Derivatives Counterparty Risk Workshop: What Have We Learnt After Lehman?

Scope and Objectives

- Lehman Brothers' bankruptcy brought the concept of counterparty risk to light across a variety of derivative* products. Market participants who were aware of master, collateral and netting agreements (such as ISDA, CSA, etc.) in principle had to quickly understand and apply them in order to settle their outstanding transactions.
- Post Lehman, and given continuing concerns about counterparty risk, it is important for those involved in executing derivative transactions to understand how they work if the derivative counterparty defaults.
- We propose a workshop that reviews the process of liquidating derivative trades post a counterparty default, including the general sequence of events laid out in master agreements, and how collateral and cross margining work. The workshop would end with a discussion of the current focus and trends in the market following Lehman's default.
- We would use three derivative examples as case studies to illustrate the concepts above:
  - Cross-currency swap between Party XYZ and Lehman
  - Repo transaction* between Party XYZ and Lehman where Lehman borrows money from Party XYZ by repo-ing a corporate bond
  - Credit default swap on Lehman where Party XYZ buys protection on Lehman from Goldman Sachs

* For the purpose of this workshop we include repos under derivatives. Though they are technically not derivatives, they generate derivative-like exposures and are transacted under master agreements, and are therefore discussed in one of the case studies.

Target audience

This workshop has been designed for audiences in front office, legal and risk management that are already familiar with the mechanics and applications of derivatives. It aims to round out their knowledge on the working of derivatives they would typically execute, document or risk manage in case of a counterparty default.

Training methodology

The workshop will focus on the practical realities of the market, rather than taking an excessively mathematical or academic approach. The workshop will blend discussion with case studies allowing the participants to think through the concepts and thus gain a more intuitive understanding of them.

Topics not included

- Pricing and modelling derivatives

The objective of this workshop is to provide a high level overview of how derivatives work if the derivative counterparty defaults. A discussion of pricing and modelling derivatives is beyond the scope of this workshop, but could be discussed in a follow-up workshop.

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Workshop Agenda

Introduction and review

- What's special about derivatives?
- What is counterparty risk?
- How is it risk managed and mitigated?

This section will serve as a general review of derivatives and counterparty risk and will help the trainer gauge the knowledge level of participants.

How derivatives work

- Do counterparty exposures look the same for all derivatives?
- How do CSAs work?
  - Controversial clauses, e.g., right of offset
- Does cross margining apply?
  - How does it work? Legal docs vs. practice
- What are the master agreement procedures when a counterparty defaults?

Case study 1: Cross currency swap with Lehman

Case study 2: Repo transaction with Lehman

Case study 3: CDS on Lehman

This section will start with a general overview of key derivative concepts with respect to counterparty risk, and will then use case studies on various derivative transactions to illustrate these concepts.

Current markets

- Current state of markets
- Central clearing for CDS
- Calls for greater regulation

This section will discuss where we are in current markets with respect to derivatives, and will review the recent initiatives to reduce counterparty risk and increase market transparency.

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- B&B was founded in 2004 and is a partnership of experienced and respected financial market professionals who uniquely have recent, relevant market experience

- B&B partners and consultants are experts across asset classes (equity, fixed income, credit, commodities and alternatives) with a focus on structured and exotic products

- B&B educates clients from basic through to advanced financial products and spanning:
    - Trading, structuring, sales and marketing, and management
    - Over 6000 course participants and 600 training days since 2004

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