

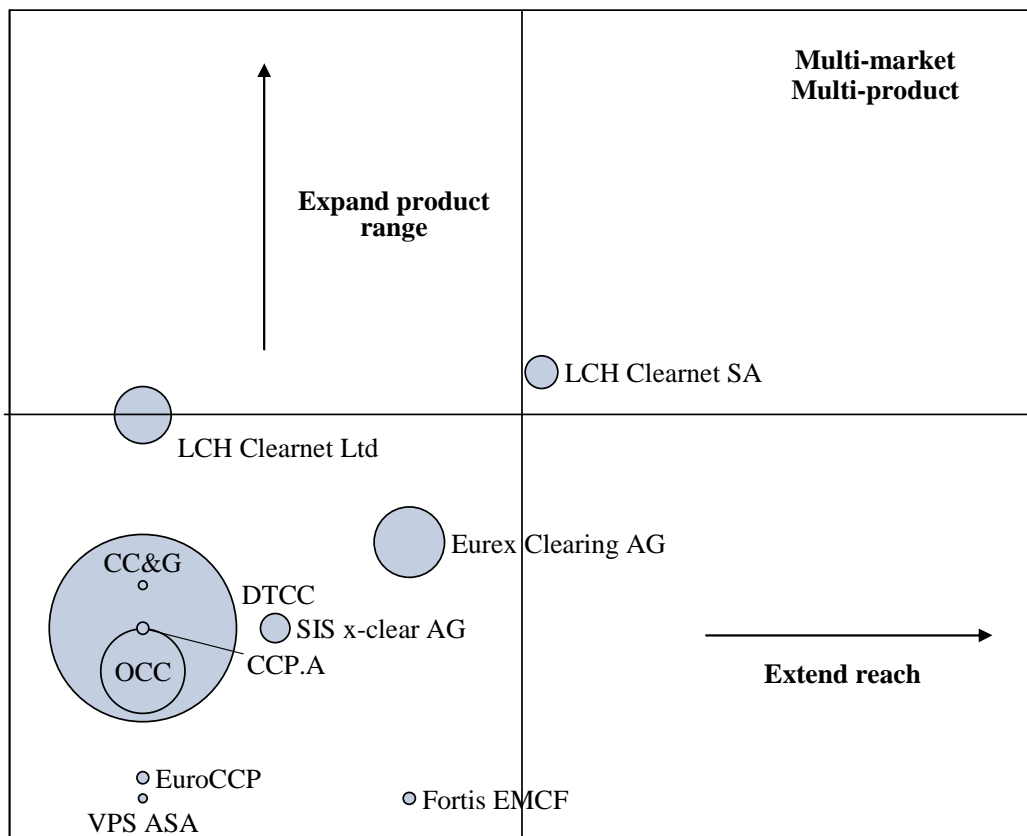
## The Next Move for CCPs

After years of languishing in the shadows of financial sector the recent global market turmoil has at last forced one of its most arcane businesses into the light. For those who have been aware of the potential of CCPs to radically reduce risk and improve efficiency in financial transactions this has come as no surprise. We at Cairneagle have been building market strategies involving CCPs for a number of years prior to the recent ‘credit crunch’ and realise that the logic for an extension of CCP activity was there before the market crash; the only difference is that now it has become overwhelming. Suddenly a large number of people are eying CCPs as a solution for the credit and risk issues so cruelly exposed in the last year. Many observers see a distant future of markets where CCPs are active in almost all transactions – mitigating risk and freeing up banks’ capital. We at Cairneagle are less concerned with long term prognostication, than we are with the immediate future. The challenge facing CCPs today is: ‘What is the next move?’

As Figure 1 demonstrates clearly, most CCPs have grown from single product – single market roots: they were the solution to a specific local problem. Some have remained true to the single product idea while others have added associated instruments to their clearing mix; options added to equities, energy to commodities, etc.

Figure 1: Product/Reach CCP profiles

### Product



*Note: Bubble size represents the number of transactions cleared as reported*

The main reasons for the relative conservativeness of many CCPs can be found in their single goal oriented beginnings and their shareholders/guarantors; the latter having been slow to extend their guarantee to new areas unless they have seen overwhelming need. However the reasons that the CCPs now find themselves in a relatively constrained position is less important than understanding how (and indeed whether) they should break out of their limited theatre of activity.

As Figure 1 demonstrates there are two potential strategic moves open to CCPs:

1. Expand the product range for the existing geographical base
2. Expand the markets covered with existing products

While these two strategies are not mutually exclusive they do require very different approaches and neither is suitable for every CCP. Key factors determining which of the two strategic approaches are right for your CCP include:

1. The level of saturation of CCP products in your home market
2. The size of the existing CCP membership
3. The willingness of existing guarantors to extend their guarantee pools
4. The ability to set up parallel guarantee pools
5. The size and sophistication of your home market
6. The legal and regulatory environment at home and abroad
7. Local and regional competition

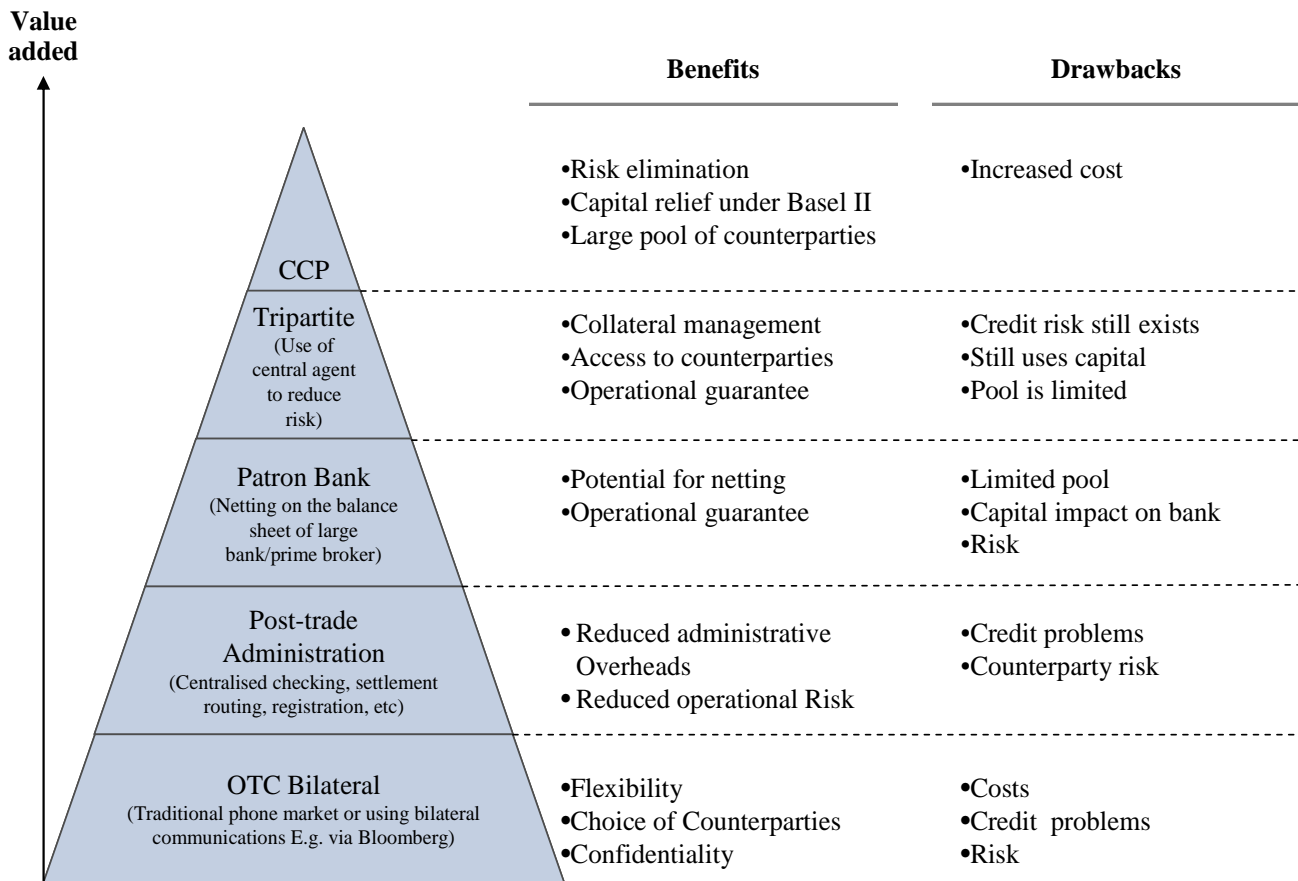
Even if the environment looks right for expansion of product or reach, the question of how to effect such changes emerges:

1. Is it best to operate a single guarantee pool or multiple pools?
2. What is the real opportunity for cross margining, rather than the theoretical opportunity?
3. What facilities are available for collateral management? Are they sophisticated enough to support expansion?
4. Which product areas are likely to be most fruitful?
5. Which of the increasing number of market operators should the CCP seek to work with?
6. Is geographical expansion best affected by partnership, acquisition or 'imperialism'?
7. Do existing risk mitigation tools provide an adequate basis for a future expanded role for the CCP?

Many challenges face CCPs in the new environment, not the least of which is the competitive challenge. Competing, acquisitive CCPs are already seeking to expand geographically so it is important that every CCP has a position on who might make the right partner. CCPs now have a financial value far more than was ever dreamed of by their founders and so the question must also emerge of how to realise or leverage that power for the benefit of the markets and the shareholders.

CCPs are not the answer to all problems in the industry; alternative post-trade structures (as shown in Figure 2) will continue to exist. However CCPs currently represent the acme of post trade management in terms of risk control and capital efficiency.

**Figure 2: Post-trade structures**



*Cairneagle Associates 2009, www.cairneagle.com*

Many operators of trading facilities (exchanges, MTFs, etc) are beginning to realise that without a partner CCP their ability to innovate in trading markets by bringing in new instruments like OTC derivatives, credit or energy, is very limited. We therefore expect that the trend for separation between CCPs and Exchanges is likely to be reversed, with exchanges and other market operations seeking to own or partner with CCPs. If this is to be the case CCPs must look carefully at potential partners for there is no doubt that consolidation is coming to the CCP industry in the same way as it came to the Exchange business.

In the future there will be bigger, more diverse CCPs associated with multiple markets. To position your CCP for this future, the moves made in the next 12 months will be crucial.

## What is Cairneagle?

The vast majority of consultants working in the financial services arena fall into one of two camps: those who have in-depth operational knowledge of the industry and those who understand the strategy. Yet neither of those skills is sufficient. What is needed is a blend of strategic thinking and understanding of the operational complexity of the industry.

At Cairneagle Associates we have a unique team of people who stand outside the financial services industry yet have an in-depth understanding of it. We have a combination of strategy, transactional and operational expertise in financial services, capital markets and technology.

Recent projects in the financial services industry include:

- **Major global exchange operator**
  - Research into development opportunities in fixed income space
  - Product design and implementation strategy
- **European MTFs**
  - Creating strategic CCP relationships
  - Strategic product development
  - Developing testing pricing scenarios
- **Global financial services provider**
  - Analysing impact of financial market regulation including BASEL II, UCITS, and MiFID
  - Developing product directed at regulation and risk management
- **UK clearing bank**
  - Strategic market study identifying opportunities for European expansion
  - UK business banking strategy
- **US international bank**
  - Evaluated electronic commerce strategy
  - Assessed strategies for competitive defence in key markets
- **European/global bank**
  - Developed strategy for rationalisation of investment business line
  - Identified outsourcing partnerships

We believe that it is our experience in board level strategic consulting coupled with in-depth knowledge of financial markets, that has allowed us to add a unique level of value to all of these tasks.

## Short Bios

Our partners and senior associates carry out the work – usually 50% and frequently 100% of their time is devoted to the client assignment, working alongside our more junior staff.

### ➤ **Rupert Barclay**

- 20 years strategy consulting experience; formerly Partner at LEK Consulting, Director of Strategy at Reuters and Chief Financial Officer at Lombard Risk Management plc
- Expert in strategy, finance and M&A
- Wide range of projects in retail and wholesale financial services
- Chartered Accountant; MBA with Distinction from INSEAD
- Non-executive director of Dimension Data plc., Lowland Investment Co plc

### ➤ **Peter Fenichel**

- Senior Adviser at Cairneagle Associates LLP and CEO, SecFinex Limited
- 30 years of senior financial services and capital markets experience at BZW, Security Pacific, Bankers Trust
- Broad and deep capital markets expertise in debt, equity and derivative markets
- Founded and ran Instinet Fixed Income
- BA, The American University, Washington, DC; MA, University of London

### ➤ **Joseph Hine**

- 15 years consulting experience
- 25 years experience in financial services including Executive Vice President of the Pacific Stock Exchange, positions at LSE and Clearstream
- Particular expertise in capital markets, clearing and settlement, exchanges, financial regulation
- BA Liverpool University, MA Lancaster University, PhD Washington (USA)

### ➤ **Gary Fisher**

- Over 15 years consulting experience, predominantly with Lansdowne, AT Kearney and IBM
- Expert in corporate strategy, restructuring, and turnaround
- Broad experience in insurance, retail banking, broking and IT services
- MBA from Henley Management College and a BSc from the University of Manchester

### ➤ **Matt Cooksley**

- 10 years strategy consulting experience
- 3 years as an equity analyst at Cazenove
- Wide range of financial services experience, especially retail
- Particular expertise in strategy, finance, and new business opportunities
- Engineering degree from Emmanuel College, Cambridge

### ➤ **Ian Koxvold**

- 10 years consulting experience in UK and US boutiques
- Specialist in commercial due diligence, strategy and change management
- Broad exposure to several different sectors including financial services, and to working in different countries and cultures
- Engineering degree from Queens' College, Cambridge