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For Immediate Release

AFME, ICMA and ISDA Publish Paper Analyzing the Impact of European Sovereigns' Collateral Policies

LONDON, December 19, 2011 – The Association for Financial Markets in Europe (AFME), the International Capital Market Association (ICMA) and the International Swaps and Derivatives Association, Inc. (ISDA) today announced the publication of a paper titled “*The Impact of Derivative Collateral Policies of European Sovereigns and Resulting Basel III Capital Issues.*”

The paper discusses and analyzes the impact of the collateral policies of European sovereigns. It identifies that such policies could significantly affect the liquidity and dynamics of the credit default swaps (CDS) market and create substantial additional bank liquidity requirements. The paper estimates European sovereign collateral policies may drive a significant percentage – approximately half - of the volume in the sovereign CDS market.

Adoption of two-way collateral agreements by European sovereigns would ameliorate all of the issues discussed in this paper and the Associations accordingly recommend that such a change in practice be given careful consideration.

As outlined in the paper, many sovereigns transact over-the-counter (OTC) derivatives on a regular basis (in addition, quasi-sovereign and para-statals are also frequent derivatives users). Nearly all of these entities do not post collateral on derivatives transactions, but their counterparties do post collateral to them. The use of such one-way collateral arrangements creates credit exposure in the banking system, in the form of credit valuation adjustments (CVAs), and significant liquidity issues for the dealer community.

Dealers routinely hedge the exposure arising from transactions with European sovereigns using CDS. In fact, under the current Basel III proposals the only way to reduce the CVA charge is to purchase single-name CDS. Preliminary estimates using data provided to AFME and ISDA by the “G14” group of dealers indicate that the notional amount of CDS required to hedge these dealers’ sovereign-related CVA would have been roughly \$70 billion as of March 2011. By comparison, the net CDS outstanding on the entire European sovereign market as reported to the DTCC was roughly \$143 billion. Such hedging may therefore account for as much as 50% of the open interest in CDS for the European sovereign community.

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The recently announced Short Selling regulation, which will be converted into technical standards by the European Securities Markets Authority (ESMA) permits European sovereign CDS to hedge

financial contracts. The Associations, respectfully, strongly recommend ESMA respect the clear intent of the Regulation, particularly as regards its identification of financial contracts as exposures that firms might legitimately hedge through CDS. The need for European sovereign CDS for hedging purposes is large and the inability of dealer firms to use European sovereign CDS in this context may create unhealthy concentrations of credit risk and reduce European sovereign access to the OTC derivatives marketplace.

Finally, the practice of not posting collateral creates an additional liquidity requirement for the banking system that runs to tens of billions of dollars. This liquidity need may constrain banks' ability to undertake other business at a time when capital is in high demand.

The research paper is available via the AFME, ICMA and ISDA websites.

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About AFME

AFME advocates stable, competitive and sustainable European financial markets that support economic growth and benefit society. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan- EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association). For more information please visit the AFME website, www.afme.eu.

About ICMA

The International Capital Market Association (ICMA) represents financial institutions active in the international capital market worldwide. ICMA's members are located in 50 countries, including all the world's main financial centres. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing the framework of rules governing market practice which facilitate the orderly functioning of the market. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants including regulatory authorities and governments.

www.icmagroup.org.

About ISDA

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA is one of the world's largest global financial trade associations, with over 825 member institutions from 57 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.