By e-mail:

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Re. CSA Staff Notice 91-303 *Proposed Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives*

Ladies and Gentlemen:

TriOptima AB ("**TriOptima**") is pleased to submit the following comments in connection with CSA Staff Notice 91-303 Proposed Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives (the "**Proposal**"). As discussed below in further detail, TriOptima is a provider of post-trade services to major market participants in the OTC derivatives markets.

Any defined terms used have the meaning prescribed to them in the Proposal, unless otherwise specified herein.

TriOptima

TriOptima offers post-trade services in the OTC derivatives markets. TriOptima is headquartered in Stockholm and also conducts its business through its four subsidiaries in New York, London, Singapore and Tokyo. The company's client base is made up of major broker/dealer banks and other financial institutions globally.

TriOptima currently offers three post-trade services for the OTC markets:

- *triReduce*: a service for early termination of OTC derivatives - so called portfolio compression[1],

[1] See Annex 1.

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- *triResolve*: a service for the reconciliation of counterparty positions in OTC derivatives and other financial products, margin management and operational risk management; and
- *triBalance*: a service for the mitigation of portfolio risk imbalances across bilateral and cleared OTC derivative exposures[2].

TriOptima previously offered a trade reporting repository for interest rate derivatives, which has been wound down.

TriOptima's comments on the Proposal

As a provider of post-trade risk reduction services for the OTC-market and for reasons described below, TriOptima encourages the Committee to clarify that transactions which are not subject to mandatory clearing when entered into, will remain exempted from the mandatory clearing requirement if these transactions are amended or replaced in a compression cycle. TriOptima also encourages the provincial regulators of the Committee (the "**Canadian Regulators**") to not include certain transactions that participants enter into as part of post-trade risk reduction services[3] in the clearing mandate.

Amended or replaced trades resulting from a compression exercise

Portfolio compression exercises result in the complete termination of some transactions and the aggregation or reducing of the notional value of other transactions. As defined in the Commodities Futures Trading Commission's (CFTC) rule on Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 Fed. Reg. 55904 (September 11, 2012), a portfolio compression exercise is

> *"an exercise in which multiple swap counterparties wholly terminate or change the notional value of some or all of the swaps submitted by the counterparties for inclusion in the portfolio compression exercise and, depending on the methodology employed, replace the terminated swaps with other swaps whose combined notional value (or some other measure of risk) is less than the combined notional value (or some other measure or risk) of the terminated swaps in the compression exercise."*

Our request applies to the reducing of the notional value in certain transactions or the aggregation of net notional exposures into one transaction between the same counterparties in a portfolio compression exercise. Compression is accomplished either through the amending of the existing transactions, "amended trade", or the termination and entering into a replacement trade which reflects the net notional exposures between the counterparties, "replacement

[2] See Annex 2.
[3] See "Certain transactions resulting from post-trade risk reduction services should not be subject to the clearing mandate" below

trade". In the vast majority of situations there is a reduction in the notional exposures due to netting, however, in some situations there is merely an aggregation of outstanding gross exposures arising from multiple transactions into one replacement trade with no net reduction in notional exposures. There is no change in the counterparties, reference entity, or maximum maturity in either the "amended trade" or "replacement trade" method.

Imposing a clearing obligation on amended trades or replacement trades that result from a compression exercise will impact the effectiveness of compression as a risk reduction tool. Specifically, it would not be appropriate to require clearing of amended trades or replacement trades that result from a compression exercise, where the transactions subject to compression had been entered into prior to the effective date of the mandatory clearing obligation (and consequently were outside scope of the clearing requirement). This is because the compression cycle would shift the counterparty credit risk as the replacement trade or amended trade would be required to face a clearing agency instead of the original counterparty.

It is very likely that firms would simply withhold from compressing uncleared transactions if – when they were replaced or amended in the compression exercise – the replacement trade or amended trade would have to be cleared. This is e.g. because compression is performed on the basis that the economic value of transactions terminated in a compression exercise must be identical to the economic value of the replacement trade in the compression exercise. If the replacement trades face a new counterparty (the clearing agency) the economic value will change and the exposure to the original counterparty may go up.

The transactions represent risk that participants had on their books prior to the compression exercise and during the course of compression no change of ownership occurs. Therefore we would encourage the Committee to clarify that in relation to any non-cleared transactions that were entered into prior to the effective date of the mandatory clearing obligation relating to such transactions, such transactions and their compression replacement trades or compression amended trades shall not be subject to mandatory clearing as a result of a compression exercise.

Support for clarification

Fundamentally, TriOptima believes that transactions which were not subject to a clearing obligation before a compression exercise, should not have to be cleared upon completion of the exercise because they represent risk that the participants already had on their books prior to the compression exercise (albeit risk reduced thanks to the exercise).

TriOptima acknowledges that the Proposal states that entering into and a material amendment to a transactions would subject the transaction to the clearing obligation. The direct consequence of having amended trades or replacement trades resulting from a compression exercise becoming subject to a change in their clearing obligation status, would be for the compression result to potentially violate counterparty credit risk limits, since amended trades and replacement trades would be required to face a clearing agency instead of the original bilateral counterparty. As participants would not know in advance which transactions may be subject to a notional change or replacement, or the amount of notional to be changed or replaced, this would represent an uncontrollable risk that would force participants to reconsider their participation in these industry-wide risk reduction exercises.

TriOptima has been approached by a number of dealers, seeking clarity on this point so that they may continue to participate in portfolio compression as effectively as possible. Moreover, compressions are now required under the EU rules (EMIR Regulatory Technical Standards) and US CFTC rules. In particular, the EU rules will require regular analysis of compression opportunities with all counterparties.

TriOptima would also like to refer to the CFTC No Action Relief from Required Clearing for Swaps Resulting from Multilateral Portfolio Compression Exercises (No. 13-01, dated March 18, 2013) where relief is granted for amended trades and replacement trades.

Compression exercises

Transactions entered into prior to the effective date for clearing may be submitted for compression. A compression exercise requires a number of derivatives to be notionally changed or replaced, in order that participants remain market risk neutral.

For amended trades, this should just be regarded as a life-cycle event, where those transactions already in participants' portfolios prior to the effective for clearing will continue to exist between the same parties, but with a changed notional and reduced overall risk.

Equally, the counterparties to a replacement trade – for a given credit reference entity and end date – remain the same counterparties that faced each other on the transactions originally submitted for compression, but with a reduced overall risk.

The compression methodology does not allow participants to specify which derivatives may be notionally changed or replaced.

Conclusion

Amended trades and replacement trades resulting from compression exercises involving two or more participants should not require the affected trades to be subject to a change in clearing obligation status in Canada. This clarification would enable the industry to continue to use portfolio compression for such trades.

Certain transactions resulting from post-trade risk reduction services should not be subject to the clearing mandate

TriOptima is of the view that it is not appropriate to make all types of OTC derivatives subject to mandatory clearing. As further described below, it would not be appropriate to include certain transactions that participants enter into as part of post-trade risk reduction services in the clearing mandate.

The objective of the G20 commitments is to mitigate systemic risk, and the actions supported by the G20 (including mandatory clearing) are means toward that end. While many OTC derivatives will be suitable for central clearing, some OTC derivatives will, as recognized by the Committee, remain bilateral and not be cleared, and the combination of cleared and uncleared components in a portfolio may create risk imbalances within such portfolios. The portfolio imbalances can however be effectively rebalanced by lowering portfolio risk/DV01 characteristics of the portfolio and, thus, systemic risks, by appropriate injections of new bilateral non-cleared trades. Injections of off-setting trades which are not cleared can help to rebalance and stabilize the portfolio by eliminating risk sensitivities in the portfolio. In a multilateral context, these trades can be generated, while the overall "compound transaction" (as defined below) is market risk neutral for each of the participants.

TriOptima offers this type of post-trade risk reduction service under the name triBalance. The compound transaction package of trades proposed in a triBalance cycle is market risk and funding risk neutral as a whole for each participant. In order to be effective, however, the new risk off-setting trades must be added to the netting sets from where the risk they are off-setting arose. In order to off-set bilateral risks these new trades must thus remain bilateral and non-cleared themselves.

As mandatory clearing requirements are primarily aimed at reducing systemic risk, it is important that they are not applied in a way which effectively limits the opportunity for market participants to reduce such risk through the use of compound transaction post-trade risk reduction services. If portfolio risk reducing/off-setting trades are to fulfill their purpose, it is essential that they are not made subject to mandatory clearing requirements.

Keeping in mind that the Canadian Regulators shall consider e.g. "*the effect of central clearing of the derivative on the mitigation of systemic risk*"[4] when determining which derivatives that are subject to mandatory clearing, we would encourage the Canadian Regulators to make clear that any class of OTC derivatives (as prescribed by Canadian Regulators) that will be subject to mandatory clearing requirements through a clearing agency should not include those derivatives (i) the sole purpose of which is to reduce systemic risk and portfolio risk between more than two counterparties and (ii) which do not change the overall market risk for the counterparties. Such compound transaction derivatives should accordingly be outside any clearing mandate imposed by the Canadian Regulators.

[4] See 12031 of the Proposal.

Compound transaction

A compound transaction may be delivered to participants by a service provider as part of a risk reducing exercise. The "component transactions" which collectively make up the compound transaction should not be subject to mandatory clearing as they are only relevant when executed as part of the compound transaction.

The differences between compound transaction services and trading are:

- A compound transaction is market risk neutral for each of the compound transaction participants:
    - Participants are indifferent to the price at which the components in the compound transaction are concluded, since overall the compound transaction is balanced;
    - Participants do not submit bids and offers to enter into a specific position, but rather indicate tolerances (e.g. maximum change in counterparty credit exposure) which the compound transaction must satisfy; and
    - The compound transaction and its components are not price-forming events. Normally, the compound transaction is effected several hours after the marks-to-market or the pricing curves are determined and, consequently, a compound transaction is calculated on basis of old and irrelevant market data.
- A compound transaction is designed to reduce second order risks emerging from existing OTC derivatives, such as counterparty credit risk, operational risk and/or basis risk.
- A compound transaction is multilateral and not bilateral (i.e. there are more than two parties to the transaction).
- All participants in the compound transaction must accept the transaction in full or it will not be executed. Unlike trading activities, it is an "all or nothing" proposal, arranged by the post-trade risk reduction service provider (e.g. TriOptima), where several thousands of individual transactions are components of the overall compound transaction. The individual component transactions are irrelevant in their own right and cannot be executed separately to achieve the desired risk reduction effect. If one party fails to accept, the entire proposal is declared null and void and no changes to the participants' portfolios take place.
- Periodicity of arranging a compound transaction is not continuous, but rather cycle-based and a cycle extends over more than a trading day.
- The service provider is not party to the compound transaction; nor is it involved in settlement of the compound transaction.

We are happy to provide further information on the above, if and as required.

Yours faithfully,

TriOptima AB

Per Sjöberg
Chief Executive Officer

Christoffer Mohammar
General Counsel

Annex 1

Because of the interconnectedness of derivatives trading, active market participants have at any one time large numbers of contracts outstanding with multiple counterparties, each creating counterparty credit risk and an operational burden to manage and oversee. However, when these risks are viewed on a portfolio basis and compared against the portfolios of other participants, there are ready opportunities to reduce certain risks without changing one's market risk. triReduce compression allows participants to terminate contracts early in order to eliminate counterparty credit risk, lower the gross notional value of outstanding contracts, and reduce operational risks by decreasing the number of outstanding contracts. triReduce is operated for rates, credit and commodity derivatives and has helped remove in excess of $400 trillion of gross notional exposure from the financial system since its launch in 2003 including, more recently, cleared transactions. triReduce has approximately 180 subscribing legal entities.

Annex 2

The objective of the G20 commitments adopted in Pittsburgh 2009 is to mitigate systemic risk, and the actions supported by the G20 (including mandatory clearing) are means toward that end. While many OTC derivatives will be suitable for central clearing, some OTC derivatives will remain bilateral and not be cleared, and the combination of cleared and uncleared components in a portfolio may create risk imbalances within such portfolios and increase initial and variation margin requirements. The portfolio imbalances can however be effectively rebalanced by lowering portfolio risk/DV01 characteristics of the portfolio and, thus, systemic risks, by appropriate injections of new bilateral non-cleared trades. Injections of off-setting trades which are not cleared can help to rebalance and stabilize the portfolio by eliminating risk sensitivities in the portfolio. In a multilateral context, these trades can be generated without changing participants' market risk and funding risk. TriOptima's triBalance (counterparty risk rebalancing) service was launched to enable rectification of such portfolio imbalances.