

**TESTIMONY OF THOMAS BOOK,  
MEMBER OF THE EXECUTIVE BOARD,  
ON BEHALF OF EUREX AND EUREX CLEARING  
BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES  
COMMITTEE ON AGRICULTURE  
February 4, 2009**

Chairman Peterson, Ranking Member Lucas, Members of the Committee, on behalf of Eurex Deutschland (“Eurex”) and Eurex Clearing AG (“Eurex Clearing”) I would like to express our appreciation for this opportunity to testify before you today and to thank the Committee for calling this hearing on this important piece of legislation, the “Derivatives Markets Transparency and Accountability Act of 2009.” My name is Thomas Book. I am a member of the Executive Board of Eurex as well as Eurex Clearing and have overall responsibility for management of Eurex Clearing. Eurex and Eurex Clearing are part of the Deutsche Börse Group.

Eurex and Eurex Clearing understand the importance of public confidence in the derivatives markets and support the Committee’s efforts to increase transparency and ensure appropriate regulation of these markets. As Reto Francioni, the Deutsche Börse Group CEO, emphasized last week at the Group’s annual New Year’s reception:

At Deutsche Börse . . . we have always seen it as an advantage – in terms of transparency and fairness – that we are subject to regulation and supervision . . . . Through the crisis, we have seen – and still see – that particularly where market organization was neither effectively and efficiently regulated . . . those cases were characterized by unfairness and opaqueness and resulted in extraordinary damages.

**Eurex and Eurex Clearing are key international exchange and clearing services providers**

As I testified previously before this Committee,<sup>1</sup> Eurex is one of the largest derivatives exchanges in the world today. Eurex is in fact the largest exchange for Euro-denominated futures and options contracts. While it is headquartered in Frankfurt, Germany, Eurex has 405 members located in 22 countries around the world, including 74 in the United States.

Eurex Clearing is one of the leading clearinghouses in the world and by far the largest European clearinghouse. Eurex Clearing acts as the central counterparty (“CCP”) for all Eurex transactions and guarantees fulfillment of all transactions in futures and options traded on Eurex, all transactions on other Deutsche Börse Group

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<sup>1</sup> To Review the Role of Credit Derivatives in the U.S. Economy: Hearing before the House Committee on Agriculture, 110<sup>th</sup> Cong, 2d sess. (December 8, 2008)(statement of Thomas Book, Member of the Executive Board, Eurex and Eurex Clearing).

exchanges and trading platforms, transactions on several independent exchanges, and transactions executed over-the-counter (“OTC”). Eurex Clearing is directly connected with a number of national and international central securities depositories, thereby simplifying the settlement processes of physical securities for its clearing members. As Europe’s largest and one of the world’s leading clearing houses, Eurex Clearing clears more than 2 billion transactions each year. Eurex Clearing has over 125 clearing members. It currently does not operate in the United States and has no U.S. clearing members,<sup>2</sup> although through its clearing members it does indirectly clear trades on behalf of Eurex’s U.S. members.

Eurex Clearing is highly experienced in offering fully automated and straight-through post trade services for derivatives, equities, repo, energy and fixed income transactions. Besides clearing transactions executed on exchange, Eurex Clearing also accepts, novates, nets and guarantees a broad range of derivatives transactions from the over-the-counter markets on the same basis that it clears exchange-traded contracts. Eurex Clearing’s OTC clearing business is growing and accounted for about 40% of the total cleared derivatives volume last year. As we discussed in our Testimony to this Committee last December, like a number of other major derivatives clearinghouses, Eurex Clearing is developing clearing services for the Credit Default Swaps market.

### **High Degree of Regulation Applies**

Eurex Clearing is required to be licensed as a CCP by the German Federal Financial Supervisory Authority (“BaFin”). In addition, on January 16, 2007, Eurex Clearing was recognized by the United Kingdom’s 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 is based on common principles and practices to those of the FSA.

As noted in our prior testimony to this Committee, the German Banking Act (“Banking Act”) provides the legal foundation for the supervision of banking business, financial services and the services of a CCP in Germany. The activity of credit and financial services institutions is restricted by the Banking Act’s qualitative and quantitative general provisions. These broad, general obligations are similar to the Core Principles of the Commodity Exchange Act which apply to U.S. Derivatives Clearing Organizations (“DCOs”). A fundamental principle of the Banking Act 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 depending on the nature of the institution and the type and scale of the financial services provided.

The Banking Act requires that a CCP 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. In addition, a CCP must have a proper business organization, an appropriate internal control system

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<sup>2</sup> However, a number of its members are European affiliates or parents of U.S. entities. In addition, Eurex Clearing has an agreement with The Clearing Corporation relating to the operation of a clearing link between Germany and the United States.

and adequate security precautions for the deployment of electronic data processing. Furthermore, the institution must ensure that the records of executed business transactions permit full and unbroken supervision by BaFin for its area of responsibility.

BaFin has the authority to take various sovereign measures in carrying out its supervisory responsibilities. Among other things, BaFin may issue orders to a CCP and its Executive Board to stop or prevent breaches of regulatory provisions or to prevent or overcome undesirable developments that could endanger the safety of the assets entrusted to the institution or that could impair the proper conduct of the CCP's banking or financial services business. BaFin may also impose sanctions to enforce compliance. BaFin has the authority to remove members of the Executive Board of an institution or, ultimately, to withdraw the institution's authorization to do business.

In addition, the German Federal Bank ("Deutsche Bundesbank") coordinates and cooperates, with BaFin, the primary regulator, in the supervision of Eurex Clearing. Deutsche Bundesbank plays an important role in virtually all areas of financial services and banking supervision, including the supervision of Eurex Clearing. Under the Banking Act, Deutsche Bundesbank exercises continuing supervision over such institutions, including evaluating auditors' reports, annual financial statements and other documents and auditing banking operations. Deutsche Bundesbank also assesses the adequacy of capital and risk management procedures and examines market risk models and systems. Deutsche Bundesbank adheres to the guidelines issued by BaFin. As appropriate, Deutsche Bundesbank also plays an important role in crisis management.

Both supervisory authorities use a risk-based approach to oversight, under which the supervisory authority must review the supervised institutions' risk management at least once a year to evaluate current and potential risks. In so doing, the supervisory authority takes into account the scale and importance of the risks for the supervised institution and the importance of the institution for the financial system. Institutions classified as of systemic importance, including Eurex Clearing, are subject to intensified supervision by both supervisory authorities.

### **The Derivatives Markets Transparency and Accountability Act of 2009**

As many have observed, the derivatives markets, both exchange-traded and OTC, are global in nature. Accordingly, Eurex and Eurex Clearing have a critical interest in, and potentially will be affected by, this Committee's deliberations. Eurex and Eurex Clearing view the proposed Derivatives Markets Transparency and Accountability Act of 2009 (the "DMTAA") as an important piece of legislation which will increase oversight and transparency of the OTC and exchange-traded derivatives markets. We commend the Committee for taking the initiative to address some of the thorniest issues that confront the financial markets in this period of economic crisis and support the Committee's efforts to ensure that these markets are appropriately regulated. With that as background, I am pleased to provide specific comments on the draft DMTAA.

## **The DMTAA Appropriately Recognizes Global Markets**

Section 3 of DMTAA has three sub-sections. The first would establish conditions that the Commodity Futures Trading Commission (“Commission”) must apply in granting Foreign Boards of Trade (“FBOT”) permission to provide direct market access to their trade matching system from the U.S. for contracts that settle against any price of a U.S. registered entity. These conditions include providing transparency with respect to certain daily trading information relating to such contracts, providing similar position accountability or speculative position limits as the U.S. registered entity imposes and providing information to the Commission with respect to large trader information. Although Eurex has been granted permission to provide direct market access to its U.S. members,<sup>3</sup> it does not currently list any contracts which would be subject to the additional section 3 requirements. Nevertheless, if in the future Eurex determines to list such a contract and make it available by direct market access from the U.S., it would be subject to these conditions.

First, it should be noted that section 3 of the DMTAA builds upon the foundation of the current procedures for reviewing and considering requests by FBOTs to provide direct market access from the U.S.<sup>4</sup> Eurex strongly supports the current procedures. The current process is premised upon the underlying concept of “mutual recognition” of international regulatory frameworks. It is based upon two broad principles: 1) the conduct by the Commission of a thorough pre-admission due diligence review to ensure that the FBOT is a bona fide market subject to a comparable regulatory scheme, and 2) recognition that the home country regulator is responsible in the first instance for regulation and oversight of the operation of the foreign market.

This U.S. approach has been widely accepted internationally and with the application by foreign regulatory authorities of broadly similar procedures to permit direct market access by U.S. exchanges in their jurisdictions, provides an important base-line of international regulatory requirements which has been critical to the ability of both U.S. and foreign derivatives exchanges to operate global electronic trading systems. This has been accompanied by an increased level of consultation and cooperation between and among national regulators.

The pre-admission due diligence review conducted by the Commission is extensive and thorough. In permitting FBOTs to establish direct market access from the U.S., the Commission imposes conditions that the FBOT must fulfill.<sup>5</sup> The

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<sup>3</sup>See Letter of the Commodity Futures Trading Commission Division of Trading and Markets, dated August 10, 1999, at: [http://www.cftc.gov/tm/letters/99letters/tmeurex\\_no-action.htm](http://www.cftc.gov/tm/letters/99letters/tmeurex_no-action.htm)

<sup>4</sup>The Commission on November 2, 2006, adopted a formal policy statement with respect to the procedure to be used in reviewing and granting permission to FBOTs to provide direct market access to their trade matching engines from the U.S. “Boards of Trade Located Outside of the United States and No-action Relief from the Requirement to Become a Designated Contract Market or Derivatives Transaction Execution Facility, 71 *Fed. Reg.* 64443 (November 2, 2006) (“Commission Policy Statement”).

<sup>5</sup>These conditions include, among others, appointment by the FBOT of a U.S. agent for receipt of Commission communications, assent by the FBOT’s members operating under a No-action letter to the jurisdiction of the Commission and appointment of a U.S. agent to receive legal process, a number of requirements relating to maintenance and accessibility of original books and records and required

DMTAA builds upon this foundation, requiring that additional transparency, reporting and other requirements apply for direct market access by the foreign market with respect to contracts that settle to prices of a U.S. registered entity.

The DMTAA provides that where markets are linked through the use of one another's settlement prices, enhanced conditions for access will be applied. However, not all jurisdictions apply speculative position limits or position accountability rules in the same manner as U.S. markets. Markets may rely on other regulatory powers or authorities to fulfill their market surveillance obligations, especially for commodities that do not have limited deliverable supplies. Accordingly, we recommend that the DMTAA be modified to explicitly permit the Commission to accept comparable or alternative methods of market surveillance on the part of the FBOT or the foreign regulatory authority. In this regard, it should be noted that foreign markets or jurisdictions may collect information on large positions, but may do so only during the spot month or only during the period preceding contract expiration, or may not routinely aggregate such information across trading members' accounts. Such a framework should be understood nevertheless as being able to meet the conditions of section 3 of the DMTAA.

The second subsection of section 3 of the DMTAA provides that a Commission registrant shall not be found to have violated the Commodity Exchange Act ("Act") if the registrant believes the futures contract is traded on an authorized FBOT and the Commission has not found the FBOT to be in violation of the exchange-trading requirement of the Act. The third subsection provides that a contract executed on a FBOT will be enforceable even if the FBOT fails to comply with any provision of the Act. Eurex supports both of these provisions which will provide greater legal certainty with respect to trading on non-U.S. markets. This greater level of legal certainty is appropriate in the face of the increasing globalization of trading. Although Eurex endeavors to be in compliance at all times with all provisions of the Act that apply to it, the third subsection will provide all U.S. participants in a foreign market with greater certainty with respect to the enforceability and finality of the contracts which they trade.

### **The DMTAA will encourage clearing of OTC derivatives, including CDS**

Section 13 of the DMTAA seeks to bring greater transparency and accountability to the derivatives markets by requiring that OTC contracts, agreements and transactions in excluded commodities (mainly interest rates, equity indexes and other types of financial instruments) be cleared by: 1) a DCO registered by the CFTC; 2) by an SEC registered clearing agency; 3) by a banking institution subject to the supervision of the Federal Reserve System; or 4) by a clearing organization that is supervised by a foreign financial regulator that a U.S. financial regulator has

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reporting by the FBOT to the Commission of specified information both on a periodic and special request basis. FBOTs must also keep the Commission informed of any material changes to their operations and the home country regulations under which they operate and must stand ready to demonstrate compliance with the conditions of the No-action relief. Finally, the FBOT must notify the Commission ten days prior to listing new contracts for trading from its U.S. terminals and must request supplemental relief with respect to contracts subject to section 2(a)(1)(B) of the Commodity Exchange Act. *See e.g.* [http://www.cftc.gov/tm/letters/tmeurex\\_no-action.htm](http://www.cftc.gov/tm/letters/tmeurex_no-action.htm) at 14.

determined satisfies appropriate standards. This last category of approved clearing organization is a multi-lateral clearing organization (“MCO”) recognized under section 409 (b)(3) of the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”). Section 13 of the DMTAA further provides that OTC contracts, agreements or transactions in exempt commodities (mainly energy, precious metals and possibly emissions or carbon rights) would be required to be cleared through a CFTC-registered DCO.

Eurex Clearing strongly supports clearing of OTC transactions as a means of safeguarding market integrity and the stability of the financial systems. Eurex Clearing believes that clearing OTC derivatives provides undeniable benefits not only to the individual clearing participant but to the entire financial market as well by enhancing transparency, avoiding undue concentrations of risk positions, and providing a system to contain and reduce systemic failures. We firmly believe that the enhanced transparency of central counterparty clearing by a neutral clearinghouse would have alerted market participants to the risk of their positions at an earlier time, resulting in much smaller trading losses, and potentially avoiding some of the extraordinary mitigation efforts that have ensued.

To be sure, a derivatives clearinghouse is not a panacea, but, with regard to our current financial turmoil, clearing might in many instances have prevented entities from building unsustainable positions. The twin disciplines of marking positions to market and collecting collateral, or margin, are market mechanisms that are the very heart of the value of CCP clearing. These market mechanisms are very efficient at discouraging the build-up of unaffordable risk. Also, direct access to clearing services is, by its nature, limited to creditworthy institutions – the clearing members – who are willing and able to mutualize their counterparty risk. Because of this structure, exchange-traded derivatives or those that were traded OTC but subsequently submitted for CCP clearing, have not been an issue during the current market crises. Derivatives clearinghouses on both sides of the Atlantic have functioned well and, by doing so, have assured that CCP-cleared derivatives markets continue to provide their crucial risk shifting and price discovery functions.

CCP clearing has previously not been available for credit default swaps (“CDS”). Eurex Clearing is confident that CCP clearing of CDS will help ameliorate systemic risk for the financial markets by mitigating counterparty risk and by enhancing transparency regarding exposures, the sufficiency of risk coverage, operational weaknesses, and technical capacity shortfalls. Given the huge, widely held exposure in CDS contracts, robust clearinghouses are needed to act as the central counterparty to these trades.

As we detailed in our prior Testimony to this Committee, Eurex Clearing has been working with ISDA, Deriv/SERV, international banks and dealers, major buy-side firms and European public authorities to launch clearing services for Euro-denominated CDS by the end of this calendar quarter.

## **The DMTAA appropriately encourages competition among providers of OTC clearing services**

We note that one of the boldest provisions of the proposed bill is the requirement that all derivatives transactions, unless exempted by the Commission, be cleared. We further note that OTC contracts in excluded commodities could be cleared by a registered DCO, by a clearing house supervised by the SEC or the FED, or by an MCO supervised by a foreign regulator that has been recognized by a U.S. regulator as meeting appropriate standards (“Foreign Regulated MCO”).

Eurex supports DMTAA’s provision of permitting a number of clearing houses to offer clearing services for OTC contracts, agreements or transactions in excluded commodities. The alternative of mandating that only a single clearinghouse be licensed by an identified regulator to clear all OTC transactions world-wide would be contrary to the public interest. That type of mandated industry-wide monopoly or utility generally has reduced incentives to maximize efficiencies and innovation.

Accordingly, Eurex Clearing supports the approach adopted by DMTAA of permitting market participants to decide which clearinghouse to use from a number of possible clearing houses. Moreover, the DMTAA’s provision which would permit such clearinghouses to be supervised by one of several possible U.S. regulators or by a foreign regulator that has been found by a U.S. financial regulator to meet appropriate standards recognizes the high degree of competence of each of the U.S. financial regulators, and of many foreign regulators, to establish and enforce an appropriate level of supervision and oversight of the activities of the CCPs. In this regard, the DMTAA addresses possible issues of overlap and duplication among the several regulators by requiring consultation by the Commission with the other regulators and by sharing of information. Eurex commends this legislation for addressing these potential problems.

## **The DMTAA Should Permit Foreign Regulated MCOs to Clear Exempt Commodity Transactions**

Section 13 of the DMTAA would require that all CCPs for transactions with respect to OTC contracts, agreements or transactions on exempt commodities be registered with the Commission as a DCO. Although DMTAA may be premised on the assumption that the Commission should exercise oversight of CCP clearing of OTC transactions in which the underlying is a commodity and not a financial instrument, section 13(b) of the DMTAA unnecessarily restricts a Foreign Regulated MCO from acting as a CCP for such transactions. As currently drafted, the DCO requirement in the DMTAA seems to erect an unnecessary barrier to well-regulated foreign competition which may undermine the Act’s general promotion of competition to assure efficiency and encourage innovation.

Eurex Clearing currently does not operate in the United States but would like to consider offering clearing and other services here in the future with respect to OTC contracts, agreements and transactions on excluded commodities, and may also consider offering such services with respect to exempt commodities.

At the moment, Eurex Clearing is not registered with the CFTC. In this regard, Eurex Clearing notes that it is in discussions with staff of the Commission regarding applying for Commission recognition as a Foreign Regulated MCO. We further note that several non-U.S. clearinghouses previously have been so recognized. Of the currently recognized Foreign Regulated MCOs, all may act as CCPs for OTC contracts on exempt commodities.<sup>6</sup> Eurex Clearing strongly encourages the Committee to amend the DMTAA to include transaction clearing of OTC contracts on exempt commodities by a Foreign Regulated MCO so long as the Commission has approved the foreign regulator of the MCO as meeting appropriate standards.

This change would reflect the fact that the Commission, in administering the provisions of section 409 of FDICIA, has significant experience in reviewing the standards of foreign regulatory authorities to ensure that they are appropriate. In this regard, the Foreign Regulated MCO process is a form of mutual recognition which facilitates the operation in the U.S of foreign clearing organizations which the CFTC has found are subject to comparable regulation in jurisdictions with comparably rigorous regulation. Furthermore, the CFTC requires that adequate information-sharing agreements with the foreign regulator are in place.

In reviewing applications by a Foreign Regulated MCO for an Order under section 409 FDICIA, the Commission determines whether the foreign CCP is subject to oversight by its home country regulator comparable to that which the Commission requires of U.S. DCOs in meeting the Core Principles. Accordingly, the Commission reviews both applications for DCO registration as well as requests for an Order recognizing a Foreign Regulated MCO in relation to the standards established by the Core Principles for Derivatives Clearing Organizations.

For this reason, Eurex Clearing also supports the DMTAA provision that would require a Foreign Regulated MCO to comply with requirements similar to the requirements of section 5b and 5c of the Act and the DMTAA's addition of three new Core Principles relating to daily publication of pricing information, fitness standards and disclosure of operational information. Eurex Clearing already meets all existing and proposed Core Principles and believes that these are an appropriate requirement for any foreign CCP wishing to operate in the U.S. as a Foreign Regulated MCO.

### **DMTAA Provides a Useful Mechanism for Exempting Transactions from the Clearing Requirement**

Eurex Clearing firmly believes that central clearing services are the most suitable option effectively to mitigate counterparty risk and to improve market transparency. These are key elements in any effort toward a sustainable reduction in risk on a global scale and we support all voluntary efforts to increase the availability and use of CCP clearing for OTC transactions. In this vein, we applaud the Committee's recognition of the important role that derivatives clearinghouses provide in stabilizing the world's financial markets.

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<sup>6</sup> They are, ICE Clear Europe, MCO Order issued on August 31, 2008; NetThruPut, Order Issued February 27, 2006; and Nos Clearing Asa, Order issued January 11, 2002. At least two, NetThruPut and Nos Clearing act as CCPs for exempt commercial markets on exempt commodities.

As the DMTAA recognizes, not all OTC transactions will be suitable for CCP style clearing. Such transactions may nevertheless serve *bona fide* economic purposes. To address this reality, the DMTAA provides a mechanism whereby the Commission can exempt certain types of non-standardized transactions from the clearing requirement. The Commission's determination would be based upon several factors, including the degree of customization of the transaction, the frequency of such transactions, whether the contract serves a price discovery function and whether the parties have provided for the financial integrity of the agreement. Eurex Clearing believes that these factors are the correct criteria to consider in making a determination that a transaction or class of transactions should be exempt from the clearing requirement.

## **Conclusion**

Eurex Clearing supports the Committee in its efforts to encourage greater use of CCPs. We are ourselves working to secure the commitment by financial institutions to participate in the development of and to use the services of our CDS clearing offering.

Eurex Clearing understands the importance of public confidence in these markets and is committed to the utmost level of cooperation with the regulatory authorities in Europe and the U.S. We appreciate the opportunity to work with the U.S. regulatory authorities with respect to our plans to offer clearing services for CDS transactions.

Eurex Clearing also believes that the existing treatment of derivatives clearinghouses which envisions the possibility of more than one CCP offering its services to the OTC markets supervised by any one of the qualified financial regulators offers an appropriate, workable and sound legal and regulatory framework.

Eurex Clearing also notes that within the framework of the DMTAA, the possibility exists for CCPs that are regulated in their home countries comparably to the requirements of the Core Principles that apply to Derivatives Clearing Organizations to be able to offer their services in the United States as a multi-lateral clearing organization. We urge the Committee to permit Eurex Clearing (once its status has been recognized by the Commission) and the other MCOs that have already received recognition as such from the CFTC to clear OTC contracts, agreements and transactions not just on excluded commodities but also on exempt commodities. Eurex Clearing supports the application of the additional proposed Core Principles to Derivatives Clearing Organizations and to Foreign Regulated Multi-lateral Clearing Organizations.

In this spirit, I would like to share with you the same thoughts we have expressed to the European Commission. We have strongly supported the Internal Markets Commissioner Charlie McCreevey's call for action to improve market infrastructure for OTC clearing and in particular for credit default swap clearing. We believe that improvements in Europe are of common interest to all market participants because they will also contribute to market stability on a global scale. Furthermore, we believe that there should be an alignment of regulatory policy regarding OTC clearing, first across the Atlantic and then globally. We recognize that that will take

time to achieve and that the European regulators believe that decisive action may be appropriate now.

Finally, I note that this is the second time that I have testified before this Committee on behalf of Eurex and Eurex Clearing and we are deeply honored to have been invited back to present our views to this Committee. We very much appreciate the opportunity to discuss these critically important issues with the Committee. I am happy to answer your questions.