

September 2008

Buckle up!



Arne Theia, Head of Repo and Collateral Trading, Unicredit Market & Investment Banking

Swedish-born Nils Ivar Bohlin has saved hundreds of thousands of lives since the three-point seat belt he invented was first offered by Volvo in 1959.

In the late 1950s, almost every motorist drove without using a seat belt. There was a strong confidence in each's own driving skills as well as those of other drivers. However, traffic got more worse, cars became faster and more people died in car accidents. When Volvo CEO Gunnar Engelau lost a relative in a car crash, he recruited Bohlin to boost safety. Bohlin had developed ejection seats for Saab fighter aircraft.

But how should a seat belt for normal road cars look like? Bohlin found the right answers. Firstly, it must be safe. After working with the four-point harnesses of fighter pilots, he knew the limitations of lap belts. Secondly, practicality is important in order to be generally accepted by drivers. Within a year Bohlin engineered a simple solution that is the industry's most widely used life-saver: the three-point seat belt.

Buckle up! Every seven seconds a seat belt saves a live. Today nine out of ten motorists wearing safety belts. Since September 1, 2007, all new cars sold in the U.S. require a three-point belt on every seat.

At the same time the new law was introduced, the liquidity crises hit the financial markets. Banks became increasingly reluctant to lend unsecured money as they lost confidence in the "driving skills" of their counterparts. Since then the times of unsecured funding of collateral are gone. And they will never come back. It's too dangerous to drive along the liquidity road without a seat belt. Too many accidents have happened. Mortality rates are too high. The market is looking for additional protection and is calling for solutions.

How could the market boost safety? The answer is collateralized refinancing via Repo and Securities Lending. These products passed the stress test during the liquidity crises and continue to function without flaws. Hence volume moves from unsecured to secured trading.

Important is the quality of collateral and its liquidity in the secondary market. The standard "three-point seat belt" has become collateral eligible to the central banks. Some might feel secured enough with "lap and dash belts" like structured collateral. Bohlin would see a risk of "submarining" which is when a passenger slides forward under a seat belt.

CONTENT

Editorial

Buckle up! (1)

Voice of the Market

Interview with Steffen Jordan,
Trading and Capital Markets,
SEB, Frankfurt (2)

ETF Business and
Securities Lending – Two Fast
Growing Markets (4)

SecLend Inside

New Basket
in the Eurex SecLend Market (5)

Your Direct Line
to Eurex SecLend (5)

Events and Training

Upcoming Events and Training
from September
to December 2008 (6)

Airbags are increasing the probability of surviving a car crash by another 30 percent – if belted. Electronic trading platforms like Eurex are offering “Supplemental Restraint Systems” by increasing trading and settlement efficiency and reducing the probability of systemic fails.

Last but not least – know your driver! Would you allow your kids to get in a car without being sure that the driver holds a license? Relationship in the bilateral market is essential. A central counterpart reduces credit risk exposure severely.

Nils Bohlin died in 2002 at the age of 82. His three-point seat belt was awarded as one of the eight most important all-time inventions.

VOICE OF THE MARKET

Interview with Steffen Jordan, Trading and Capital Markets, SEB, Frankfurt

Mr. Jordan, you are a specialist in the securities finance field. Could you introduce yourself to our readers?



*Steffen Jordan,
Head of Securities
Finance Frankfurt, SEB*

I have been working in the securities finance industry for over ten years now. I started my career at BNP PARIBAS in Frankfurt. From there I moved on to Goldman Sachs and Dekabank, where I spent three years. This allowed me to experience the equity finance business from various angles (custody bank/prime broker/lender).

For two years, I have been working for SEB ENSKILDA, where I am head of the Securities Finance Desk in Frankfurt. We are responsible for trading stock loan, repos and all sorts of delta one (?) products on the equity side. Currently we are working on an expansion into collateral trading as well as the fixed income repo business.

Do you have any experience with electronic trading platforms? And how do you feel about electronic trading in general?

When electronic trading platforms initially started on the fixed income repo side, I gained my first experience by participating in these platforms. Over the last 5–6 years, electronic trading has started to tap into the equity lending business as well. There are a couple of vendors that have become established in the market and there is an increasing focus on these platforms. SEB is currently using two electronic platforms and is looking into further opportunities. The existing platforms can be divided into two groups: platforms that focus on automated straight through processing in order to make GC trading more efficient and reduce trader workloads and others that focus on pricing

information and more "classical" trading by providing quotes to the market. Both categories have their own merits and it will be interesting to follow the developments going forward. As liquidity is key to any platform, the increasing number of vendors in the market is a threat to that. So in the long run, we could see a certain concentration/aggregation process in this industry.

In your opinion, did the recent financial crisis have an impact on the securities lending market? And if so, what effect did it have?

Clearly there are huge impacts/effects that can be attributed to the recent market developments. The biggest ones I can see are in spread developments and liquidity. Credit risks are given far more attention than in previous years and we see more adequate pricing and differentiation within the asset universe. Liquidity is also heavily affected by decreasing credit limits as well as a more conservative approach towards collateral and financing in general.

As a result, the need of banks to have an efficient securities finance business, including collateral trading and refinancing, has increased massively.

Is the securities lending market already standardised or do you expect this to happen in the near future?

If you compare the equity lending market with the fixed income repo market we are still talking about a significant difference in terms of standardisation (the repo market is much more standardized). There are features of the equity lending business such as dividends, number of specials and volatility that make standardisation more difficult. Having said that, we have seen a certain trend towards harmonisation of the European GC business over the last few years, which should be a driver for a move towards electronic trading.

As a consequence, will the SLB market become continually more electronic and have to be traded via a central counterparty?

Increasing volumes on one side and the need for increasing efficiency on the other do lead to a higher importance of electronic trading and STP processing. On the other hand, the mentioned peculiarities of equity lending will slow down this process. In the next couple of years, I do not think there will be the same market penetration of electronic platforms for equities that we see in the fixed income business.

It should be a driver for the development and spread of equity platforms if the function of a central counterparty is available. Especially in the current environment, anything that helps to avoid counterparty risk has a lot of charm. And the increasing need for stable, noncallable, nonratable borrowings could help to push this as well.

SEB is joining Eurex SecLend very soon. Why did you choose this marketplace?

As we are already using Eurex on the fixed income side, joining the SecLend platform is a logical step for us. We are especially interested in the mentioned central counterparty function and are following this development very closely.

Mr. Jordan, thank you for taking the time to answer our questions.

Many thanks to you.

A Perspective of Timber Hill – *ETF Business and Securities Lending, Two Fast Growing Markets*

Timber Hill (Europe) AG, the Switzerland-based subsidiary of Interactive Brokers Group (Nasdaq: IBKR), specializes in equities and equity derivative products as a principal trader and/or market maker in 21 countries across Europe and Asia. In addition, the firm also executes orders on behalf of its affiliates within the Interactive Brokers Group of companies.

As a leading equity-focused market maker, we actively trade equity-based Exchange Traded Funds (ETFs) of all major ETF issuers. In order to support our active trading, we are both a borrower and lender for more than one hundred ETFs. Our ETF trading encompasses the major blue chip indexes and also extends to sector indexes that are spread over a broad geographical area. Our trading activities give rise to settlement needs to cover short positions and finance long positions. For that reason, our Securities Lending and Borrowing (SLB) desk plays a fundamental role in enhancing our ability to carry these positions.

With the majority of ETF issuers we have Authorized Participant (AP) agreements. The agreement allows us to be active in the primary market by granting us the capability to create and redeem ETF's. The basket of stocks (that is the ETF composition) is defined by the issuer and typically mirrors the composition of the underlying index. For an ETF to be created, an AP delivers the appropriate basket of stocks to the ETF issuer. In exchange the AP receives the ETF. Upon completion, the ETF can either be sold on the secondary market or be lent out. The redemption process is simply the reverse: the AP delivers the ETF and receives the underlying stocks.

Generally several factors are considered before the decision is made to create or redeem an ETF. Such factors may include fees payable to the issuer/agent, settlement costs, complexity of share deliveries, size constraints, applicable taxes and dividend treatment. Analyzing these factors helps explain why certain ETFs are tight or liquid in the SLB market and why this may change throughout the year.

Both the SLB and ETF business are fast-growing markets and it is our goal to contribute in these markets with our substantial knowledge and experience. Our membership with Eurex SecLend allows us to upload our ETF availability daily. This offers an opportunity for other Eurex SecLend participants to view our extensive ETF portfolio for their respective needs. One benefit of Eurex SecLend is that participants who wish to focus on ETFs can use the filter function to view ETF availability.

Due to our continuous development in automated trading, we are strongly focused on automating our SLB trading. While traditionally the effectiveness of SLB's function has been dependent upon the developed relationships amongst counterparties in that market, the advent of more automation is bringing about a more efficient, lower cost way to do business. Therefore, we value the importance of having the Eurex SecLend electronic platform for SLB due to the efficiency and transparency it creates. In connection with the current global markets, it is imperative to react quickly to global circumstances while dealing with other market participants. Eurex SecLend provides an ideal platform for speedy transactions, which leads to an efficient market for its participants. We see great promise in Eurex SecLend and it is our hope that more participants decide to join us in utilizing the platform, because with greater participation comes more liquidity, more efficiency and lower costs.

Should you have any questions or require further information, please feel free to contact Josef Kornmann at Timber Hill (Europe) AG, Zug/Switzerland. e-mail: jkornmann@interactivebrokers.ch.

New Basket in the Eurex SecLend Market

As of September 1, we are pleased to announce a new basket in the Eurex SecLend Market. This basket contains a wide range of ECB (European Central Bank) eligible euro-denominated securities.

The new basket is based on the following criteria:

Basket Description	European Economic Area Fixed Income GC Basket (EEA FI GC)
Symbol/ISIN	EEAFI / CH.000'826'492'8
Implementation per	September 1, 2008
Total Number of Eligible Securities	> 4,500
Basket Owner	Eurex Zürich AG
Credit Rating Standards	Minimum Rating: A- / A3 (The rating must correspond to at least one of the rating agencies Moody's, S&P or Fitch)
Currency	EUR
Minimum Issue Size	EUR 200 million
Place of Settlement	SIS SegalInterSettle/bilateral
Type of Assets	ECB eligible securities
Remarks	<ul style="list-style-type: none"> • For settlement and tax reasons, Italian, Spanish and Portuguese securities are not included in the new basket. • No haircuts will be applied to the basket. • The basket is also tradable in the Eurex Repo Swiss Franc Market.

The individual securities of the new EEA FI GC basket is published on the Eurex SecLend trading screen (go to menu and select Tools – Basket – Securities).

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Upcoming Events and Training from September to December 2008

	Place	Date
Repo & SecLend Bar	Vienna	September 9
Pre-Summit Repo & SecLend Bar	Luxembourg	September 30
Clearstream Summit	Luxembourg	October 1–2
Joint Repo & SecLend/Bonds Bar	Munich	October 23
Special Xmas Repo & SecLend Bar	Zurich	December 11
Further Eurex SecLend Training		on request



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