Consensus Emerges on Derivatives Market Structure: BNY Mellon

By Editor Test *Wed, May 26, 2010*

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A surprising level of agreement exists among regulators and market participants on what the key components of a workable derivatives market structure should be, according to a survey conducted by BNY Mellon and the TABB Group.

For instance, nearly two-thirds of market participants say they have already implemented changes in advance of regulatory reform, with 79% expecting central clearing to become standard.

The report, "Derivatives-Protection without Suffocation: Thriving in a New Era of Regulatory and Market Transformation," found substantial consensus on a more efficient, transparent global framework that will feature, besides central clearing, electronic price discovery and execution and collateral management standards.

"While market participants and regulators are at odds over certain aspects of derivative market reform, our research detected a strong movement toward creating a workable framework that will accommodate stronger regulations and risk reduction without suffocating market activity and ongoing innovation," said Art Certosimo, senior executive vice president and CEO of Alternative and Broker-Dealer Services at BNY Mellon.

The reports findings, based on a survey of asset managers, broker-dealers and clearinghouses, include:

- 63% of survey respondents have already implemented changes ahead of regulatory reform, with these changes primarily focused in the areas of clearing, front-, middle- and back-office operations, and trading currently being implemented.
- 79% of respondents indicated that they believed central clearing for standard products will reduce systemic risk, while three-quarters acknowledged central clearing and execution will reduce profit margins.
- 58% of respondents currently do not post or accept collateral when conducting OTC derivatives trades. In addition, the majority of participants have concerns regarding potential changes in the types and amounts of collateral being used when moving from OTC to cleared environments.
- Nearly half (47%) of respondents see movement towards electronic execution for OTC derivatives products, with the use of algorithms to trade OTC derivatives just starting to emerge.
- 58% of respondents believe that joint oversight of the OTC derivatives market by the Securities and Exchange Commission and Commodity Futures Trading Commission would be a mistake, given their different approaches to oversight.

The report also indicates that while changes to the market will initially reduce revenue and profits for participants, revenue and profits will eventually increase as a result of standardization and higher volume.