

ICE cements dominance as CDS clearing doubts grow

Monday, December 20, 2010. David Wigan



Anu Munshi

ICE Group has cemented its place as the dominant clearer of credit default swap contracts over the past year, data from the various companies active in the space shows. However, doubts remain over the way the market is moving towards clearing.

ICE, which is supported by most of the big investment banks, has cleared some \$14 trillion of CDS contracts in Europe and the US since launching its service in March 2009. LCH Clearnet meanwhile cleared \$27 billion notional while CME Group clocked up \$236 million. Eurex has a CDS clearing facility but did not see any transactions in 2010, while Euronext Liffe's offering has evaporated.

"ICE got a head start because it worked with the dealers right from the start," says Anu Munshi, a partner at B&B Structured Finance in London. "But there is a question over whether having one dominant player is a good thing from a competition point of view and also in terms of risk management."

On the grounds of efficiency, particularly in netting, market participants have welcomed the emergence of fewer counterparties for credit default swaps. Some have gone further and called for the integration of clearers across derivative asset classes.

"The introduction of clearers for credit derivatives is only effective if multilateral netting in that asset class offsets the resulting loss in bilateral netting opportunities across uncleared derivatives from other asset classes," says leading quant Darrell Duffie at Stanford University.

The net impact of clearing credit through separate clearing houses in Europe and the US, and of clearing credit separately from other assets, could be a net increase in counterparty risk and collateral costs, Duffie warns.

Another concern is that central clearing simply migrates the moral hazard seen in investment banking to a new place. The clearers themselves could quickly become "too big to fail", say analysts.

"If you can't let the central counterparty fail then it is not clear why it should be a commercial entity," says Arthur Berd, head of macro vol strategies at Capital Fund Management in Paris.

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