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Central Counterparty Clearing and its impact on the market

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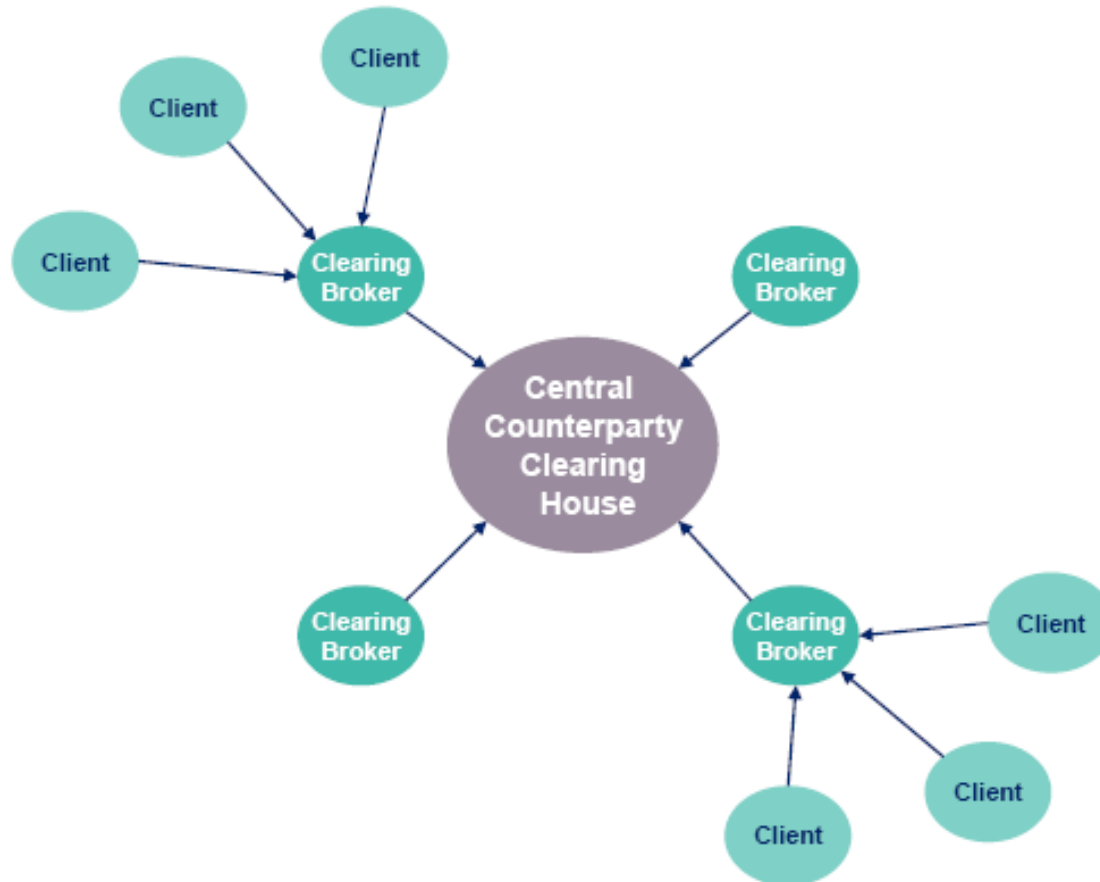
Market Structure Changes – Why?

- Lehman Brothers default – September 2008
- Regulators wanted to find ways to:
 - Reduce Systemic Risk
 - Expand OTC Market Transparency
- *"All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and **cleared through central counterparties** by end 2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."* – September 25, 2009, G20 Summit
- *US legislation (Dodd-Frank 2010) "**Requires central clearing** and exchange trading for derivatives that can be cleared and provides a role for both regulators and clearing houses to determine which contracts **must be cleared**."* – July 21, 2010
- **Regulatory Capital** will be lower for Cleared OTC trades

Market Structure Changes

- In addition to regulatory changes – the market for OTC derivatives have changed
 - Move from LIBOR to OIS discounting
 - CVA pricing of Derivatives
 - Focus on Collateral
 - Eligibility – Quality of collateral
 - Haircuts – Ensure value of collateral is sufficient
 - Concentration Limits – Diversity
 - Enforceability – Legally enforceable agreements

Impact on Banks



Clearing is not Exchange

- Clearing is Post Trade
- Credit Risk
- Default Management
- Margining
- Clearing Brokers
- Clients of Clearing Brokers

Options for Banks

- Become a direct Clearing Broker (not for everyone)
- Become a client of a Clearing Broker
- (Stop trading OTC derivatives)?

- Increased Regulatory Capital will be required – increased cost of doing business
- Use of Collateral will significantly increase
- Regulatory changes will impact banks outside G20 and US when dealing with counterparties that fall under these regulations (there is no escape)

Opportunities for first movers

- Monte Paschi “outsources” its IRD clearing to BarCap
- BarCap becomes principal for those trades on LCH
- What’s in it for BarCap?
- Who offers client clearing services in Russia?



MPS Capital Services Clears OTC Interest Rate Swaps On LCH.Clearnet's SwapClear Through Barclays Capital

- Transaction represents first major client to move to full scale clearing -
- Backloading of \$200 billion total notional value of OTC interest rate swaps already underway -

8 September 2010, SIENA, Italy; NEW YORK, USA; LONDON, UK – MPS Capital Services (MPS), a wholly owned subsidiary of Banca Monte dei Paschi di Siena S.p.A., Barclays Capital, the investment banking business of Barclays Bank plc, and LCH.Clearnet Ltd (LCH.Clearnet) today announced that MPS has signed an agreement to clear interest rate swaps on LCH.Clearnet's SwapClear service through Barclays Capital. The transaction represents the first major client clearing mandate for backloaded trades.

Barclays Capital is the primary clearing broker for MPS's interest rate swap transactions under an agreement that includes the backloading of a significant portion of MPS's historical interest rate swap transactions, a first for client clearing.

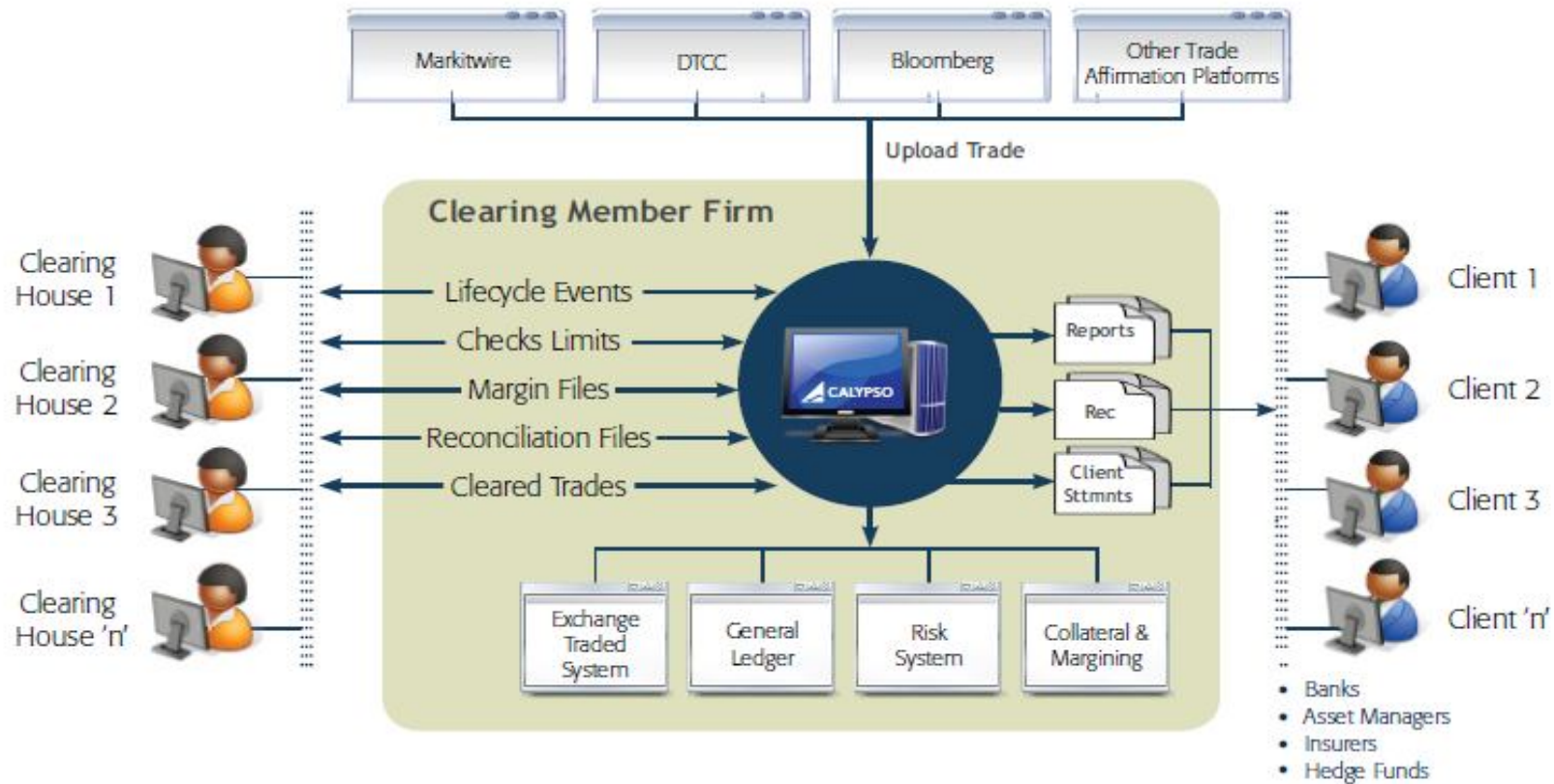
The total notional value of interest rate swaps to be backloaded is in excess of \$200 billion, with a material portion of that backloading already undertaken, including dollar, sterling and euro swaps with multiple counterparties.

"This agreement is an important step for MPS in developing a leadership position in OTC Derivatives. MPS is fully supportive of the expected EU regulatory reform towards central clearing," said Matteo Bertotti, Head of Fixed Income Derivatives at MPS Capital Services. "Barclays Capital has displayed a clear commitment, leadership and readiness to adapt to these new market developments. MPS was pleased to extend its long history of working with Barclays Capital through this transaction."

By backloading and clearing future interest rate swap transactions, MPS will benefit from reduced counterparty risk, potential capital relief, a more efficient collateral management process and lower overall operational risks.

"This is a clear milestone in the work to take the clearing of OTC interest rate swap transactions beyond the dealer-to-dealer level. OTC clearing represents a significant technology challenge for the industry and we are proud to be able to extend our leading position in clearing by being the first broker dealer to backload a substantial portfolio," said Ajay Nagpal, Head of Prime Services at Barclays Capital.

Case Study of Calypso Client



Direct clearing bank members are able to clear and process OTC derivatives for multiple clients (non clearing banks, asset managers, hedge funds, insurers etc) from multiple clearing houses

Case Study – Manage Client Activities

Real-Time Margin Management

	BMM	FXGap	FXGapMargin	RiskMargin	PositionMult	PositionMargin	CreditMultiplier	CreditMargin	VM	Totainmargin
CMF	3,371,481		3,371,481	6,742,963		0		0		5,170,326
House	502,748		502,748	1,005,495		0		0		862,033
House Account 01										
House Account 02	250,187	1	250,187	500,375	0	0	0	0	-3,757	496,618
House Account 03	88,002	1	88,002	176,003	0	0	0	0	-141,440	34,563
House Account 04	164,559	1	164,559	329,117	0	0	0	0	1,735	330,852
Client	2,868,734		2,868,734	5,737,468		0		0		4,308,292
Client 1	2,091,104		2,091,104	4,182,208		0		0		2,912,873
Client 1 Account 01	1,377,968	1	1,377,968	2,755,936	0	0	0	0	-1,123,789	1,632,148
Client 1 Account 02	56,087	1	56,087	112,174	0	0	0	0	1,139	113,313
Client 1 Account 03	430,796	1	430,796	861,591	0	0	0	0	-3,423	858,168
Client 1 Account 04	226,254	1	226,254	452,507	0	0	0	0	-143,262	309,245
Client 2	777,630		777,630	1,555,259		0		0		1,395,419
Client 2 Account 01	87,204	1	87,204	174,408	0	0	0	0	-155,613	18,795
Client 2 Account 02	209,879	1	209,879	419,759	0	0	0	0	-814	418,944
Client 2 Account 03	137,299	1	137,299	274,598	0	0	0	0	-975	273,623
Client 2 Account 04	343,247	1	343,247	686,495	0	0	0	0	-2,437	684,057

Real-time Margin Views across multiple CCP's

Monitor impact of new trades on margin requirements in real-time

Pre-configured account heirarchies - dramatically reduce set-up and implementation

	BMM	FXGap	FXGapMargin	RiskMargin	PositionMult	PositionMargin	CreditMultiplier	CreditMargin	VM	Totainmargin
CMF	3,441,599		3,441,599	6,883,198		0		0		5,312,079
House	502,748		502,748	1,005,495		0		0		862,033
House Account 01										
House Account 02	250,187	1	250,187	500,375	0	0	0	0	-3,757	496,618
House Account 03	88,002	1	88,002	176,003	0	0	0	0	-141,440	34,563
House Account 04	164,559	1	164,559	329,117	0	0	0	0	1,735	330,852
Client	2,938,851		2,938,851	5,877,703		0		0		4,350,614
Client 1	2,161,222		2,161,222	4,322,443		0		0		3,054,627
Client 1 Account 01	1,448,086	1	1,448,086	2,896,172	0	0	0	0	-1,122,270	1,773,902
Client 1 Account 02	56,087	1	56,087	112,174	0	0	0	0	1,139	113,313
Client 1 Account 03	430,796	1	430,796	861,591	0	0	0	0	-3,423	858,168
Client 1 Account 04	226,254	1	226,254	452,507	0	0	0	0	-143,262	309,245
Client 2	777,630		777,630	1,555,259		0		0		1,395,419
Client 2 Account 01	87,204	1	87,204	174,408	0	0	0	0	-155,613	18,795
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Margin Optimization – select ideal CCP's to reduce client capital requirements

Case Study – What Calypso offers

- **Connectivity** to Clearing platforms
- **Position Keeping** for house and client accounts
- **Margin Calculation** for independent verification and more granular margin allocation
- **What-if trade** incremental margin requirement
- **Reconciliation** with the Exchange reports
- **Life Cycle Events** (Resets, Terminations, Defaults, ..)
- **Collateral Management**
- **Client Statement** production for customers
- **Settlement and Accounting** of Margins
- **Reporting** for internal and regulatory

Any Questions?

- We are available after the conference as well to answer questions
- Contact us after the event
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