To each of

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

Via

Robert Blair, Secretary
Ontario Securities Commission
comments@osc.gov.on.ca

and

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
consultation-en-cours@lautorite.qc.ca

Re: CSA Consultation Paper 95-401

TriOptima AB ("**TriOptima**") is pleased to submit the following comments in connection with the Canadian Securities Administrators' ("**CSA**") CSA Consultation Paper 95-401 on Margin and Collateral Requirements for Non-centrally Cleared Derivatives (the "**Consultation Paper**"). We note that there is no specific question in the Consultation Paper which is directly relevant to our comments so we provide general comments.

As discussed below in further detail, TriOptima is a provider of post-trade services to major market participants in the OTC derivatives markets.

TriOptima AB
Mäster Samuelsgatan 17
111 44 Stockholm
Sweden

tel +46 8 545 25 130
fax +46 8 545 25 140
Company reg no. 556584-9758

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

TriOptima background

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

TriOptima offers post-trade services for the OTC markets such as:

- *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;
- *triBalance*: a service for the mitigation of portfolio risk imbalances across bilateral and cleared OTC derivative exposures[2]; and
- *triCalculate*: a service for counterparty credit risk analytics.

TriOptima's comments on the Consultation Paper

TriOptima understands that initial margin and variation margin requirements would apply to new contracts entered into from the effective dates of the margin requirements (each a "**Margin Effective Date**"), and thus exempt existing derivatives from such margin requirements. TriOptima also strongly supports the guidance provided in footnote 28 of the Consultation Paper that amendments to existing derivatives contracts and replacement of existing derivatives contracts, resulting from compression, will not qualify as new derivatives contracts under certain circumstances. The footnote is found under the Initial Margin heading. With reference to footnote 28 of the Consultation Paper and as further explained below, we would encourage the CSA to not make (i) amendments to trades or replacement trades, as a result of portfolio compression, and (ii) certain derivatives trades entered into for the sole purpose to reduce post-trade risk in legacy portfolios, subject to the *initial or variation* margin requirements – even if they were entered into after the Margin Effective Date.

Post-trade risk reduction services are widely recognized as important risk mitigation tools. CFTC rulemaking under the Dodd-Frank Act explicitly requires Swap Dealers and Major Swap Participants to *"establish, maintain, and follow written policies and procedures for […] periodically engaging in multilateral portfolio compression exercises […]"* in relation to uncleared swaps. In the EU, the MiFIR regulation has expanded on the definition of post-trade risk reduction services, not merely limiting it to post-trade compression services, by highlighting that "*the obligation to conclude transactions in swaps pertaining to a class of*

[1] See Annex 1
[2] See Annex 2

swaps that has been declared subject to the trading obligation on a regulated market, MTF, OTF or third country trading venue should not apply to the components of non-price forming post-trade risk reduction services which reduce non-market risks in swaps portfolios including existing OTC swaps portfolios in accordance with Regulation (EU) No 648/2012 without changing the market risk of the portfolios. In addition, while it is appropriate to make specific provision for portfolio compression, this Regulation is not intended to prevent the use of other post-trade risk reduction services." (MiFIR, Recital 27). The Monetary Authority of Singapore has also proposed making portfolio compression mandated.[3]

Scope of activities

The above regulatory examples further underline the importance of post-trade risk reduction services in financial markets, both today and in the future.

The scope of activities that would classify as post-trade risk reduction services is limited as these services only aim at reducing risks for derivatives transactions already entered into. Examples of specific post-trade risk reduction services include:

- **Portfolio compression**: Counterparties wholly terminate or change the notional value of some or all of the transactions submitted by the counterparties and depending on the methodology employed, replace the terminated transactions with other transactions whose combined notional value is equal to or less than the combined notional value of the terminated transactions in the compression exercise.[4]

- **Counterparty risk balancing**: Counterparty risk management that rebalances counterparty risk exposure between multiple CCPs and bilateral relationships.[5]

Margining and post-trade risk reduction services

The scope of the margin requirements set forth in the Consultation Paper does not explicitly cater for all types of post-trade risk reduction services.

With respect to portfolio compression, imposing margin (initial margin or variation margin) requirements on amendment trades or replacement trades that result from a compression exercise will impact the effectiveness of compression as a risk reduction tool in cases where the derivatives subject to compression were not subject to any margin requirements pre-compression (entered into prior to the Margin Effective Date). If such trades would be subject to the variation margin requirements (but not initial margin requirements as noted in footnote 28 of the Consultation Paper), then participants may be significantly disincentivized from participating in portfolio compression exercises as participants would not know

[3] See paragraph 3.20 of the Monetary Authority of Singapore's Consultation Paper P009 – 2015, June 2015 on Regulatory Framework for Intermediaries Dealing in OTC Derivative Contracts, Execution- Related Advice, and Marketing of Collective Investment Scheme.
[4] The portfolio compression methodologies are further explained in Annex 1.
[5] See Annex 2

how their margin would be impacted as a result of the compression exercise and its amendment or replacement trades.

With respect to counterparty risk rebalancing, if all new derivatives trades resulting from the post-trade risk reduction exercise would attract initial and variation margin payments, legacy portfolios (consisting of derivatives trades entered into prior to the Margin Effective Date set forth in the Consultation Paper) would be significantly dis-incentivized from the use of such post-trade risk reduction exercise, as such post-trade risk reduction trades would be subject to margining requirements whereas the original derivatives trades are not. For counterparty risk rebalancing to work, adjustments must be made to the cash flows belonging to the same netting set from which the bilateral risk emerges, in order to achieve the intended reduction of bilateral portfolio risk. Accordingly, to the extent the Consultation Paper has the effect that derivatives trades resulting from post-trade risk reduction services are not allowed to be maintained in the same netting set as that from which the bilateral risk emerges (i.e. for legacy trades the non-margined netting set), the Consultation Paper will significantly decrease the efficiency of, and disincentivize market participants from using, such risk reduction services.

We would urge the CSA to consider classifying trades that result from post-trade risk reduction services on legacy portfolios equally as legacy transactions that (i) are not subject to the margin requirements – initial margin or variation margin, and (ii) are allowed to be maintained in the same netting sets from where the risk emerged.

To assist, we have suggested below some key components that define these post-trade risk reduction services and that could serve as a basis for classifying these services in legislation:

"Components of non-price forming post-trade risk reduction services which reduce non-market risks in derivatives portfolios shall mean only components of a compound transaction where:

- the transaction is designed to be overall market risk neutral for each participant;
- the participants of the transaction do not submit bids and offers to enter into a specific position;
- the transaction is cycle-based and multilateral (e.g. including at least two participants), and must be accepted in full by all participants or it will not be effected;
- the transaction is designed to reduce secondary risks emerging from existing derivatives transactions, such as counterparty credit risk, operational risk and/or basis risk."

Conclusion

The margin Consultation Paper as it is currently proposed could impede the use of compression, counterparty risk rebalancing and other post-trade risk reduction activities and services that align with the policy objective of lowering systemic risk in the financial system, and again we strongly urge the CSA to consider classifying trades that result from post-trade risk reduction services on legacy portfolios equally as legacy transactions (non-trading transactions) that do not require the posting of bilateral margin – initial margin or variation margin.

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

Yours faithfully,

TriOptima AB

Per Sjöberg

Group Chief Executive Officer
TriOptima

Christoffer Mohammar

General Counsel
TriOptima

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 $700 trillion of gross notional exposure from the financial system since its launch in 2003 including, more recently, cleared transactions. triReduce has approximately 250 subscribing legal entities.

A multilateral compression exercise results in the complete termination of some transactions and the aggregation or reducing of the notional value of other transactions. As defined in Art 2(47) of MiFIR, portfolio compression means

> "a risk reduction service in which two or more counterparties wholly or partially terminate some or all of the derivatives submitted by those counterparties for inclusion in the portfolio compression and replace the terminated derivatives with another derivative whose combined notional value is less than the combined notional value of the terminated derivatives."

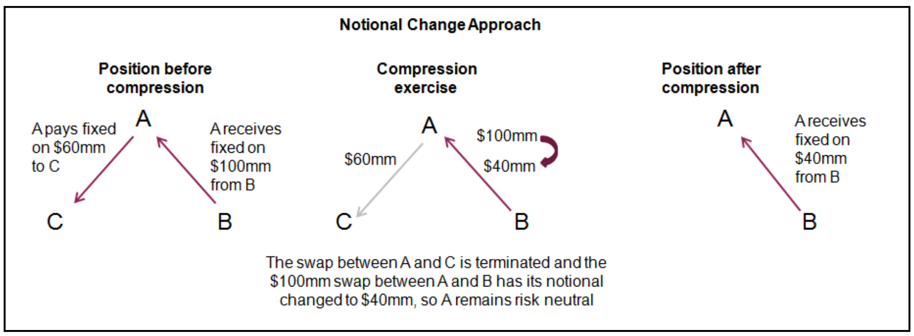
In accordance with the above definition, compression can be accomplished through (i) the "amended trade" method where transactions are wholly or partially terminated to represent (as closely as possible) the net notional exposures between a pair of counterparties, or (ii) the "replacement trade" method where transactions are wholly terminated and compression replacement transactions which reflect more closely the net notional exposures between a pair of counterparties (hereinafter called "replacement trade") are entered into. As noted above, there is no change in the counterparties, reference entity, or maximum maturity in either the "amended trade" or "replacement trade" method. These two compression methods are explained graphically below.

Compression methodology description

The triReduce compression process involves notional adjustment and/or replacement of transactions, depending on the methodology employed. The examples below illustrate how these approaches differ. In both methodologies, the counterparty credit exposure remains between the same counterparties that originally submitted the transaction.[6]

Example using notional change – amended trade (typically used for IRS products)

As a result of a compression exercise, a $100mm swap between parties A and B is required to be notionally changed to $40mm, in order that A remains overall risk neutral. Parties A and B adjust the notional on the swap in their respective systems from $100mm to $40mm. All swaps which are required to be notionally changed are enriched with an event processing ID by TriOptima.



[6] In the diagrams, only party A's risk neutrality is illustrated.

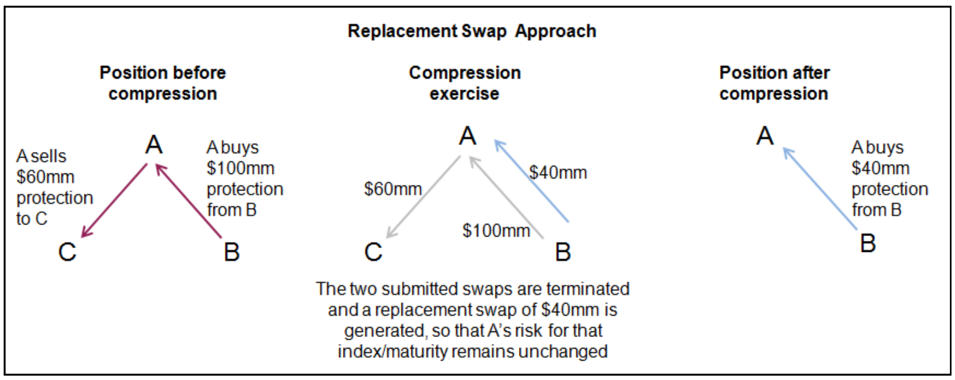
Example using replacement swaps (typically used for CDS products)

For CDS products, although a swap may be notionally changed as in the description above, more commonly, the net position of two or more swaps is represented with a replacement swap.

Party A has two swaps in a CDX index (same maturity date and coupon)

- Swap 1 is \$100mm bought protection versus counterparty B
- Swap 2 is \$60mm sold protection versus counterparty C

As part of a compression exercise, both swaps are terminated. Party A's net position is represented with a replacement swap of \$40mm bought protection versus counterparty B. The replacement swap is enriched with an event processing ID by TriOptima, which provides a common link between compressed and replacement swaps.



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 counterparty risk/DV01 in a portfolio.

Injections of offsetting 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.