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The Top 10 Market Structure Trends to Watch for 2014

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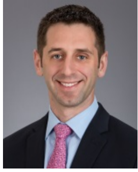

Kevin McPartland is the head of the Greenwich Associates new market structure and technology advisory service. He helps the firm's clients navigate market structure changes driven by regulation, technology and behavior shifts.

The year 2013 will likely go down as the year of mandatory clearing. Once ignored by eager financial market professionals as boring back-office stuff, collateral management, credit limits and all other things clearing stood front and center in 2013 as swaps went from a 10-day clearing cycle to a 10-second clearing cycle.

Given the progress made in 2013, one might think market structure change will slow in 2014—not the case. In no particular order, here are the trends that the Greenwich Associates market structure research team will be watching in the New Year.

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1. SEFs Come of Age Finally the time has come for mandatory trading on swap execution facilities (SEFs) in the U.S. to begin. Made available to trade applications are in; platforms are up, (mostly) compliant, and reporting trade volumes; and the buy side is preparing for the shift. Keep in mind this isn't mandatory electronic trading; it's mandatory *SEF* trading. We expect interdealer broker voice RFQ to remain strong, but we're watching for the breakthrough platform that creates the elusive interest rate swap central limit order book.

2. European Regulatory Reform While the Europeans have surpassed the U.S. in their implementation of Basel III capital rules, they've lagged behind in derivatives reform. One major reason: The Europeans must reconcile the views of more than a dozen sovereign nations—no small feat when you consider the struggle the U.S. has had coordinating among just two regulatory agencies.

Mandatory trade reporting is a sure thing in 2014, but mandatory clearing via EMIR seems a stretch. However, voluntary clearing appears likely as client account models are clarified and pension funds look to reduce their counterparty exposure. Mandatory electronic trading via MiFID II is out for 2014. The rule is much bigger than the U.S. SEF definition, encompassing cash fixed-income products for example, which will make it take a few more years to come online.

3. Marginal Changes in Corporate Bond Trading Despite the market's best efforts, don't expect to see major changes in corporate bond trading in 2014. The leaders will remain the leaders, startups will continue to build market share and both groups will continue to innovate. Two things need to happen for bond market liquidity to get healthier: dealers need to commit more capital to facilitate client trades and someone must find a way to unlock the hoard of bonds sitting in client accounts around the world.

4. Clearing Efficiency Last year the market learned how to clear—this year the market will learn how to clear more efficiently, which should include a huge push toward margin optimization. The infrastructure will finally come up to speed with the opportunities presented by the clearinghouses, and customers will begin to realize how expensive

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clearing is compared to the old bilateral world, driving an adoption of margin best practices. Clearing workflow issues will smooth out significantly. The block trade workflow, credit hub usage and sponsored access approach will all move toward business-as-usual status.

5. Rising Clearing Costs Swaps clearing is a sticky business. Once an institutional investor has legal documents and pipes in place with a clearing member or two, the likelihood of switching due to costs and operational complexities is small. Fully aware of this dynamic, most swaps clearing members have been underpricing their offerings to gain market share since inception: This is about to end. Charges for capital usage, overnight funding, and position maintenance will start to show up on clearing statements. These charges will increase swaps clearing costs in 2014.

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6. Clearing Mandates: Take Two The consequence of business-as-usual client swaps clearing is the next round of mandatory clearing determinations from the Commodities and Futures Trading Commission (CFTC). We won't be so bold as to predict what will appear on that list, but our conversations with market participants and regulators indicate one or more of the following will make the cut: FX NDFs, interest rate swaptions and/or energy swaps.

7. A New CFTC Three of five commissioners are set to change in 2014. While the ongoing presence of Commissioners Scott O'Malia and Mark Wetjen will provide some stability, the injection of Timothy Masaad and Christopher Giancarlo will certainly change the dynamic of the Commission. Giancarlo knows the market and its issues cold. Agree with him or not, he gets it. Masaad is a wild card. Even those most connected to Washington have little insight into the kind of leader he will be. Regardless, it's important that those appointments are approved quickly so the pace of implementation can continue.

8. FX Derivatives in the Spotlight With interest rate and credit default swaps becoming business as usual and non-deliverable forwards (NDFs) a likely component of the next CFTC mandatory clearing determination, FX markets will enter the spotlight in 2014. Financial and corporate end-users will begin looking to the FX futures markets for cheaper access to needed exposures as NDFs begin to command higher margin rates.

9. Rates Market Volume and Volatility With the Fed's taper announcement on December 18th, the imminent rise in long-term rates has begun. While this might spell trouble for mortgage rates and long-only, long-duration bond funds, it's good for the institutional capital markets. Rising long-term rates will cause market volatility, which will increase volumes: a positive development for most capital market participants. Our biggest worries about the rate rise: No one is willing to catch the falling knife to help investors exit their bond positions and the fixed-income ETF market will take an AUM beating, driving additional selling in the underlying markets and, ultimately, pricing distortion.

10. Structured Product Volumes Return
Our latest U.S. fixed-income study shows that in 2013, CMBS volumes finally broke above pre-crisis levels. Several circumstances point to a continued rebound in the structured segment: Investor demand for yield, a growing supply of raw materials in the form of loans to corporations and consumers borrowing on the cheap, and big banks looking to grow in markets that still provide decent margins.

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6 High Ridge Park Stamford CT 06905 USA

Tel: +1 203.625.5038/+1 800.704.1027 Fax: +1 203.625.5126 email: ContactUs@greenwich.com www.greenwich.com