



NEWS RELEASE
For Immediate Release

ISDA Publishes Research Papers on the Value of OTC Derivatives

MUNICH, April 9, 2014 –The International Swaps and Derivatives Association, Inc. (ISDA) today published two new research papers at its 29th Annual General Meeting in Munich that highlight the value of the over-the-counter (OTC) derivatives market.

The Value of OTC Derivatives: Case Study Analyses of Hedges by Publicly Traded Non-Financial Firms is authored by Ivilina Popova, Associate Professor at the Department of Finance and Economics at Texas State University, and Dr Betty J Simkins, Professor of Finance and Williams Companies Chair of Business at Oklahoma State University.

The research examines the value of OTC derivatives for publicly traded non-financial firms. Building on previous academic research, the authors focus on four case studies. In each case, the authors consider real-world examples of OTC derivatives used by non-financial corporates, but replicate the OTC hedges with exchange-traded alternatives.

The paper states: "...advances in interest rate, currency and commodity derivatives instruments and the resulting risk management applications are making it possible for US firms to expand globally, become more internationally competitive and successful, and achieve business strategies and objectives, despite market volatilities. Academic research shows that derivatives also help lower the cost of capital of non-financial firms, both debt and equity, and this in turn increases the enterprise value. Overall, the success of non-financial firms in managing risks benefits the macro economy and can help reduce systemic risk."

Several of the paper's important conclusions include:

- Suitable exchange-traded derivatives available to replace OTC hedges do not always exist;
- OTC hedges can be more efficient and effective as compared to exchange-traded alternatives;
- OTC hedges can reduce earnings volatility as compared to the exchange-traded alternatives;
- The mark-to-market and any potential margin requirements can impact the liquidity of non-financial firms and increase costs of operations;
- Exchange-traded derivatives can lead to increased ineffectiveness and may potentially not qualify for Financial Accounting Standard (FAS) 133 hedge accounting;

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ISDA's study, *Size and Uses of the Non-cleared Derivatives Market*, focuses specifically on the interest rate derivatives (IRD) market and examines the scope of the non-cleared segment and the instruments it encompasses. In addition, the paper analyses various case studies describing some common uses for these products by derivatives end-users to manage risk.

Among the paper's conclusions are:

- The derivatives industry has made huge progress in moving towards central clearing, with 65% of IRD notional outstanding cleared as of year-end 2013.
- However, a significant portion of the IRD market currently remains non-clearable. This includes swaptions (\$30 trillion in notional outstanding), cross-currency swaps (\$30 trillion), options (\$12 trillion) and inflation swaps (\$3 trillion). An additional \$8 trillion of the IRD market comprises transactions in products that are available for clearing, but in currencies that can't be cleared.
- Non-clearable derivatives have an important social value. They are widely used by corporates, pension funds, insurance companies and retail banks for important risk management purposes. Without non-clearable derivatives, users of these products may experience greater earnings volatility due to an inability to qualify for hedge accounting, or be unable to offset the interest rate, inflation and longevity risks posed by long-dated pension or insurance liabilities.

The Value of OTC Derivatives: Case Study Analyses of Hedges by Publicly Traded Non-Financial Firms and *Size and Uses of the Non-cleared Derivatives Market* are available on the [ISDA website's Research section under Studies](#).

For Media Enquiries, Please Contact:

Lauren Dobbs, ISDA Munich AGM Office, +49 89 9264 9370, ldobbs@isda.org
 Nick Sawyer, ISDA Munich AGM Office, +49 89 9264 9370, nsawyer@isda.org
 Donna Chan, ISDA Hong Kong, +852 9312 1311, dchan@isda.org

About ISDA

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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