Citi Alums Mint Counterparty Risk Boutique

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Katy Burne
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Six alumni from Citigroup have formed a start-up to advise Street firms on unsecured counterparty credit risk arising from over-the-counter derivatives. Down the track it plans to sell contingent credit default swap protection to dealers.

Called Novarum after the Latin phrase 'rerum novarum' meaning 'of new things,' the firm has been consulting on risk management while it builds a platform to start trading CCDS later this year. Discussions are also under way with Standard & Poor's in a bid to score an independent, high investment grade counterparty credit risk rating for the trading arm.

Novarum's co-founders are Andrew Hollings, Shankar Mukherjee and Svein Stokke. Hollings was head of Citi's counterparty risk desk in New York, which he formed in 2002 after leaving JPMorgan, where he had been global head of new financial products. Mukherjee was a managing director in London, responsible for establishing the counterparty risk function for Europe and Asia. Before that he was the European co-head of new financial products at JPMorgan. And Stokke, based in Zug, Switzerland, was head of contingent credit risk trading at Citi. They are supported by three directors in New York: Ganesh Kandasamy and Helen Kim, each a v.p. under Hollings, and Kristel Adler, an associate who traded contingent credit risk.

The desk at Citi where all six worked was once 20 people strong and is now headed by David Elsley, managing director in London, who joined after Hollings left. It primarily exists to manage Citi's proprietary counterparty risk and would occasionally take on third-party accounts, but non-compete restrictions are not expected to be an issue.

The catalyst for Novarum's business model to take off will be improved liquidity and certainty over what the new banking landscape will look like, Adler told DWO, adding, "Current balance sheet constraints...and Basel II coming into effect makes [our proposition] relevant." The company will be distinct from credit derivative product companies and traditional monoline financial guarantors in the sense it will lay off all its own risk via CDS trades with select broker dealers. Novarum's capitalization will consist of members' capital contributions, senior unsecured liabilities, reserves withheld, collateral received and retained earnings, Adler said.

CCDS is increasingly used by credit risk managers for hedging unsecured credit risk because it is recognized by regulators as an effective counterparty risk mitigant under the Basel II Capital Accords. Any inter-company CCDS transactions do not get regulatory capital relief, hence the need for outside counterparties. CCDS is variation of CDS where the notional amount of protection the buyer has is determined by the daily mark-to-market replacement value of a hypothetical reference derivative, such as a swap.