

To each of:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
Financial and Consumer Services
Commission (New Brunswick)
Nova Scotia Securities Commission
Ontario Securities Commission

By e-mail:

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Re. CSA Staff Notice and Request for Comment Proposed National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives and Proposed Companion Policy 04-101CP 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 and Request for Comment Proposed National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives (the

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“Proposal”) and Proposed Companion Policy 04-101CP Mandatory Central Counterparty Clearing of Derivatives. 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
- *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’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 services³ in the clearing mandate.

Amended or replaced trades resulting from a compression exercise

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

¹ See Annex 1.

² See Annex 2.

³ See “Certain transactions resulting from post-trade risk reduction services should not be subject to the clearing mandate” below.

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 of risk) of the terminated swaps in the compression exercise."

As noted, compression can be accomplished through amending existing transactions, "amended trade" method, or termination and entering into replacement trade(s) which reflects the net notional exposures between the counterparties, "replacement trade" method. 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 change in notional exposures. There is no change in the counterparties, underlying, 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 notes that the Proposal states that entering into and a material amendment to a transaction 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 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. It should be noted that this is not a time limited relief.

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 clearing mandate becoming effective will continue to exist between the same parties, but with a changed notional and reduced overall risk.

Equally, the counterparties to a replacement trade 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 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 as well as cleared trades. Injections of off-setting trades which are not cleared can help to rebalance and stabilize the bilateral portfolio by eliminating risk sensitivities in such uncleared portfolio and injection of cleared trades can help to rebalance and stabilize the cleared portfolio and lower risk in the CCP. In a multilateral context, all these trades can be generated while the overall "compound transaction" (containing all new proposed bilateral trades as well as new cleared trades) 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 purpose of the Proposal is "*to propose mandatory central counterparty clearing of certain standardized over-the-counter (OTC) derivatives transactions, in order to improve transparency in the derivatives market and enhance the overall mitigation of systemic risk*",⁴ 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) whose sole purpose 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 derivatives should accordingly be outside any clearing mandate imposed by the Canadian Regulators.

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

⁴ See page 2 of CSA Notice and Request for Comment, Draft Regulation 94-101 respecting Mandatory Central Counterparty Clearing of Derivatives and Draft Policy Statement to Regulation 94-101 respecting Mandatory Central Counterparty Clearing of Derivatives.

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 \$600 trillion of gross notional exposure from the financial system since its launch in 2003 including, more recently, cleared transactions. triReduce has approximately 210 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 efficiently rebalanced by lowering counterparty risk/DV01 in a portfolio.

Injections of off-setting trades between specific counterparties can rebalance risk exposures across multiple CCPs and bilateral counterparties alike. Proactive risk rebalancing helps reduce systemic risk and is a valuable tool for both CCPs and their members in the administration of their default recovery and resolution situations. 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.