

**28<sup>th</sup> June 2019**

# **6th Seminar on Enterprise Risk Management**

## **Systemic Risk Reduction in Counterparty Credit Risk in OTC Derivative Contracts: A Case Study**

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**“..Complete evaporation of Liquidity...”**  
**“...impossible to value certain assets fairly regardless of asset quality or credit rating”**



## **9<sup>th</sup> August 2007, BNP- On freezing 3 Investment funds**

- Liquidity : 0
- Valuation : Unknown
- EU credit markets tighten dramatically as Banks hesitate to lend to one another irrespective of collateral- Nobody wants to face a possibly defaulting counterparty even if backed up by 100% risk free collateral
- ECB had to immediately step in to lend

**“...But as long as the music is playing, you've got to get up and dance. We're still dancing,”**  
**-Chuck Prince, CEO Citi**



## **16<sup>th</sup> March 2008, Bear Stearns- Rescued by JP Morgan with a Credit Line from the US Federal Reserve**

- Unofficial “Bad Bank”: ‘Maiden Lane LLC’ containing non-performing assets –Nominal notional \$30 Bio
- Unwritten Tax payer support without Congressional approval
  - JP Morgan: First \$1 Bio loss,
  - Rest of losses, if any, is for the US Treasury- without Congressional approval
- Quantum of Tax payer support : Unknown

## **26<sup>th</sup> July 2008, Freddie & Fannie- Rescued by US Tax Payers ‘Blank Cheque’**

- US Congress Votes “unlimited” tax-payer money
- Quantum of Tax payer support utilized:
- US\$ 400 Billion
- Freddie and Fannie are still controlled by US Govt. in 2019today- even after 11 years!!!

# Last minute attempt to find a private sector buyer for Lehman Brothers



## Post Midnight, 14 September 2008, Federal Reserve , NY

-Scramble to trace out, value and track:

- Triparty repo positions, counterparties
- Derivative positions, counterparties
- CDO/Bonds positions-underlying/references
- CDS positions, underlying , counterparties
- Subsidiaries & Group entities: How many, & Which entities

Bank Bidders, Regulators Chaotic Due Diligence: Rummaging through multiple files, records, trade confirmations etc. multiple K-10 filings

## Socio-Political Situation: Catch 22

- Socialism on the wane
- Capitalism touted as “only” solution

## Technological Revolution

- IT/Internet Technologies
- Wider, more efficient access to Banking services
- Drastic reduction in Cost of Services
- Offshoring- Manufacturing & Services

## Economics-Challenging Times in many ways

- Convergence in Wages/PPP
- Free Trade: Impact of GATT/WTO
- Trade/Capital Imbalances: Deficit vs. Surplus Nations

## Regulatory Evolution

# Issue & Challenges

- Is there a problem with Economics as a Science?
- Do we understand Finance, at all?
- Can we manage complex Credit Societies?
- Tradeoff management: Growth vs. Risk

From Confidence prior to 2007 to Depression in 2008

# G20 Leaders Statement: The Pittsburgh Summit September 24-25, 2009, Pittsburgh



## Key Decisions

- Strengthen Prudential oversight,
- improving Risk Management,
- strengthening Transparency,
- promoting Market Integrity,
- protect Consumers, Depositors & Investors against abusive market practices,
- avoid Fragmentation of Markets,
- Avoid Protectionism, and
- Avoid Regulatory Arbitrage.

*Improving over-the-counter derivatives markets:* 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.



# India: Progress Card

- Trade Repository(TR)
- Central Clearing Counterparty(CCP)
- Legal Entity Identifier(LEI)
- Electronic Trading Platforms(ETPs)

# Future Developments



- Regulatory Enablement
  - ASTROID: Insurance Companies
- Non Cleared Derivatives
  - Valuation Agent
- Central Clearing Counterparty(CCP)
  - More Product coverage
  - Wider Participation- Clearing Member Str.
- Legal Entity Identifier(LEI)
  - Seeding and Inter-linkage of Statutory databases
- Electronic Trading Platforms(ETPs)
  - Wider Product coverage
  - Wider Participation- Clearing Member Str.