Why CCP?

The 2008 financial crisis and today’s European debt crisis highlight the vulnerability of the financial system. By assuming counterparty risk as a way to assure the obligations of cleared trades, Clearinghouses -- and their ability to manage risk -- play a crucial role.

New regulations, including the push for increased clearing of OTC instruments, and multi-asset trading are two factors increasing complexity -- especially in margining and default management - and driving the demand for more sophisticated post-trade risk management systems.

The alpha on plain vanilla products has been mined away, and only the fastest and nimblest are still capturing it. Firms are looking for other opportunities globally, especially in more complex product and asset class mixtures. Clearinghouses need data management and analytics capabilities that enable them to understand the risks associated with these new alternatives.

Clearinghouses that already handle diverse products are higher up the learning curve than those that are niche-oriented. Still, there is room for innovation in areas such as combining cash and futures positions to offset margin.

Risk Management

Risk Management’s main task is to maintain the integrity of the Clearinghouse, and that is only possible with an efficient and robust risk management solution.

Clearinghouses need sophisticated modeling and stress testing capabilities to analyze the size, nature, diversity and volatility of participating banks’ portfolios and to strike the right balance between margin and guarantee fund levels. The objective: a detailed and comprehensive statistical footprint of the market and its players.

Real-time information is critical, but the speed of “real-time” data updates can range from milliseconds to minutes. The definition of “real-time” has implications for the infrastructure.

Clearinghouses also need to aggregate data flow from various exchanges and liquidity pools. New, updated and historical data enables them to perform sophisticated risk calculations that determine margin levels and influence the degree of leverage and amount of capital that can be committed to positions. Computational power plays a role. Although clouds and multi-core servers are getting cheaper, getting the data to flow at the proper speed and in the right format can be complicated.

Also, to establish proper controls, Clearinghouses should define automatic limits according to their risk policy and promptly act on any breaches.

Default Management

Increased clearing of non standard instruments and sophisticated margin models that offer cross margin benefits means increased demands on default management policies.

Clearinghouses need robust system tools for handling incidents and defaults. They also must demonstrate that they have strategies in place to resolve default situations, including execution capacity, liquidity providers and member commitment.

As part of the default management process, Clearinghouses must also maintain a financial waterfall mechanism, including a member sponsored default fund to safeguard market stability should a member default.

Real-time risk monitoring

The Nordic clearinghouse, NASDAQ OMX Clearing, recognizes the importance of sophisticated risk management technology to safely and proactively protect the clearinghouse and its members from financial risk.

To increase risk policy automation and to calculate risk in real-time across a wide range of asset classes, NASDAQ OMX recently implemented significant enhancements to its Genium INET Clearing platform. It also integrated Sentinel Risk Manager from NASDAQ OMX to the enhanced solution. Now NASDAQ OMX Clearing has Europe’s first risk management system capable of integrating all asset classes and handling both OTC and exchange traded instruments. Managers can monitor risk in real-time using a browser-based dashboard, customize risk models and parameters for different types of asset classes and credit risks.

Sentinel Risk Manager’s integration enables the setting of limits and alarms so the risk management team is notified of any problems straightaway and can take immediate action. NASDAQ OMX Clearing runs Sentinel Risk Manager on a single server, so it is inexpensive and maintains a low footprint. Functionally, it addresses the enterprise risk needs of a clearinghouse and supports OTC clearing. Further, the solution was implemented in about six months.

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