

Insideview

OTC Derivatives Clearing

INTERVIEW WITH THOMAS BOOK, EUREX FRANKFURT AG

As a consequence of the financial crisis, OTC clearing has become an important piece of the public policy discussion on how to improve the integrity of OTC derivatives markets. International clearing houses including Eurex Clearing are currently preparing to deliver OTC clearing solutions.

Please briefly explain the role of a Clearinghouse /Central Counterparty (CCP).

Clearing is the process after trading and before settlement of transactions. Basically, it delivers two key value propositions: operational efficiency with central trade management services and effective risk management to mitigate counterparty default risk. As a CCP, the clearinghouse takes over counterparty risk of every transaction and guarantees delivery. In exchange, clearing members have to collateralize open risk positions to protect the clearinghouse against adverse market movements, i.e. a CCP is comparable to an insurance model on a mutual basis.

What were challenges and issues for Clearinghouses in the crisis and what are the main lessons learned?

Over a long time, market integrity and stability has been taken for granted – this is obviously not the case. The crisis again highlighted the importance of sound market infrastructure. Latest with the event of a major market participant defaulting, a massive revaluation of counterparty risk took place and markets experienced exceptional volatility – all this challenged also the clearing value proposition. As a main lesson learned, clearinghouses have proven robust and resilient, risk management processes have worked smooth and effectively. On that background, CCP clearing is a key element to a sustainable reduction of systemic risk – to reduce the likelihood of a possible next crisis, or at least, to limit its negative consequences.

How will the markets benefit from centralized clearing in OTC products and how does your organization contribute to these benefits?

There is an on-going public policy discussion on how to improve market integrity as a consequence of the crisis. Central clearing is stan-



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dard for regulated markets so far, but given the fact that some 80% of notional value in the global derivatives market refer to OTC, one logic step is to expand the reach of CCP services also beyond listed derivatives. Centralized clearing delivers counterparty risk mitigation, reduces gross market exposure by multilateral netting and improves the transparency of open risk positions. Clearing members benefit by balance sheet relief and the efficient use of collateral. More important, the market as a whole benefits by reduced incentives to build-up unaffordable individual risk positions, negative spill-over effects on other market participants in case of a default are avoided. Overall, market integrity can be expected to be strengthened significantly. Over the last months, Eurex has developed a European OTC clearing solution for Credit Default Swaps – Eurex Credit Clear. Our solution is designed to support the commitment of major credit dealers to the EU Commission

to shift European CDS products from a bilateral to a multilateral market structure in clearing by the end of July. Today, we are running the simulation together with market participants and will launch Eurex Credit Clear aligned with the industry commitment.

Some market observers point out that the accumulation of OTC risk positions might lead to a new systemic risk, i.e. the potential collapse of a Clearinghouse. What is your response to this attitude?

We all just recently experienced the default of a major market participant with all its negative consequences. In contrast, clearinghouses managed this event well for the benefit of other clearing members. I think the message out of this experience is quite clear – rely on what has proven valid during times of crisis. In the end, market risks are best managed in a neutral and transparent environment with the collateralization of open positions. From my perspective, central clearing can contribute much to improve the risk management capabilities of financial markets in that sense.

Thank you for this interesting conversation.