Foreword

August 2017 is the 10 year anniversary of the beginning of the global credit crisis which began on 10 August 2007 when BNP Paribas announced huge losses and the closure of three of its largest structured investment funds. This led to the announcement of similar unprecedented losses by other banks, such as UBS AG and Citigroup, and to a freeze in lending between financial institutions. As the crisis intensified in late 2007 and 2008, governments provided direct and indirect taxpayer support to financial institutions, in the form of credit and liquidity guarantees, direct capital investment and in some cases nationalisation. Clearly, financial institutions – especially those in Europe and the United States – had catastrophically mismanaged their credit, market and liquidity risks. As the crisis unfolded, it became apparent that regulators had failed to understand the systemic risks in the securitisation and the bilateral (over-the-counter or ‘OTC’) derivatives markets. The OTC derivatives markets constituted a complex web of financial contracts between financial institutions in which they had speculated and hedged against trillions of dollars of liabilities and assets. As the bankruptcy of Lehman Brothers investment bank in September 2008 demonstrated, these risks were not well understood by the banks and institutions which traded them, nor by the regulators whose responsibility it was to protect society against the system-wide consequences of such risks.

Dr Alexandra Balmer’s important book, Regulating Financial Derivatives: Clearing and Central Counterparties, provides an in-depth analysis of the rationale and reform of international financial regulation following the financial crisis of 2007–2008 to address systemic risks in the OTC derivatives market. Indeed, financial market derivatives have attracted much attention in the regulatory reform debate. This book critically analyses the post-crisis regulatory reforms that require most OTC derivatives contracts to be standardised and centrally cleared by third-party clearing houses or central counterparties. These regulatory reforms are analysed from a doctrinal and policy perspective and suggest, among other things, that these reforms may only be shifting risks to central counterparties without having adequate regulatory and market discipline safeguards in place to manage these risks efficiently. The book addresses
an important area of the regulatory reform debate and is well-researched and clearly written. It explains a difficult and complex area of financial regulation from a comparative and international perspective. It draws on a vast amount of research in both primary and secondary government documents, including EU and US legal and regulatory materials, industry and trade association reports, and academic studies to analyse the evolution of regulation of the derivatives markets in general and the OTC derivatives markets in particular. The analyses of the international regulatory developments following the crisis are informative and identify important weaknesses in the new regulatory framework for central clearing of OTC derivatives and the operation of central counter parties and derivative clearing houses.

Policymakers have observed that it would be a mistake to ‘waste’ the financial crisis by failing to learn the lessons of regulatory reform that are necessary to prevent or mitigate a future crisis. This book takes us a step closer to understanding how systemic risks in the OTC derivatives markets toppled the financial system in 2008, but also sheds light on how certain post-crisis regulatory reforms can potentially introduce new risks to the financial markets that threaten financial stability. The book also sets forth some interesting regulatory reform proposals for the OTC derivatives market. I have no doubt that the book will make an important contribution to the literature and a reference for both academics and practitioners.

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