

# Spotlight on: Corporate Bond Index Futures





# Introduction

The European Fixed Income Markets are in a state of fundamental change with investment banks and asset managers restructuring their businesses to meet new regulatory requirements. Furthermore, buy-side firms' investment approach is undergoing structural changes as passive products such as exchange-traded funds (ETFs) are gaining momentum.

Along with an extraordinary monetary policy, these changes are creating a need for alternative instruments for hedging and portfolio management in the European corporate bond market.

**Corporate Bond Index Futures –**  
manage your credit risk exposure  
of EURO STOXX 50<sup>®</sup> constituents

**A new asset class –**  
first listed futures on a European  
Corporate Bond index

# Corporate Bond Index Futures

Today, the corporate bond market plays a key role in facilitating economic growth, productivity and employment in Europe. This is reflected in the constant growth of outstanding corporate debt in the Eurozone. The recent strong inflows into bond ETFs come after the asset class emerged as the top-seller in 2016, with European-listed bond ETFs drawing in a net EUR 9.1 bn over 12 months. At the same time, European corporate bonds have benefited from the ECB's Corporate Sector Purchase program, including European non-financial bonds.

## EURO STOXX 50® Corporate Bond Index

STOXX launched the Corporate Bond Index in April 2016. It is based on the debt of the constituents of the benchmark EURO STOXX 50® index, and is the only index that tracks the performance of investment grade, EUR-denominated, corporate bonds of the EURO STOXX 50® constituents. Tailored index methodology, real-time calculation every minute and on independent data source guarantee quality of valuation services and improved market transparency.

## EURO STOXX 50® Corporate Bond Index Futures

With the EURO STOXX 50® Corporate Bond Index Futures, Eurex new corporate bond index future provides buy- and sell-side participants with a versatile hedging instrument to manage their credit risk exposure and replicates some of the exposure within their portfolios.

The Corporate Bond Index Future is a cash settled index future with a quarterly expiry and the unique advantages of an exchange traded, straight-through processed and centrally cleared product. As it has the structure of a standard Eurex index future, the new product can be easily added to existing infrastructure.

## Key benefits

### Futures alternative

An unrivalled trading and hedging alternative in the European corporate bond market, Corporate Bond Index Futures serve as a proxy for the debt of the EURO STOXX 50® constituents as alternative to existing benchmarks such as CDS.

### Optimized portfolio management

Reduce tracking risk as well as help generate leveraged access to corporate bond beta as a portfolio overlay.

### Operational efficiency

Improve daily operational procedures (e. g. cash bond settlement procedure).

### Supports the development of structured products

Offers banks that sell bespoke and structured products an efficient hedge.

### Spread trading opportunities

A liquid instrument to trade Eurozone corporate debt versus European sovereign debt or versus EURO STOXX 50® equity index futures. Exchange for Physicals (EFP) Services allow for the simultaneous purchase/sale of futures along with a sale/purchase of other futures contracts.

### Block Trade Services

In addition to the Central Limit Orderbook (CLOB), Corporate Bond Index Futures trades can also be agreed bilaterally, and subsequently registered via Eurex' T7 Entry Services. The minimum block trade threshold is 100 contracts (does not apply to EFP).



*With the introduction of Corporate Bond Index Futures, Eurex has a unique, exchange-traded offering for the corporate bond segment in Europe.*



Lee Bartholomew, Head of Fixed Income & FX Product R&D, Eurex

### Contract specifications

EURO STOXX® 50 Corporate Bond Index Futures	
Contract standard	EURO STOXX 50® Corporate Bond Index (price index, EUR), corporate bonds from companies that are constituent of the EURO STOXX 50® index at the time of rebalancing.
Product code	FCBI
Contract value	EUR 1,000 per index point (about EUR 100,000 in notional)
Price quotation / tick size / tick value	In points with two decimal places / 0.01 points = EUR 10
Contract months	The three nearest quarterly months of March, June, September and December cycle
Settlement	Cash settlement, payable on the first exchange day after following the expiration day
Last trading day	The third Friday of each maturity month if this is an exchange day at Eurex; otherwise the exchange day immediately preceding that day; close of trading in the maturing futures on the last trading day is 19:00 CET.
Final settlement day/expiration day	Final settlement day is the exchange day immediately following the last trading day.
Final settlement price	Based on EURO STOXX 50® Corporate Bond Index (price index, EUR) closing level on the last trading day
Daily settlement price	Determined from the volume weighted average of all transactions during the minute before 17:15 CET (reference point), provided that more than 5 trades are transacted within this period.
Trading hours	<b>Order book</b> 08:00 – 19:00 CET <b>Off-book</b> 08:00 – 19:00 CET (Eurex T7 Entry Services)
Market Making	09:00 – 17:15 CET
Block Trading	Allowed. Minimum Block Trade size: 100 lots

### Vendor codes

Underlying instrument							
Index	Currency	Index type	ISIN	Bloomberg	Reuters		
EURO STOXX 50® Corporate Bond Index	EUR	Price	DE000A0QZJL9	SX5BPI Index	.SX5BPI		
Eurex products							
Product name	Currency	Index type	ISIN	Bloomberg	Reuters	Product code	Product type
Future on EURO STOXX 50® Corporate Bond Index	EUR	Price	DE000A2GF978	CBIA Index	0#FCBI:	FCBI	FINX

# Corporate Bond Index Futures – a new asset class emerges

The first listed futures tracking Eurozone credit open up significant possibilities in a changing market.

An interview with Lee Bartholomew, Head of Fixed Income & FX Product R&D and Jan-Carl Plagge, Head of Applied Research at STOXX.



**Lee Bartholomew**  
Head of Fixed Income & FX  
Product R&D, Eurex



**Jan-Carl Plagge**  
Head of Applied Research,  
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The introduction this month of the Corporate Bond Index Futures on Eurex, the first listed futures covering the Eurozone's corporate bond market, creates a new asset class and novel possibilities in exchange-traded derivatives.

The futures track the performance of the EURO STOXX 50® Corporate Bond Index, made up of debt issued by the highly capitalized companies selected into the Eurozone's well-known blue-chip index EURO STOXX 50®. The contracts offer the security and transparency of a cash-settled, centrally cleared instrument at a time when demand for fixed income products is growing.

## A new solution in times of significant change

Record-low interest rates are driving demand for high-yielding corporate debt, prompting more issuers to come to the market. Trading volumes in European corporate bonds have further benefited from the European Central Bank's asset-purchasing program. At the same time, however, new European regulatory requirements have forced investment banks to re-evaluate their business model and focus their trading activities, which has led to reduced market liquidity.

All these changes are creating a need for new and efficient instruments to hedge and manage portfolios in the credit market, according to Lee Bartholomew, head of fixed income and foreign exchange product development at Eurex.

"European credit markets are undergoing significant change, and traders and investors are likely to welcome the advantages that having exchange-traded futures brings," said Bartholomew. "Additionally, the bond-index futures will benefit from their direct link to a well-established benchmark such as the EURO STOXX 50® Index."

## A blue-chip benchmark for Europe's credit market

The EURO STOXX 50® Corporate Bond Index includes investment-grade, euro-denominated bonds issued by EURO STOXX Index members and their subsidiaries. All eligible bonds must have a remaining maturity of at least 15 months and a minimum nominal amount outstanding of EUR 750 million, improving investability. Only fixed- and zero-coupon issues are included. Subordinated debt is excluded.

The index is weighted by market capitalization, and has a unique capping methodology to avoid concentration risk or bias: any constituent issuer is capped at 20%, while the weight of single industries is capped at a maximum of 40%.

"The Corporate Bond Index follows the rules-based and transparent philosophy that is common with all STOXX products," said Dr. Jan-Carl Plagge, Head of Applied Research at STOXX. "The index methodology aims at

offering investors access to the Eurozone corporate bond market while being very mindful towards issuer- and industry diversification.”

“A key edge of the EURO STOXX 50® Corporate Bond Index over individual bonds is the availability of real-time pricing,” Plagge added. The Corporate Bond Index is calculated based on by-the-minute continuously evaluated prices, which allows for high quality price determination of the index portfolio.

### **A hedging and trading alternative**

Eurex had corporate bond desks, portfolio managers, risk desks and traders of exchange-traded funds (ETFs) in mind when designing the new contracts. “With the EURO STOXX 50® Corporate Bond Index Futures, Eurex new corporate bond index future provides buy- and sell-side participants with a versatile hedging instrument to manage their credit risk exposure and replicates some of the exposure within their portfolios”, said Bartholomew.

“Through the Corporate Bond Index futures, money managers can gain exposure to a single basket of the region’s most liquid and representative bonds issued by blue-chip companies,” Bartholomew added, “eliminating the cost and heavy due diligence incurred in the selection of individual debt instruments.” The contracts also offer banks that sell bespoke and structured products an efficient hedge.

The Corporate Bond Index futures – which have a quarterly expiry – represent an alternative to existing benchmarks, i.e. credit default swaps (CDS), which carry an inherent counterparty risk and potentially larger tracking error relative to bond markets.

### **A plug-and-play product**

“The trading community appreciates that these are straight-through processed, cash-settled, standardized futures that match existing parameters for products such as the EURO STOXX 50® or German Bond futures,” said Lee Bartholomew.

The centrally cleared and cash-settled nature of the futures means there are no settlements or deliveries to be monitored and no daily closing prices to be checked as opposed to holding bonds.

“As they have the structure of a standard Eurex index future, the new products can be easily added to existing infrastructure,” Bartholomew added. “They do not require any additional effort, for example, from the back office.

### **A portfolio optimization tool**

Bartholomew points out that the futures are also a valuable trading instrument that gives leveraged access to generate alpha in the European credit market. This can be achieved via a portfolio overlay, making the addition or removal of bond exposures in portfolios a seamless process.

“Sharing a common structure means the EURO STOXX 50® Corporate Bond Index futures and their equity index equivalent can easily be combined to develop multi-asset strategies and portfolios,” Bartholomew said.

There are also unique opportunities in relative-value trading with the possibility to trade the yield spread between Eurozone corporate debt and futures on European Sovereign Debt. This is also supported by T7 Entry Services for block trading and EFP transactions on Eurex.

### **Further possibilities ahead**

While the EURO STOXX 50® Corporate Bond Index has a family of sub-indexes tracking maturity buckets, industries and credit ratings, Eurex is for the moment focusing on introducing futures on the main index and is set to extend the offering to other bond indices.

### **A milestone for change in fixed-income markets**

The introduction of a versatile trading and hedging vehicle for the Eurozone credit market is a positive development at a crucial time in the market’s supply-and-demand balance. New trading regulations that will come into force in 2018 are likely to tilt fixed income volumes further towards on-exchange transactions, complementing the market’s traditional reliance on over-the-counter liquidity.

Bartholomew draws a comparison to the evolution in the European fixed income periphery markets, and says the introduction of the Corporate Bond Index futures is a milestone that could transform the region’s credit market.

“Adoption of futures, generally speaking, brings direct benefits,” he said. “But also increasing use of derivatives can have a high impact. They can play a very big role in the development and stability of, as well as confidence in, fixed-income markets.”

# EURO STOXX 50<sup>®</sup> goes multi-asset

In the aftermath of the global financial crisis, and given ageing developed-markets demographics, more and more investors turned to fixed income securities as a source of stable returns. Additionally, bonds offer extensive diversification opportunities to broaden asset allocations.

With this in mind, in 2016 STOXX introduced the EURO STOXX 50<sup>®</sup> Corporate Bond Index, which tracks the performance of investment-grade, EUR-denominated debt issued by constituents of the EURO STOXX 50<sup>®</sup> Index, the undisputed flagship benchmark for Eurozone stocks. The purpose behind this first and unique concept was to bank on investors' familiarity around the EURO STOXX 50<sup>®</sup> – which had EUR 43 billion in financial instruments linked to it as of mid-2017 – as a stepping stone to build similar recognition for bonds analysis.

## **Bond index built on EURO STOXX 50<sup>®</sup> offers familiarity, easy analysis**

In using the same membership for the EURO STOXX 50<sup>®</sup> equity and credit indexes, two benefits emerge quickly. Firstly, investors are already acquainted with the issuing companies, their finances and strategies.

Secondly, the concept allows for a more analogous comparison between bonds and equities, with any performance differential attributable to the behavior of the asset class rather than of the issuer. Finally, by comparing debt and shares of same companies, investors can gain an additional perspective on the financial health of the businesses.

## **Efficient market representation**

The EURO STOXX 50<sup>®</sup> equity index has a well-balanced sector representation and covers about two thirds of the Eurozone's free-float equity market capitalization. Its bond counterpart gives exposure to a single basket of the region's most liquid and representative bonds issued by blue-chip companies, eliminating the cost incurred in the selection of individual debt instruments.

The same rigorous, rules-based methodology on which all STOXX equity indexes are based is also employed on the EURO STOXX 50<sup>®</sup> Corporate Bond Index. This makes it perfectly suited as underlying for financial products such as exchange-traded funds (ETFs), derivatives and structured products.

## **A selection methodology to ensure liquidity and investability**

The EURO STOXX 50<sup>®</sup> Corporate Bond Index comprises a universe of 250 to 300 bonds. All issues are strictly screened to ensure liquidity and investability, accounting for minimum maturity of 15 months and nominal amount outstanding of EUR 750 million. Only fixed and zero-coupon bonds are included.

The Corporate Bond Index combines the selection criteria for Eurozone equity benchmarks with the widely implemented principles of the European Federation of Financial Analysts Societies (EFFAS) for fixed income indexes.

STOXX derives continuously evaluated bond prices from Interactive Data Corp., a market leader and trusted name in corporate-bond data. Index calculations are performed every minute, providing a high degree of transparency, which is not the norm in the bond market due to large amounts being traded over the counter.

## **A way to fine-tune bonds strategies**

With the aim of boosting the capabilities of listed fixed income instruments, the EURO STOXX 50<sup>®</sup> Corporate Bond Index was expanded in 2017 into a family with sub-indexes tracking maturity buckets, industries and credit ratings.



The sub-indexes allow investors to more efficiently and accurately capture their fine-tuned views in European credit markets, helping match desired strategies (sector allocation, duration and credit quality) that can enhance returns. All sub-indexes comply with the same methodology and criteria of the parent index.

### **Stamp of quality in bond markets**

An increasing number of corporate bonds are moving to be negotiated on exchanges, and this will improve their status and transparency in the eyes of institutions. Ease of use and clear analysis in fixed-income markets are indispensable tools for managers seeking multi-asset portfolio diversification.

The EURO STOXX 50® Index is the Eurozone's most widely followed equity benchmark, and the reference index on which most of the derivatives traded in Europe are based on. This is a reflection of trust and endorsement by the financial community. With the EURO STOXX 50® Corporate Bond Index, STOXX aims to provide the same stamp of quality in bond markets.

- EURO STOXX 50® Corporate Bond 1–3, 3–5, 5–7 and 7+ index versions
- EURO STOXX 50® Corporate Bond Financials Index
- EURO STOXX 50® Corporate Bond Ex-Financials Index
- EURO STOXX 50® Corporate Bond Ex-Financials 1–3, 3–5, 5–7 and 7+ index versions
- EURO STOXX 50® Corporate Bond AAA–A Index

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