the requesting and requested market authority consistent with their legal and contractual obligations. The document establishes a mechanism whereby the occurrence of certain agreed triggering events affecting an exchange member's financial resources or positions will prompt the sharing of information under the Boca Declaration. The trigger levels are designed to facilitate the identification of large exposures by firms that could have a potentially adverse effect on markets. Under the terms of the Boca Declaration, a signatory supervisory authority may request information if it becomes aware that any of the triggering events has occurred with respect to a member of an entity that it supervises. These include, among others:

- a large decrease in Owner’s Equity in any six month period.
- a Member’s cumulative net Variation Payments over ten consecutive business days for proprietary and non-customer positions which are unusually large in relation to the Member’s Owner’s Equity;
- a Member’s cumulative net Variation Payments over six consecutive months for proprietary and non-customer positions are unusually large in relation to the Member’s Owner’s Equity;
- a Member’s net Variation Payments for customer positions for one business day which are of unusually large size in relation to the Member’s Owner’s Equity;
- total positions in a contract registered in a Member’s name which represent at least 50% of the total long or short positions in a contract with less than 100,000 open interest or 25% in contracts with greater than 100,000 open

interest; or the supervisory authority has a reasonable basis to believe that a Member, also subject to the jurisdiction of another Authority, or

- a Member’s customer or counterparty’s position may be having a price impact or may be engaging in abusive activity.

It is Eurex Clearing’s understanding that BaFin, as an adherent to the Boca Declaration, would provide information, if requested, pursuant to the terms of the Agreement, as discussed above, including information with respect to “clearing and settlement” by ECAG as an MCO. Eurex Clearing expects that its understanding would be confirmed in bi-lateral discussion between the Commission and BaFin.

Moreover, insofar as BaFin is the single point of contact for foreign supervisory authorities, BaFin would respond to inquiries from the Commission for information which may in the first instance have been developed by the Deutsche Bundesbank in its “current supervision” of ECAG. As discussed above, BaFin and Bundesbank cooperate very closely based on the Supervision Directive, including having access to each other files, establishing common files and sharing reports and other information. Accordingly, BaFin would be in a position to respond promptly to such requests for information from the Commission.<sup>40</sup>

As noted above, BaFin has also entered into bi-lateral and mutli-lateral information sharing agreements with other national supervisory authorities. Together, these agreements ensure that BaFin has the tools effectively and seamlessly to supervise ECAG’s operation as an MCO.<sup>41</sup>

Accordly, Eurex Clearing believes that it and BaFin and the CFTC have an established mechanism for the sharing of information which also would apply to Eurex Clearing’s operations as an MCO..

***Core Principle N: ANTITRUST CONSIDERATIONS—Unless appropriate to achieve the purposes of this Act, the derivatives clearing organization shall avoid (i) adopting any rule or taking any action that results in any unreasonable restraint of trade; or (ii) imposing any material anticompetitive burden on trading on the contract market.***

Pursuant to section 5b(c)(3) of the Act, a registered derivatives clearing organization or an entity seeking registration as a derivatives clearing organization may request that the Commission issue an order concerning whether a rule or practice of the organization is the least anticompetitive means of achieving the objectives, purposes, and policies of the Act. The Commission intends to apply section 15(b) of the Act to its

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<sup>40</sup> It should be noted that in responding to requests for information, BaFin will comply with Section 9 of the KWG, which requires employees of the supervisory authorities to maintain the confidentiality of information and to release it only as authorized by law. *Compare*, section 8(a) of the Commodity Exchange Act.

<sup>41</sup> For example, as a signatory to the FESCO MOU, BaFin can request or share information with other European regulators. In addition, BaFin, as the successor agency to BaWE, is an adherent to a bi-lateral information sharing arrangement with the U.S. S.E.C.

consideration of issues under this core principle in a manner consistent with that previously applied to contract markets

### **Corresponding German Requirements:**

The German Act against Restraints of Competition (Gesetz gegen Wettbewerbsbeschränkungen “GWB”) prohibits cartels, imposes controls on mergers and prohibits restraints of trade and other abuses of competition. It is administered and enforced by the Federal Cartel Office, or Bundeskartellamt. See <http://www.bundeskartellamt.de/wEnglisch/index.php>.

In addition, to the GWB, European-wide competition rules, which were included in the EC Treaty, prohibit cartels (Art. 81 EC) and restraints of trade and other abuses of competition (Art. 82 EC). The Federal Cartel Office, along with the competition authorities in the other member states, has been granted far-reaching authority to enforce the European-wide provisions if the anticompetitive or abusive practice is likely to affect trade between the Member States.<sup>42</sup> The different forms of abusive conduct prohibited by European law and by the GWB include exclusionary abuses and exploitative abuses. Exclusionary abuse includes denial of access and predatory pricing and exploitative abuses are restraints of trade with respect to customers or suppliers.

The Federal Cartel Office enforcement authorities include broad investigatory powers and the power to levy significant fines for violations.

### **As applied to Eurex Clearing:**

Eurex Clearing is subject to both the GWB as well as the European competition laws. Its practices and operations are in strict compliance with both.

## **V. Additional Considerations and Conclusions**

The Commission has considered several additional factors in its determination that a foreign regulator exercises appropriate standards, including its participation in IOSCO, its participation in information sharing agreements, and whether the regulatory framework has been the subject of World Bank or International Monetary Fund review.<sup>43</sup>

BaFin meets each of these additional considerations. BaFin is an active participant in IOSCO and other international fora, including FESCO, the Federation of European Securities Commissions. Moreover, BaFin’s predecessor agency, BaWe, was one of the original signatories to the Boca Declaration and Agreement on Information Sharing and BaFin is a signatory to the IOSCO Multi Lateral Memorandum of Understanding on Information Sharing. Finally, the German regulatory framework with respect to the

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<sup>42</sup> Generally, the European Commission is the competition authority at the European level.

<sup>43</sup>FSA/ICE order at 44707.

financial sector has been favorably reviewed by the IMF.<sup>44</sup> Moreover, the Commission has examined the adequacy and correspondence of the German regulatory framework to that administered by the Commission in granting Eurex Deutschland a no-action letter with respect to placement in the U.S. of its trading terminals<sup>45</sup> and its Order under Commission Rule 30.10.<sup>46</sup>

\* \* \* \* \*

Based upon the above, Eurex Clearing believes that the German Bundesanstalt für Finanzdienstleistungsaufsicht, the competent, primary regulatory and supervisory authority of Eurex Clearing meets appropriate standards within the meaning of section 409 FDICIA and the criteria that the Commission has applied in considering past section 409 orders, with respect to its regulation and supervision of Eurex Clearing, a Multi Lateral Clearing Organization. Eurex Clearing believes that the German legal and regulatory regime that applies to the licensing and oversight of CCPs and how those requirements have been applied to Eurex Clearing, in particular, demonstrates that Bundesanstalt für Finanzdienstleistungsaufsicht exercises its regulatory and supervisory authority according to appropriate standards, within the meaning of Section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991.

For the foregoing reasons, and as detailed in this request for an Order, Eurex Clearing respectively requests that the Commodity Futures Trading Commission issues an Order Pursuant to Section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991, recognizing that the standards by which Bundesanstalt für Finanzdienstleistungsaufsicht, regulates and supervises Eurex Clearing are appropriate and thereby permitting Eurex Clearing to operate as a Multi Lateral Clearing Organization in the United States for the purpose of clearing over-the-counter derivative instruments.

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Please direct any questions with respect to this Request to Paul M. Architzel, of Alston + Bird, LLP at (202) 756-3492 or to Dr. Ekkehard Jaskulla, Director, Section Markets and Regulatory of Eurex at +49-69-211-15133.

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<sup>44</sup> See Germany: Financial System Stability Assessment, IMF at : <http://www.imf.org/external/pubs/ft/scr/2003/cr03343.pdf>

<sup>45</sup> See, “Sections 5 and 5a—Eurex Deutschland; Request to Install Additional Electronic Trading Terminals in the U.S. and to List Certain New Contracts for Trading,” at [http://www.cftc.gov/tm/letters/99letters/tmeurex\\_no-action.htm](http://www.cftc.gov/tm/letters/99letters/tmeurex_no-action.htm)

<sup>46</sup> See, 30.10 Order Eurex Deutschland,” at: <http://www.cftc.gov/files/foia/fedreg02/foi020508a.pdf>