

Derivatives Clearing: The Next Chapter

September 26, 2017

Executive Summary:

Despite strong headwinds, the global derivatives market is thriving. Regulations put in place following the financial crisis in 2008 have created a safer and more efficient market, with market participants now appreciative of and adapting to the evolving landscape. While interest rates and volatility remain staggeringly low, trading of futures and swaps is robust under the economic circumstances. But with much of the regulatory change behind us, it is time for dealers and investors alike to examine ways in which current practices can be made more efficient within this new market structure.

Reducing the amount of capital required to back derivatives trading is the key to higher profitability for banks and lower costs for investors. While on the surface this sounds like a systemically risky proposition, if banks and their derivative customers better optimize their swaps and futures holdings across clearinghouses, such that they can be better risk-managed and, in a default scenario, neutralized at a lower cost, this reduction in overall risk in the system justifies reducing the amount of capital required to back derivatives trading.

Based on conversations with major dealers and investors, this research examines where this optimization lies, what can realistically be achieved and the money that could be unlocked by moving the derivatives market to the next stage of its reform.

Methodology:

In the spring and summer of 2017, Greenwich Associates interviewed top-tier interest-rates derivatives dealers and clearing members to discuss derivatives market reform, including capital requirements and costs, portfolio margining and relevant regulatory efforts. In addition, 159 interest-rate derivatives users in Europe and 63 in the United States provided input during the Greenwich Associates 2016 European Fixed-Income and the 2017 North American Fixed-Income Studies. A quantitative analysis of derivatives-clearing-related charges and bank capital costs was also conducted utilizing Greenwich Associates primary research and other prominent industry studies, with the results validated by our study participants.

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