

Clearing is good for swaps, regulation is good for futures

March 17, 2015

The market has been talking about this since at least 2009: swaps clearing will reduce systemic risk and take most of the counterparty risk out of the swaps market. Yet despite this risk reduction, regulators still seem determined to make the swaps market either look like the futures market or migrate its volume over all together.



I'm over simplifying of course, but there's some truth to it. Over the past 6 months we've been conducting research examining both ideas: [the impact of clearing on systemic risk and the swaps market](#), and [the cost of trading futures as compared to comparable swaps](#). The pair of studies included over 100 interviews with investors and dealers as well as quite a bit of quantitative modeling via a very big spreadsheet. We found that investors believe the increased cost of clearing swaps is largely worth the benefits received and systemic risk has in fact been reduced, but even with those benefits in hand, futures do in fact provide considerable cost savings over swaps in many cases. So while investors will begin to put new risk on via futures rather than swaps over the next 12-18 months (not just swap futures, but futures), those taking this leap will be a subset of the market leaving the cleared swaps market robust albeit slightly smaller. In short, there is room for both products to thrive. The caveats behind these statements are long and nuanced.

The caveats are in fact what took up most of the page space of the research reports in question.

Understanding if futures have yet to take share from swaps, if futures should start to take share from swaps if clearinghouses are too-big-to-fail and if the cost to investors must pay to ensure safe clearinghouses requires much more than a yes or no answer. Investment strategy, tolerance for basis risk, holding period, FCM fees, running IM rates, turnover frequency and other related factors can all change the result of the analysis.

When it comes to derivatives regulation the devil is very much in the detail; a fact of life we've all grown to accept over the past few years. The conversations at [FIA's conference in Boca Raton](#) last week were about those details - skin-in-the-game, margin methodologies, product selection and more. I see this dive into the details as a sign of progress; no longer are we debating if clearing makes sense or if SEF trading must be via an RFQ of 1 or 5, but instead the nitty gritty of creating a market that will stand the test of time. With that, we leave you with our two new research papers that will hopefully help you understand the nitty gritty a bit more, and make up your own mind as to how the market will develop. As I've said many times in my research career, the numbers are what the numbers are.

Coalition Greenwich, a division of CRISIL, an S&P Global Company, is a leading global provider of strategic benchmarking, analytics and insights to the financial services industry.

We specialize in providing unique, high-value and actionable information to help our clients improve their business performance.

Our suite of analytics and insights encompass all key performance metrics and drivers: market share, revenue performance, client relationship share and quality, operational excellence, return on equity, behavioral drivers, and industry evolution.

About CRISIL

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better. It is majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics, and data to the capital and commodity markets worldwide.

CRISIL is India's foremost provider of ratings, data, research, analytics, and solutions with a strong record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights and efficient solutions to over 100,000 customers through businesses that operate from India, the U.S., the U.K., Argentina, Poland, China, Hong Kong, and Singapore.

For more information, visit www.crisil.com

Disclaimer and Copyright

This Document is prepared by Coalition Greenwich, which is a part of CRISIL Ltd, an S&P Global company. All rights reserved. This Document may contain analysis of commercial data relating to revenues, productivity and headcount of financial services organisations (together with any other commercial information set out in the Document). The Document may also include statements, estimates and projections with respect to the anticipated future performance of certain companies and as to the market for those companies' products and services.

The Document does not constitute (or purport to constitute) an accurate or complete representation of past or future activities of the businesses or companies considered in it but rather is designed to only highlight the trends. This Document is not (and does not purport to be) a comprehensive Document on the financial state of any business or company. The Document represents the views of Coalition Greenwich as on the date of the Document and Coalition Greenwich has no obligation to update or change it in the light of new or additional information or changed circumstances after submission of the Document.

This Document is not (and does not purport to be) a credit assessment or investment advice and should not form basis of any lending, investment or credit decision. This Document does not constitute nor form part of an offer or invitation to subscribe for, underwrite or purchase securities in any company. Nor should this

Document, or any part of it, form the basis to be relied upon in any way in connection with any contract relating to any securities. The Document is not an investment analysis or research and is not subject to regulatory or legal obligations on the production of, or content of, investment analysis or research.

The data in this Document may reflect the views reported to Coalition Greenwich by the research participants. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Coalition Greenwich compiles the data received, conducts statistical analysis and reviews for presentation purposes to produce the final results.

THE DOCUMENT IS COMPILED FROM SOURCES COALITION GREENWICH BELIEVES TO BE RELIABLE. COALITION GREENWICH DISCLAIMS ALL REPRESENTATIONS OR WARRANTIES, EXPRESSED OR IMPLIED, WITH RESPECT TO THIS DOCUMENT, INCLUDING AS TO THE VALIDITY, ACCURACY, REASONABLENESS OR COMPLETENESS OF THE INFORMATION, STATEMENTS, ASSESSMENTS, ESTIMATES AND PROJECTIONS, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE ARISING OUT OF THE USE OF ALL OR ANY OF THIS DOCUMENT. COALITION GREENWICH ACCEPTS NO LIABILITY WHATSOEVER FOR ANY DIRECT, INDIRECT OR CONSEQUENTIAL LOSS OR DAMAGE OF ANY KIND ARISING OUT OF THE USE OF ALL OR ANY OF THIS DOCUMENT.

Coalition Greenwich is a part of CRISIL Ltd, an S&P Global company. ©2024 CRISIL Ltd. All rights reserved.