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Days of Futures Past | Episode 6
Dan McElduff and Joe Raia, Abaxx Exchange

We continue our *Days of Futures Past* series this week with two guests from Abaxx Exchange: Dan McElduff and Joe Raia. Dan is President, Head of Strategy & Development and Joe is Chief Commercial Officer at Abaxx Exchange.

SmarterMarkets™ host David Greely sits down with Dan and Joe to discuss the launch of ClearPort at the NYMEX in 2002, which brought the backing of the clearinghouse to the global OTC markets and today clears transactions from 1,800 listed contracts across multiple asset classes.

Dan McElduff (00s):
It became evident that we were filling a commercial need that, you know, if not being filled, could have been a catastrophe. Being ready when that opportunity presents itself – there's a lot of legwork that went into it in terms of evaluating the markets and knowing when folks said they wanted a new product, you know, how to interpret their needs into a futures contract. It's a lot of art and a lot of science, but it can't be done unless you're getting input from a broad community.

Announcer (00m 25s):
Welcome to SmarterMarkets. A weekly podcast featuring the icons and entrepreneurs of technology, commodities and finance ranting on the inadequacies of our systems and riffing on ideas for how to solve them. Together, we examine the questions: are we facing a crisis of information or a crisis of trust, and will building Smarter Markets be the antidote?
This episode is brought to you in part by Abaxx Exchange, bringing you better benchmarks, better technology and better tools for risk management.

David Greely (01m 05s):
Welcome back to days of Futures Past on Smarter Markets. I'm Dave Greely, Chief Economist at Abaxx Technologies. We have two guests with us today from Abaxx Exchange in Clearinghouse in Singapore. They are Dan McElduff, President Head of Strategy and Development, and Joe Raia the Chief Commercial Officer. We'll be discussing the launch of ClearPort at the NYMEX in 2002, which brought the backing of the clearinghouse to the global OTC Markets, and today clear's transactions from 1800 Liston contracts across multiple asset classes. Hello, Dan and Joe, welcome to Smarter Markets.

Joe Raia (01m 40s):
Hey, David.

David Greely (01m 41s):
We get to talk with each other quite a bit as colleagues, but I was really looking forward today to getting to talk with the two of you about experiences you had long before I met either of you and that's because before the two of you teamed up to launch the Abaxx Exchange in clearinghouse in Singapore, you worked together to launch ClearPort at the NYMEX in 2002 and just to give our listeners a little context, Joe, I was hoping you could start us off today by telling us what ClearPort is and what commercial need was it meeting in the market at the time?

Joe Raia (02m 14s):
Oh, thanks David. Thanks for having us. The clipboard name really didn't come around or be added to the platform, the clearing platform till probably a year or so after we actually launched the Clearing system. I think we, in the beginning we called it OTC clearing, for lack of any other word and we ended up sitting in Bo Collins' office who was the president of the NYMEX at time, Dan, myself, and Nakama, who was our marketing head to come up with a name for it and me being the nautical person in the room, came up with the, with the Lighthouse logo and the, and the ClearPort and, you know, it was, I guess that, and that was for lack of anything else or any other, other suggestion. That's what really stuck and you know, there's some always great anecdotes around it.

Joe Raia (02m 59s):
But you know, we ended up using a little Light Lighthouse logo for a couple of years with the first FIA Boca after we launched it and came up with the name, which was probably the third year of ClearPort. We actually contracted with a marketing company in Boca Raton, Florida to build a lighthouse to put on next to our stand at the, at the FIA. We spent a lot of money on it and it basically looked like a conehead and we put it in the back of the closet and never used it for the conference. So, you know, those are some, some of the, the funny things about it. But in all seriousness, clipboard was, you know, such a, an important clearing and risk management tool for the industry that was really suffering as a result of the default of Enron and the lack of the ability to trade with each other bilaterally, which is how the market had existed primarily in in off exchange trades that weren't, you know, on the NYMEX or any other the platform or any other futures exchange.

Joe Raia (03m 54s):
So natural gas contracts and lectures of the contracts. Those, those contracts didn't exist from a basis perspective. The benchmark Henry Hub was there and the WTI, but those were literally the only benchmarks around and all the basis contracts had formed in the o TC market, primarily as Enron as the buyer and seller to either side of the marketplace and so when Enron defaulted that buyer or seller or risk taker exited the marketplace, and all these merchant energy firms, utilities, natural gas companies, all were left not being able to transact with each other because of the risk that was in the marketplace.

David Greely (04m 29s):
And we often think of, you know, over the counter or OTC trades, and then we think of trades that occur on exchange and I think people often think about the exchange, but they don't think about the clearinghouse, particularly if you're not involved in the nuts and bolts and the plumbing of the financial markets. So, Dan, can you give our listeners just a, a brief background in what is the importance of the clearinghouse and in the case of allowing clearing services for over the counter trades, why have it operate independently of the exchange?

Dan McElduff (05m 02s):
Oh yeah, happy to David, and thanks, thanks for, for having us on this, this discussion. So long time coming and to add on a bit of Joe's history of the term ClearPort, I think it was in that meeting I was kind of opposed to the idea because there were mechanics to it that I wanted people to understand better as opposed to throwing a, a marketing term at it but it turned out to be perfect because it really was that simple, right. We wanted to open the clearing house to the OTC market and, and resolve some of the issues that the market was facing. It was clear there was a commercial need for it and it was solving a problem in terms of where we might enter the market after years of evaluating what we could do beyond the traditional role of an exchange in clearinghouse.

Dan McElduff (05m 45s):
So the, the clearinghouse, you know, the exchange brings people together. The clearinghouse supports what we call efficient price discovery by putting everybody on the same level and, you know, when a commodity is border sold, its price may reflect, it may be impacted by a number of things, whether it be grade quality in different fundamentals in different regions. Those are all addressed by standardizing products. But to get everybody, you know, a really big thing on that became evident in that time around Enron and throughout the history of the market is that it could be a buyer or seller is not particularly credit worthy and needs, and, and the price is gonna reflect that because the party on the other side can't take that risk. They have to extract the premium somehow and that kind of distorts the price discovery process because, you know, a good traded between two credit worthy counterparts and a good traded at the same time between one, you know, two counterparts, one of whom is not credit worthy, could have a very different price. So the clearinghouse creates that level playing field creates an environment where the price discovery process can get to fair value, much like in the interest rate market where if the US treasury market is the, the risk free rate for interest, then any place where there's a clearinghouse operating and counterparty credit worthiness is not a concern, then you can have faith that what you're buying or selling is at a fair price.

David Greely (07:12):
And Dan, you've been talking about how the clearinghouse puts even OTC trades participants on the same level in terms of credit risk because the clearinghouse operates as you know, I guess the buyer for every seller and seller for every buyer. So you're facing the credit risk of the clearinghouse, not the credit risk of your counterparty. Are there other risks that the clearinghouse also helps to mitigate?

Dan McElduff (07m 33s):
It does, and key to that is, is delivery risk, right. There's parties who, who may or may not be interested in, well, who may be interested in the market, but may or may not be able to deliver a specific grade or a specific quality or at a specific location, right, but they're very interested in participating in the market and if you create a clearinghouse and a standard product where parties can come in and if they choose to be so anonymously, they can, you know, buy or sell a good with not just a chosen counterparty, but they have access to an entire, you know, whoever has access to that system, an access to that system is simply opening up a futures account and if they're, instead of a bilateral deal where you have, you may have a handful of counterparts, now all of a sudden you're potentially exposed to dozens of counterparts and you can manage that risk you'd rather not have including delivery.

Dan McElduff (08m 25s):
So there may, there're participants in the market who bring a great deal of liquidity that have no interest in going to delivery. They're market makers or their hedge funds that want to have exposure in certain commodity markets and now they have the ability to do that because they also have the ability to go back to other counterparties and cover their positions before they mature into a delivery obligation and that creates this opportunity to expand on the community that that's trading in a particular commodity. It increases liquidity and the community grows more and more along with liquidity. You know, with diversity you just have market conditions improving for everybody and another element of delivery risk, and, and we often use the term a market of last resort parties will always want specifics of, you know, their own business particulars met when they're buying or selling a physical good. But if they, if they have a market of last resort they can go to where they can at least meet, at least meet some of their terms and address their delivery risk, then that creates a forum for liquidity that's not gonna happen outside of an environment like a clearing house.

David Greely (09m 30s):
And Joe, I wanted to follow up with you on a point that Dan raised because in my financial markets 101 mind too simplistically, I often think of OTC contracts as being more customized and bespoke and the over-the-counter markets are where those types of transactions occur with exchange traded contracts being standardized, but ClearPort would require standardized contracts for clearing correct and then how did you go about introducing those new contracts?

Joe Raia (09m 58s):
Yeah, that's correct and you know, that was the argument from the beginning that we got from the majority of the marketplace that didn't have, it didn't come on board with ClearPort in the beginning because they said, well, you can't take OTC contracts that are so customized and bespoke and make them, you know, turn them into futures contracts that that, that are cleared and, and, you know, there's no counterparty risk. And what we did through, you know, Dan's team and the research team at NYMEX was to really engage with the marketplace to find the common terms of products that they were trading. And initially it was 15 natural gas contracts, basically that were the most liquid OTC contracts in the net gas, the US net gas basis markets that were affected by the default of Enron. And we started with that and we said, okay, how do we take those OTC bespoke contracts and, and find the commonality between those and the, the rules-based program at the NYMEX and, and, and the clearinghouse?

Joe Raia (10m 55s):
And how do we mitigate that risk and how do we turn them into futures contracts that that mitigate that risk between counterparties and, and it wasn't, I wouldn't say it wasn't easy, it was generally there was a lot more common, I think, themes than we thought, and that led to developing more products. But as we became more and more known in the marketplace, particularly through the broker community, which was a big supporter of what we were doing, because they did sit on a lot of the liquidity that was in the OTC markets, and we were just helping them renew their businesses. And so they kept bringing to us additional products that, that were, you know, not being looked at in the, in the clearing marketplace for us to list. And we were able to basically replicate the model for net gas into power, into oil products, into freight, into whether into many, many asset classes that as long as you have that connectivity or control to your own clearing house, and you do the due diligence on the products and you have the marketplace behind you, those pools of liquidity can then be, be brought in onto the exchange and then cleared, which obviously helps the counterparty risk situation.

David Greely (12m 00s):
So from a little more than a dozen natural gas contracts in the beginning, I think CME who now owns ClearPort has about 1800 listed contracts Yeah. On there today. Now when

Joe Raia (12m 11s):
When I left there in 2011, I was almost, it was almost 2000. They delisted some that just became somewhat obsolete, but right. Yeah, we listed almost 2000 individual contracts across multiple asset classes, even in metals markets and all of that was a result of interaction with, with the marketplace that we feel we are bringing here to Abaxx and where the current exchange is just whether they don't have the attention span or the internal ability to do it from a, from a talent perspective. But we do feel that we have you know, the right people with the right connectivity to the marketplace to bring what we did back then to what we're doing here now.

David Greely (12m 51s):
And back then, Dan, I mean, you were a senior director in research at NYMEX well before the launch at ClearPort. So I'm curious, you might have some perspective of where did the idea for ClearPort come from and how did it develop over time before it actually launched?

Dan McElduff (13m 07s):
Yeah, and Joe made the comment about, you know, we, well, we had been calling OTC Clearing became ClearPort and OTC Clearing was something that really became evident because of the credit crisis in the early s amongst the merchant energy companies. But we were able to build on some, some efforts in the nineties that NYMEX was involved and there was, you know, after having success in Henry Hub markets, there was thoughts that we might be able to offer services in the physical market and bulletin board type system was, was built, it was called Channel Four. It had the logo CH 4 like the, the chemical composition of methane and there was a lot of efforts like that underway, very few, which, which took hold but it started the processes of us defining what trades in, in the OTC.

Dan McElduff (14m 00s):
And over time things kind of evolved where there was the swat, the OTC swap market particularly natural gas had developed and it offered so much in terms of depth and breadth of product that we were tracking that for many years. But we recognized that the opportunity really came about in the context of what we did with clearing just, you know, through the evolution of our thinking on it. And after spending a lot of money on things like Channel 4, another one was called the NYMEX. And the NYMEX thing was like during the.com era, and we realized the matching mechanism was something that was already addressed by other OTC electronic venues or the voice brokerage community in particular which remains an important and robust part of the market today. We had the opportunity to seize on that and, you know, I had been working on these products for quite some time.

Dan McElduff (14m 56s):
It all kind of came together in that context in the early s and in, in the wake of the credit crisis. And we were facing a bit of a challenge if not an existential crisis because there were OTC venues like Enron online and the Intercontinental Exchange's first effort was really effectively an electronic OTC brokerage system, neither of which offered any credit capabilities at the time. So when things came to be, and it really proved out our point that, you know, what, what value of are these exchange systems if there's not some credit capacity behind it and it was kind of amidst in around the Enron collapse that, you know, we really, the idea started coming together. For me, it was a moment in, in the fall of a one I was, you know, on a boat ride after the end of a long day, a bunch of guys who lived in New Jersey were on the ferry across the Hudson and the COO of of NYMEX at the time Neil Woff turned to the, the CTO David Keller, and he said, David, can you put a pick card on the internet and have the ability to, for clearing firms to approve a trade.

Dan McElduff (16m 04s):
And David said, yeah, and, and David was responsible for a lot of great technology innovations at, at NYMEX at the time. And he and his team delivered a system that that did that in part. And that evolved into something that was really useful in putting the task into the hands of the users, the people who were entering the trades, and being able to give confidence to parties that, that a trade was done and cleared in a matter of minutes, if not seconds. I think it was on that boat ride that, you know, what, what came to be ClearPort was really born. And that through lots of effort after that, we were able to deliver.

David Greely (16m 36s):
And you, you've both spoken to the, the importance of having the trading community embrace what you're doing, so you can build it, but it's not the field of dreams. People won't just come and I know, Dan, I've heard you talk about in the context of ClearPort, the role of what I've heard you refer to as the Short Hills Summit after short Hills, New Jersey, I presume. What was that event and what happened there?

Dan McElduff (17m 01s):
So we, the, the system was coming together, and this is in, in the spring of, 02 and the system was coming together and we knew we had to get key players to the table. We knew we, we wanted to embrace the OTC brokerage community, which had always really avoided us because they're entirely focused on OTC bilateral trades and there was somewhat of a competitive environment between us, but because of all the credit issues in the market, it, it occurred to us there was an opportunity to engage them. So because they were hurting from a lack of, of liquidity in the market because all the counterparties had credit issues with each other. So we decided to, to gather and invite this group of, of OTC brokers and Joe has always cast a very wide net to reach everybody.

Dan McElduff (17m 50s):
My boss Bob Levin in research said, Dan, get the, get the product stacked decked together and we're gonna, you got to come down to Short Hills on Sunday morning and we're gonna do this presentation. So I, I didn't have high hopes for, you know, I thought, I thought there'd be a handful of us NYMEX staffers and, and our chairman Vinny Viola and President Bo was there. And I was, I couldn't believe the response we got in that not only were all the brokerage firms represented, but in many cases the principles of the firms were there. It was clear from that moment that we were onto to something, you know, and that really was the start of it, you know, David's team delivered on the system and, and we were up and running, you know, in the following month.

David Greely (18m 29s):
And I imagine there are no like soft openings for an exchange or for an operation like this like, you're either open for business or you're not and so Joe, I'm curious, what was the launch of ClearPort like, and can you take us back to those early days of being open for business?

Joe Raia (18m 46s):
Yeah, it was pretty interesting. We had a marketing team down at so as Dan said, the, the Short Hills meeting happened it was, we thought pretty good success. We still had to get final board approval and the board was still suspicious, which were mostly made up of locals that we were going to take their business away from them. So that was always a, a chance. But Viti thankfully had enough power at the board at the time to push it through and so, you know, we, we launched and the interesting thing was that ICE decided to launch a competing platform about a week or two before us, as, as competitors normally do and we kind of shrugged that off and we knew we had the right product. We knew we were clearing a mass futures, the products as futures versus ice, which were cleared, swapped because they didn't control our own clearinghouse.

Joe Raia (19m 33s):
It was cleared in London. It was a, a little bit of a different situation structural wise and anyway, so they copied the products we had, we launched after they did I remember very, very distinctly we had one of our marketing guys, one of my, my still closest friends, Jerry David was down at one of the big trading firms and the system that time was very, very, I would say basic in its in its structure and that we had to have the traders approve the trade once they were inputted by the broker, which they all did. And when they clicked the button, it would print out a ticket in our, in our trade management system at the NYMEX and I remember we were on the, all on the phone at the same time and we said, okay, submit the trades. And we submitted the trade and the paper didn't print out.

Joe Raia (20m 18s):
And so the guy who was up in the trade management room said we thought he was asleep, actually. He basically we figured that there was no paper in the printer, so Dan had to run from like down to the fourth floor and then back up to the 15th floor to get on the phone again to tell everybody to push the trade in again. So we, you know, thankfully he survived and didn't, I mean it was quite, quite a run up and down the stairs. But it's a true story and you know, from that point, you know, it was, it was really education. I remember spending the year after we launched ClearPort, mostly on the road, educating the community the trading community, the FCMs in part in particular about how to clear how to take an OTC contract that was used to be a bilateral contract and turn that into a futures contract.

Joe Raia (21m 03s):
And for a lot of FCMs with the exception of maybe a couple, they didn't get it. They didn't really want to get it because they were making a lot of money on the benchmark contracts and other markets but to educate them on how to do that and what was actually going to result of it. I spent three days at a big one of the big trading firms down in Houston, going through almost every department within the organization, legal, compliance, risk, trading back office to explain to them in various sessions for those three days exactly what we were doing and, you know thankfully and for, thankfully for the market to the marketplace, most of the firms got it. And they,

they adopted it and we, you know, they saw the benefits of it and I think probably one of the biggest, I would say, backers of us and even ICE at that time was John Arnold.

Joe Raia (21m 48s):
John was a big natural gas trader. He was just starting out his Centura fund. He was really at its infancy good kind of anecdotal story. Bo Collins sent me down to Houston to meet him. I had never met him before and had dinner with him one-on-one. And we told him what we were doing and said, listen, we're gonna give you the ability to cross margin. This gets to the point of, you know, the ability to make your trades more efficient, cross margin, your Henry Hub futures against your OTC cleared contracts, your Henry Hub Financial. And he said, I don't think you can do that. And I said, well, we are. And he said, if you do that, well, I will back you guys, I will be in on this. And sure enough, I, when I got back, we showed him how we were gonna do that through cross margining, and he was he was all in.

Joe Raia (22m 28s):
And that obviously was one of the other successes of getting the marketplace to move towards using us, was getting big players like John and some of the bigger firms and the brokers all in but it took a, a long time to get clearing firms. There was one clearing firm that couldn't, couldn't clear negative price differentials on net gas basis, which is a way that it trades for a lot of times. They couldn't get their systems to acknowledge or recognize negative price contracts, so they weren't on board for, for net gas basis anyway for years and so, you know, it does come at incremental points of adoption.

Dan McElduff (23m 04s):
I would add to that point, you know, Joe gave the example of a hedge fund trader who got the benefits but like the, on the other side of that, where he was the liquidity provider, there were and we spoke about Enron's problems. Well, Enron didn't survive all this, but the companies that adopted what we were doing from a clearing perspective, particularly the merchant energy electricity producers, you know, they had sound business where they'd hedged their gas purchases and they had hedged their power sales, but they were putting out so much collateral because of the credit crisis. And clearing gave them the ability, the ability to offset some of those risks and reduce their, their trade financing costs dramatically. So for companies like DynaGen or Reliance or Calpine, many of which survive in one way, shape or form, and are responsible for much of the generating capacity in the country, these companies were literally saved by mechanisms like ours and the ability, as I said, in the clearing earlier on in the context of a clearing house, these parties were able to come together for the first time, you know, in a way where your transactions would be executed OTC, but cleared through a traditional futures clearing house.

David Greely (24m 12s):
So Joe, you're out on the road doing the hard work winning customers and market participants one meeting at a time.

Joe Raia (24m 18s):
It wasn't that easy. I wouldn't have called it winning in the beginning.

David Greely (24m 23s):
Yeah, and Dan, I've often, you guys have both brought up Enron a number of times, and Dan, I've heard you say many times that crises are often what speed the adoption of new exchanges and clearinghouses and new contracts and ClearPort launched within I think a year probably less of the collapse of Enron. So I would love Dan for you to dig into a little more, how did that crisis speed the adoption of ClearPort and could you almost like palpably experience it in people's attitudes?

Dan McElduff (24m 53s):
Yeah, it's and I may have jumped the gun a little bit in my last response and but I'll go back to it, right there, there were companies that were, and this is, let's also remember in the early s there was significant issues with energy supply, both fuel and power, and the market was quite volatile and many market participants had taken on programs to hedge themselves, but were, were suffering from the liquidity risk. But they were all of their programs were born into the, OTC markets and now all of a sudden their counterparts were drying up if they had a hedge and they wanted to cover that hedge, they were limited in their ability and who they, who were they gonna go to cover that and it was indeed a crisis that, that we launched into, but we were able to, you know, hold up here are the benefits of clearing in terms of being able to exit or enter, depending on what your risk capabilities were into positions in a common place.

Dan McElduff (25m 56s):
And to do so in a way that you didn't have the concerns that you would if you had done a hedge with an Enron that collapsed or all the other firms that kind of took the lesson and survived it by adapting in the environment. We did. So, you know, the, the concept had been around for a long time and, and this is, and, and with ClearPoint we introduced a whole bunch of new products on top of the benchmarks. But you know, even before that, we had seen a great deal of what are called lookalike stuff. So Henry Hub, you know, was, is one of the Benchmark Nix contracts. There was almost as much Henry Hub trading going on in the bilateral markets. And we pointed out it went from a cost perspective that OTC market participants weren't taking into account the true cost of credit.

Dan McElduff (26m 43s):
We'd said that for many years, but to no avail. The crisis made it real for everybody and it caused traders to have to justify their costs in terms of how they were financed and how the firm was supporting them in their activities. And we really saw, I mean, it was just an amazing shift in part because of what NYMEX introduced in, in, in the form of ClearPort and, and some reforms. It made in some rules that kind of conformed better to commercial practices in the energy sector. So it absent those events, I don't know it, it could have been a good idea that never had its time, but fortunately the two, the two worlds came together.

David Greely (27m 22s):
Yeah, and I'm just curious, Dan, on the one hand you have, Enron is a large participant in the market, you know, large trader on the other hand was the Enron platform doing some of the work that an exchange or a clearing house or other market infrastructure would do prior to its collapse.

Dan McElduff (27m 38s):
It was, and it was doing it pretty effectively and you know, theoretically it, it may have gone on for, for, you know, much longer time than it did if not for the crisis in the credit that they encountered. I remember talking to traders, you know, across the evolution of line, where a trader would say, oh, there's no way they're making money because their margins are too narrow and oh, I'll never trade that and it got to a point, you know, six months later I'm there and the guy's like, oh, I'm, I'm making some great trades because of that. I use it all the time now. It became a tool that almost everybody was using and, and they were getting enough liquidity where in many cases some of their markets were on autopilot, but at the end of the day it was built on a shaky foundation, you know, because it was one single credit that the whole market was going up against and we, we see what, you know, we saw it happened in the energy markets a couple years later. We saw it happen in the financial markets when AIG was in a similar role. So, you know, it really, it set the stage, and again, a lot of it was timing in Providence, but because of our persistence and the things we'd done and, and a lot of hard work and recognizing the opportunity that was at hand, we were able to deliver on it.

David Greely (28m 48s):
And Joe, I'd like to ask you about that next big credit crisis, the global financial crisis and the reforms that followed. How did that affect ClearPort's role in the financial markets?

Joe Raia (28m 59s):
Yeah, it just gave us opportunities in other product areas and it really focused more, I think more intensely on the, on the issue of, of counterparty risk and efficiencies in margining and, and who you're trading with and really that was an important, I think next step in the marketplace, right. Everybody, just like we, we were talking about earlier, you know, the inefficiencies of, of the markets where, you know, volatility brings higher margins. There's no way to offset your OTC trades against your exchange trades. That was really, you know, the banks were really at a point where they were becoming looked at as, as being suspect from a credit perspective during the, you know, the, the financial crisis in 2008 and so, you know, I think there was even more focus on the use of an exchange and a clearinghouse for risk mitigation, for counterparty risk mitigation. Those were really important points in the marketplace. And we just saw in even more, I would say shift in the use of the NYMEX and, and other clearinghouses for not only energy products, but metals and other asset classes that that might have been traded bilaterally.

David Greely (30m 03s):
And it must have been a, a different experience to have regulators starting to push customers towards you with the move towards putting OTC swaps on exchange. And did they get pushed through ClearPort as well?

Joe Raia (30m 14s):
Not the financial contracts. So they were the, there was the, the, the rail after the, the financial crisis Dodd-Frank came about and there was more focus on, on cleared swaps versus and, and the markets in financial markets. Dan was involved in that in some of it after, after he left the NYMEX. But that was, we didn't use ClearPort for that. It was no, the exchange had the NYMEX and that, that point CME after we merged with them had interest rate markets out there. So there was there was a lot of discussions about how, you know, how clear swaps can be used on exchange or how would they be you know, through a swap execution facility. There was a lot of talk around that during the years. We, we looked at it, you know, CME looked at building or buying a swap execution facility, but felt that futures were a better credit or risk mitigation tool than, than swaps themselves.

Joe Raia (31m 03s):
So, you know, there was a lot of talk about how things were gonna change and the market did evolve after that, right. SEFs were with the big talk of the time in 2008, 2009 after dot Frank came about and, you know, and still, and, and the clearing of OTC contracts outside of energy or commodities was also a big focus. I mean, we kept saying to the, to the regulators, Hey, we've been doing this for 10 years, right. We, we know how to do this. There's been this tool in place in the energy marks from the last crisis. You guys should look at this to make sure you're following similar ideals and, and, and structure because it's efficient, it works well. It brought the market together and it solved a lot of the problems that were in the counterparty trading community and energy and commodities back then.

Joe Raia (31m 46s):
And now you should potentially look at this for other, other financial instruments. We also saw a shift in other markets and commodities in European markets that were traditionally bilateral moving into a clear environment. So that helped us, again, build more liquidity, more open interest in other products. We got extremely active in European power and gas. We looked at the time to buy an exchange over in Europe to get entry into the European markets. We listed Asian clear products that were index related out in Singapore and other areas. So yeah, we definitely expanded our footprint because of the focus on counterparty risk and also the mitigation of risk and also the more efficient use of capital.

David Greely (32m 26s):
Yeah. Now it seems like we've definitely have moved beyond the textbook version where futures are cleared and forwards and swaps are not, and we have, you know, cleared swaps and cleared forwards and everything else. I'm curious, Joe, looking back, how did the innovation of clearing OTC trading change the futures markets, maybe both in the nature of the participants, how people access them. What was that evolution like?

Joe Raia (32m 52s):
It was both really. So it, it changed, it brought more participants that might not have been able to access these markets because they didn't want put a NSDA in place or take the time to put a ISDA in place for, you know, 60, 10 months, however long it takes to get active into a new contract or a new asset class. It brought in funds, hedge funds, definitely different asset classes, I would say even some big institutional clients that didn't you know, maybe only traded big benchmarks. Now we're looking at other asset classes like European Power and Gas or Asian products also. So it did, it definitely broadened out the community of participants in the marketplace. I think it also kind of reinforced the, the role of the broker in the marketplace. Everybody kept writing off the, the existing of the inter dealer brokers or the OTC brokers, the intermediation of the marketplace, so to speak.

Joe Raia (33m 39s):
And, you know, we kept seeing and saying that wasn't gonna happen from what we saw from our markets, which were largely brokered. We didn't see that happening where they were going to, they actually became more efficient. They weren't gonna go by the wayside and in fact, the marketplace was looking as the, as we listed more products, the marketplace was looking to the brokers to give the customers, you know, the pricing signals in those new markets and so they found you know, continued life because of the increase in clearing. And even to this day, there's still a very relevant part of the marketplace, including some of the newer markets that we're gonna list on Abaxx in the next coming months. So, you know, they haven't gone by the wayside and they're still very relevant. And I think that despite the effort to disintermediate them through electronic trading, they are a very, very relevant part of the marketplace. So, you know, I guess what's, you know, what's old is sometimes new again too.

David Greely (34m 29s):
Well, speaking of that, I wanted to ask each of you your thoughts on this final question. And that is, what lessons did you learn from your experience in launching ClearPort about what it takes to successfully build and launch new market infrastructure? Many fail. I think you've, it just today you've rattled off quite a few things that didn't work out. How do you succeed in doing this? And maybe I'll start with you first, Dan. Yeah,

Dan McElduff (34m 55s):
The, it, it became pretty clear to me and it's becoming more and more clear the older I get, and the more I understand history as, you know, I view and review it. You know, when, when I was involved in NYMEX and, you know, my mentors were always pushing us to focus on commercial needs and being focused like, what good is a product if there's not a commercial need for it, and what good is it if you can't get to critical mass in engaging them the key parts in, in any marketplace? You know, the, the natural sellers, the natural buyers, and the trading companies who, who move everything in between and that became clear to us, you know, historically we would do that on a product by product basis, but now all of a sudden we recognize the benefits of a clearing house extended well beyond the benchmark products.

Joe Raia (35m 42s):
And, you know, it became evident that we were filling a commercial need that that couldn't, you know, if not being filled, could have been a catastrophe being ready when that opportunity presents itself. There's a lot of legwork that went into it in terms of, you know, evaluating the markets and, you know, knowing when folks said they wanted a new product, you know, how to interpret their needs into a futures contract. And that's, you know, that's something I've done throughout my career. It's, it's, you could take an 80 page bilateral agreement and you boil it down to a five page futures contract, and it's a aren't a lot of science, but it can't be done unless you're getting input from a broad community and that's the last piece and you know, we, if you think of the history of NYMEX as I have and known who the players were, and an earlier interview that you had with Michael Marks, he spoke of the early days where the FCMs and the, and the exchange staff were out beating the pavement, getting folks to put in orders into a marketplace.

Joe Raia (36m 40s):
And this is back in the days of the pit, the Commodity Futures Modernization Act made our job a little bit easier, and that OTC trades were permitted in the form of, of blocks and EEF PS and, and even encouraged back then, everything had to go through the pit, but they did it on the back of a real commercial need. They went out there and hit the payment and they built that community that offers enough depth and diversity where all the benefits come about because that, that community is participating, bringing its bids and offers and trades into the market and, and, and sharing that information with each other, which otherwise outside of an exchange environment goes unheard. And so we very much did in ClearPort what, what NYMEX did when, you know, it converted from potato energy into hydrocarbon energy and historic, you know, looking back on it, it's, it's those three elements I think that are most important and seizing on them is, is what leads to success. You know, certainly in the case of NYMEXand it's moving to energy and, and clipboard into, you know, addressing how, how does one effectively get a bigger part of the market's portfolio into a sound environment.

David Greely (37m 44s):
Thanks, Dan. Maybe now I'll turn to you, Joe. Can you let us know what lessons did you take away from your ClearPort experience?

Joe Raia (37m 52s):
You know, it's, it really, it even goes before that and, you know, I've been in, in commodities for a long time, and I think the one thing, there's two points, but the one thing that does keep coming around is relationships and the value of relationships is as equally or if not more valuable than the value of a market. It's it really, you know, and, and I think anyone will attest that our markets are as large as they are, are really small. And the relationships that you have with traders or trading firms and the, the impact or the how you nurture those relationships is really critically important over the years and I think that that helps us as we're launching a new exchange here. The other thing that I always keep reminding myself is that liquidity is relative. We sometimes we get too, not we here, but we got caught up in the years past of especially after our merger in 2007, that, you know, pools of liquidity had to be massive.

Joe Raia (38m 45s):
We had to be trading a million contracts a day, but yet, and the smaller pools of liquidity that we had built around some of the smaller contracts like NGLs, like LPGs, like, you know, some of the other refined contracts, maybe they had only 25 players in it, but satisfying the, the, the risk and the pricing components of that small pool of liquidity led to other contracts that we were able to launch led to

other volume and open interest led to better risk management tools. So I think that liquidity is relative, and I think if you do satisfy a portion of the marketplace that may seem relatively small, it will eventually help build other markets that you have on your exchange. So, you know, sometimes you get caught up in that it's got to be a benchmark that's trading a million contracts a day. I think if we had 10 contracts that traded a hundred thousand contracts a day, I think we'd be equally as happy as one that's trading a million. So it's really an interesting part of the marketplace and it all goes back to relationships. And I think that's what we'll differentiate ix from the others, is how we approach the marketplace and how we, how we develop those relationships and use them for, for better tools, for, for trading and risk management.

David Greely (39m 54s):
Thanks again to Dan McElduff and Joe Raia of Abaxx Exchanging Clearinghouse. We hope you enjoyed the episode. Join us next week with our guest, Adi Imsirovic, Director at Surrey Clean Energy, Former Global Head of Oil Trading at Gazprom Marketing & Trading, and author of *Trading and Price Discovery for Crude Oils* and editor of the book, *Brent Crude Oil Genesis and Development of the World's Most Important Oil Benchmark*. We'll be discussing the history and speculating on the future of the Brent crude oil market. We hope you'll join us.

Announcer (40m 26s):
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Announcer (41m 15s):
That concludes this week's episode of SmarterMarkets by Abaxx. For episode transcripts and additional episode information, including research, editorial, and video content, please visit smartermarkets.media. Please help more people discover the podcast by leaving a review on Apple Podcast, Spotify, YouTube, or your favorite podcast platform. SmarterMarkets is presented for informational and entertainment purposes only. The information presented on SmarterMarkets should not be construed as investment advice. Always consult a licensed investment professional before making investment decisions. The views and opinions expressed on SmarterMarkets are those of the participants and do not necessarily reflect those of the show's hosts or producer. SmarterMarkets, its hosts, guests, employees, and producer, Abaxx Technologies, shall not be held liable for losses resulting from investment decisions based on informational viewpoints presented on SmarterMarkets. Thank you for listening, and please join us again next week.