

All the Benefits of OTC, Without the Downside

Liffe's Bclear is seeing a massive increase in trading volume

STUART FIELDHOUSE

The launch of Bclear by Liffe in October 2005 was a seminal event in the world of European equity derivatives. The exchange had seen there was a demand in the market for listed equity derivatives that could be traded with the same degree of confidentiality as the OTC market and it was hedge funds that proved to be some of the most enthusiastic of its early clients.

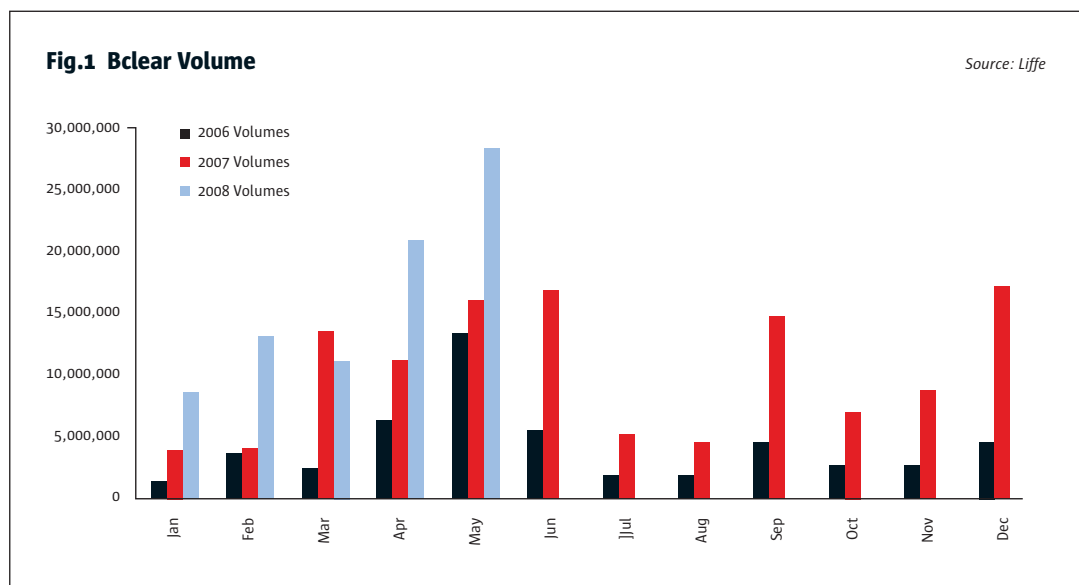
"This solution really appealed to hedge fund customers, and they have been the quickest to move to the platform," says Ade Cordell, Head of Wholesale Services at Liffe. Part of the appeal of the OTC sector for hedge funds was coverage (eg. contracts linked to specific equities), price and the ability to transact deals away from the eyes of the rest of the market. Bclear's response was contracts linked to 300 of Europe's largest companies, ranked by market cap, available from day one. The Bclear offering also included a considerable degree of client input: firms could nominate settlement dates and elect whether the trade would be private or not. Other options include cash settlement or physical delivery, America or European style options, indeed all the flexibility traders would come to expect from OTC deals. Liffe has even been able to compete on price.

This has translated into considerable, even explosive, growth for the Bclear platform and Cordell is justly pleased. The platform now has almost 1000 companies listed for trading and has seen broad uptake across the asset management industry, including from both hedge funds and traditional asset managers.

The growth in volume has also been considerable [see Fig 1]. In 2006, Bclear's first complete calendar year in operation, 52.8 million contracts traded. Last year it saw 122.8 million, a growth rate of 133%. So far this year, over 82 million contracts have traded (to the end of May), leaving the platform well on course to maintain its startling growth rate. "It has certainly exceeded our expectations," says Cordell. "Lots of the London-based hedge funds are familiar with it and are now asking their brokers to transact on Bclear."

Geographical coverage has also increased [see Fig 2 and Fig 3]. In 2006, Bclear listed contracts based on companies in 15 European countries. This has now extended to include 23, amongst them Russia, Poland, the Czech Republic, Hungary and the US. The expansion has been driven by a mixture of customer requests and organic growth determined by Bclear's own strategic priorities.

"Most of the time we receive feedback from the broker dealers, who ask for a certain name to be made available on Bclear," explains Cordell.



"Typically, if we hear from one house, we'll hear from others as well." Although currently focused on European names, Bclear is now also considering some Asian and emerging markets contracts. It is also planning to become a cross-asset platform in the future, including contracts based on factors other than equity products.

According to the head of operations at a long/short European equity fund manager and client of Bclear, the platform has additional cash management advantages. "It allows me to trade OTC options without having cash away from my prime broker," he explains. There is no margin that needs to be paid to the executing broker and, in addition, the fund doesn't need to meet maintenance margin calls.

Bclear also improves things on the pricing front. "You can choose which broker you close out with," says another Bclear hedge fund client. If he needs to close out an option, he explains, he is not bound to do it via the broker he opened it with. "Ultimately, we're getting all the benefits of the OTC market without the disadvantages," he enthuses.

From an operational perspective, Bclear is also helping hedge funds to meet the operational challenges of reporting to investors on time. Obtaining a price for an OTC can be a nightmare. It speeds up the entire NAV generation process for funds at a time when investors are applying constant pressure for speedy reporting. In addition, funds don't need to worry about a trade failing, unlike in the OTC market.

Bclear hasn't missed a beat in the wake of the credit crisis either. According to Cordell, the platform has appealed to funds and investors concerned with counterparty risk. "You're effectively facing the clearing house if you're a broker dealer," he

says. "Given some of the comments we've been seeing around credit, with the banks looking at having a central counterparty, it does make sense. But this is something we already have in the Liffe environment." **THFJ**

