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Banks agree OTC protocol for default trades

The Association for Financial Markets in Europe (AFME) has today published a new over-the-counter (OTC) protocol for banks and investment firms trading with each other bilaterally, which is to be followed in the event of an insolvency of a signatory.

OTC currently represents less than 25% of the European equity market\(^1\). The protocol allows a signatory to strike a cash balance for open trades with a signatory that defaults and follows the model already used in other OTC markets, such as stock lending and swaps and derivatives.

To date, investment firms from the UK, France, Germany and Switzerland have signed up to the protocol.

Administrators for Lehman Brothers had to deal with tens of thousands of open trades and it became clear that improvements to contractual arrangements were required between banks trading cash equities bilaterally. As well as saving time and cost, it provides added certainty in the event of a counterparty becoming insolvent.

The OTC protocol does not extend to trades covered by exchange rules or trades covered by other contractual arrangements.

John Serocold, Managing Director of AFME commented:

“The purpose of this OTC protocol is to provide a way to limit and manage the risks arising on insolvency of open bilateral cash equity trades between adhering banks and investment firms. They will benefit from the ability to manage their risks and, if appropriate, put their customers in the position they would have been in, had the trade settled as expected.

“It is launched at a time of heated debate surrounding the true size of the OTC cash equity market. Contrary to some reports suggesting OTC represents 40% of the equity market, AFME studies show that the true figure is nearer 25%.”

Ends

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Notes:

¹ Half of the commonly reported figure (40%) of OTC equities business is not standard share dealing - it includes trades between brokers squaring up their books or 'give-ups', where the broker making the trade gives it up to a different broker for clearing and settlement. Taking away this proportion of OTC trades means OTC represents 25% of the equity market.

1. A list of signatories can be found at http://www.afme.eu/document.aspx?id=4378. The protocol text is available from AFME.

2. The protocol satisfies concerns raised in HM Treasury's consultation on establishing resolution arrangements for investment banks http://www.hm-treasury.gov.uk/consult_investment_banks2.htm

3. AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association). For more information please visit the AFME website, www.AFME.eu.