Risk Blog
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Transforming Finance: A Deep Dive into Smart Derivatives - Whitepaper

Funding cost reduction through derivative life cycle automation and risk limitation – Can smart derivative contracts be the game changer?

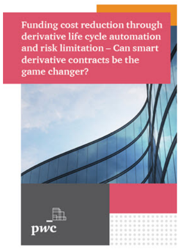
By enabling instant termination through derivative life cycle automation and pre-funded variation margins, smart derivative contracts can remove counterparty credit risk from bilateral over-the-counter (OTC) derivative trades, reducing funding costs, operational costs and capital requirements.

An initial estimation under simplified assumptions for a conservative example indicates a potential funding cost reduction of up to several basis points by replacing the initial margin based on ISDA SIMM with the funding costs for smart derivative contracts.

For each product category considered, the degree to which funding costs can be saved depends on the current availability of post-trade risk reduction techniques, the typical length of the margin period of risk, and the availability of other offsetting smart derivative contracts as well as the funding rates and duration.

In addition, the removal of counterparty credit risk also frees up capital, which can in turn be used to fund new trades: an avenue for potentially vast additional revenue which is, however, difficult to estimate.

More information can be found in our white paper:



Get ongoing updates on the topic via regulatory horizon scanning in our research application, PwC Plus. Read more about the opportunities and offerings here.

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Keywords

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