

Recent Developments on the CDS Market for CESEE Sovereigns

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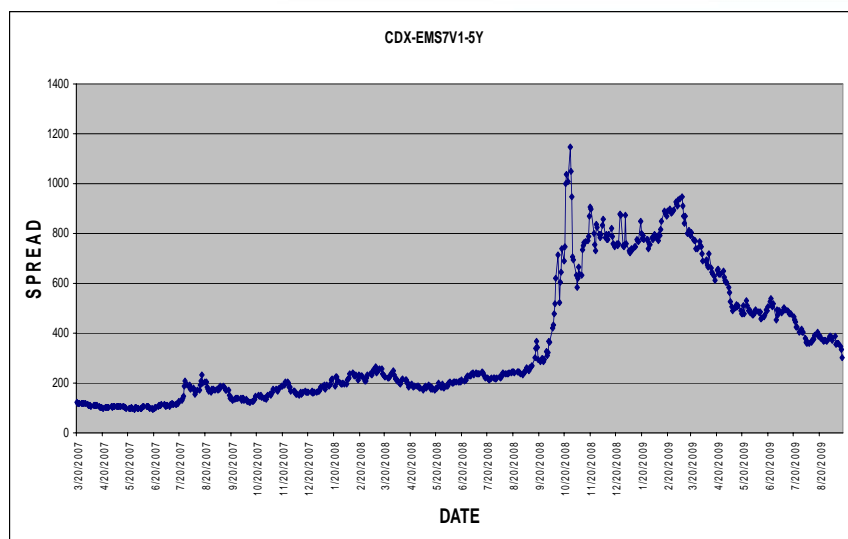
Summary

1. Abuse or missuse? – market development
 2. Efforts for standardization – steps for a sustainable market place
 3. Significant issues to be addressed
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1. Abuse or misuse? – market development...

- CDS entered the market as insurance products – very quickly turning in „the most fashionable investment product“
- Credit correlation added on randomness
- Spring 2007 – actually marked the start of the sell off with EM CDS markets breaking into fresh highs 1 year later
- During Lehman days everything went the wrong way:
 - Need to deleverage
 - Need to hedge
 - Need to EXIT – and as always the door was too narrow:
 - Correlations
 - CDS pricing
 - CDS legal aspects
 - As most of the markets lost liquidity – CDS turned in „the most fashionable hedge product“
- Underlying and counterparty risk contributing to the complete risk profile
- Bottom line: system gapped and, subsequently, temporarily stopped operating under tension

...and the EM world



2. Efforts for standardization – steps for a sustainable market place (part 1)

- December 2008 / January 2009
 - Novations have to be submitted electronically now (for example via DTCC)
 - March/April 2009 Big Bang protocol
 - Determination committee for credit events
 - Standardized auction settlement in case of credit event
 - June 2009
 - New market conventions introduced
 - Standard coupons for NA and Europe (25/100/500) upfront fee, full first coupon, recovery rate for calculation is set (40% on western Sov.)
 - Quarterly rolls for EEMEA (previously monthly)
 - Effective date 60 days backwards
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2. Efforts for standardization – steps for a sustainable market place (part 2)

- July 2009 Small Bang protocol
 - Auction settlement applied for restructuring credit event
 - September 2009
 - Standard coupons for EEMEA, (100/500) with upfront fee
 - Quarterly coupons (previously semi annual), full first coupon (EEMEA)
 - Fixed recovery rate, 25% (EEMEA)
 - The changes are designed to make CDS more standardized especially **to facilitate central clearing – CCP – key critical initiative**
 - Easily offset trades, due to equal cashflows and dv01.
 - T+0 matching
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CCP – a critical measure on the way forward

- Use of Central Counterparty for Credit Default Swaps (CDS):
Progress, in cooperation with international regulators, towards large-scale use of a central counterparty (CCP) for clearing of CDS.
 - CDS on indices are being centrally cleared on a massive scale in US and Europe.
 - CDS written on single names will follow progressively.
 - Market participants are continuing to assist the efforts of central clearing service providers, through dialogue and feedback on the technical challenges to establishing efficient, sound clearing houses.
 - Major CDS market makers are vocal about their commitment for a transparent functioning market:
 - Submit 95% of new eligible trades (calculated on a notional basis) for clearing beginning October 2009 on individual basis
 - Submit 80% of all eligible trades (calculated on a weighted average notional basis) beginning October 2009 on a collective basis
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3. Significant issues to be addressed

- Standardization (including legal domicile) and expansion of the “standard” universe
 - Eligibility of contracts for clearing
 - Regulatory capital incentives
 - Central data repository
 - Conditions to be met, market and regulatory support for CCP’s
 - Transparency
 - Collateral
 - Trade compression
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