

Collateral Secured Instruments

Description and empirical analysis of the influence of COSI on the derivative environment in Switzerland.

Bachelor Thesis

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Executive Summary

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The importance nowadays regarding issuer's risks can be confirmed and therefore an increased sensitivity while investing in derivatives. Especially in those turbulent and changing times within the banking industry (i.e. financial crisis, Euro debt crisis, banking regulations), and after Lehman Brothers collapse in 2008, investors bring more than ever counterpart's solvency into question. Therefore SIX Group Ltd created in September 2009 a standardised Collateral Secured Instrument, better known as COSI, for the listed Swiss structured products market regarding minimization of the issuer's risk. Since then, COSI has grown in popularity and could play a fundamental role within the future finance sector (separate banking system). Its innovative function got acknowledged with several awards.

In the first part of this thesis a theoretical description is provided, quantifying *pro-rata shares of net realization proceeds*, collateral maintenance and *current value* pricing method. The reader should get a profound understanding of the mechanism and an overview of the process. Furthermore the influence of market and pricing risks on the fair value of the Collateral Secured Instruments is explained with an example of rising CDS-Spreads. In a second step statistical and empirical analysis is conducted in order to evaluate the influence of COSI. The statistical analysis includes listed products, turnovers, issuers, product categories, durations and ratios. For the empirical research an online survey for qualified investors and financial intermediaries has been implemented.

Although COSI total turnovers increased over 130% in the last two years, unfortunately the entire listed derivative market had a loss in revenue of approximately one third of its total turnovers. With nearly four percent, Collateral Secured Instruments only have a moderate influence. However Investment Products have been frequently secured through COSI in contrast to Leverage Products. Furthermore non-system-relevant issuers are the market leaders, system-relevant banks (too-big-to-fail) on the other hand have issued only a few Collateral Secured Instruments.

Finally Investor should bear in mind that market and pricing risks are not hedged through COSI. Especially undefined collateral realization proceeds costs can lead to significant losses.