

KNOW-HOW

BCI

The Italian Pioneer of Credit Derivatives

BCI has been leading the interest-rate swaps ranking for several years now, thanks to its leadership in the Overnight Indexed Swap market. However, it is probably the first time that an Italian bank, in this case BCI, ranks among the leaders in a sophisticated segment of international capital markets, namely that of credit derivatives. This type of product allows two counterparts to exchange credit risk originating from loans or bond underwriting. In the case of a "credit event" (a default in payment, or a widening in the spread), the acquirer of protection is paid by the seller. The most commonly used instruments are credit-default swaps and credit-spread options. BCI ranks fourth in the U.S. market, with USD 21bn of principal covered, behind JP Morgan, Citibank and Chase (see table) and boasts first position among the non-U.S. banks.

One of the reasons underlying BCI's success is the relatively modest number of large banks competing with BCI in the U.S., since the credit derivatives business is an activity that demands a lot of financial muscle in order to withstand the related risks. Also, BCI counts on its very active presence in New York.

The situation in Europe, on the other hand, is somewhat different. The large banks are far more numerous, hence the market is more fragmented. Deutsche Bank occupies the lead position, while Credit Suisse has fallen behind in the league tables, on the back of the problems relating to the Russian crisis in 1998. BCI entered this business in late 1996, spurred on by Francesco Caputo, one of the pioneers of securitization in Italy and who is now in charge of BCI's entire structured finance division. The credit derivatives desk now counts a staff of 13 professionals — eight in Milan, four in New York, two in London and one in Hong Kong, all of them in their late twenties — and is headed by Paolo Gribaudo, 36-years old, whose entire career has been with BCI. "BCI's activity in the credit derivatives segment is carried out entirely with foreign counterparties. The lack of any regulations governing this



Paolo Gribaudo, head of BCI's credit derivatives desk

business in Italy has prevented the market from developing until now" says Gribaudo. However, this regulatory vacuum is soon to end, as the Bank of Italy is due to roll out the first set of rules at the beginning of July. Italy has no players other than BCI in this market at the moment, although other large groups such

as Banca IMI and UniCredito Italiano are starting to warm up to the idea. Nevertheless, it will be difficult to overtake BCI, which has ploughed in investments totalling tens of billions of lire in this business. The potential of this market is considerable, on account of the huge number of medium-sized businesses which, according to Gribaudo, "a foreign bank cannot get to know as well as an Italian bank does".

One of the most interesting applications of credit derivatives is the so-called synthetic securitization, which reproduces the cash flows of a classic securitization through a series of credit-default and asset swaps which prevent the originator from having to sell its assets to a special purpose vehicle. A good example of this is the "Scala" deal, worth around USD4bn, structured by Gribaudo's team and placed by Citibank Salomon Smith Barney. Business in this market segment is so buoyant that just in the month of June alone a USD 20 bn equivalent of synthetic securitization will go on the European market. Know-how in credit derivatives is normally considered to be the domain of commercial banks. However, the U.S. investment banks are doing some aggressive recruiting to secure sufficient expertise. Merrill Lynch has hired the whole of Citibank's London-based team. Goldman Sachs has taken several people from JP Morgan and Deutsche Bank. Lehman Brothers is also searching for know-how.

US CR. DERIV. MARKET: TOP PLAYERS

MN OF US\$ BANK	NOTIONAL AMOUNT*
JP MORGAN	172,398
CITIGROUP	41,912
CHASE	28,024
BCI NY BR.	21,906
BANK OF AMERICA	20,820
FIRST UNIONE BANK	13,609
CREDIT AGRICOLE INDOSUEZ	6,039
WEST LB	4,647
SOCIÉTÉ GÉNÉRALE NY BR.	4,475
FNC	4,314

* AS OF END 1999 SOURCE: CALL REPORTS