Basel Committee on Banking Supervision

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Subject: Consultative Document Guidelines for counterparty credit risk management (D574).

16th June 2024

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OSTTRA, 50/50 owned by CME Group and S&P Global, is a leading provider of progressive post-trade solutions for the global OTC markets across interest rate, FX, equity and credit asset classes. It incorporates CME Group's legacy optimisation businesses – Traiana, TriOptima, and Reset – and IHS Markit's legacy MarkitServ business. OSTTRA brings together the people, processes, and networks to solve the market's most pressing problems through innovating, integrating, and optimising the post-trade workflow. The combined force of the product suite ensures a streamlined post-trade ecosystem that helps clients drive even greater efficiencies. As the demands for automation continue to transform the post-trade landscape, OSTTRA is at the forefront of helping market participants build a secure and sustainable market infrastructure.

Headquartered in London, with a substantial global presence, including regulated entities in the UK and Sweden, OSTTRA employs over 1,400 staff in 10 countries.

OSTTRA is the home of:

MarkitServ: Our end-to-end trade processing and workflow solutions connect more than 2,500 counterparties across the global derivatives and FX markets. We process 10 million trades per month and have transaction confirmations of live customer transactions representing $500 trillion in notional outstanding.

Traiana: A network of over 2,000 counterparties, Traiana processes 37 million trades and $22 trillion in notional per month.

TriOptima: We have supported the OTC industry for over 20 years, compressing more than 2 quadrillion gross notional across 28 currencies and connecting 2,000 counterparties to reconcile 34 million trades per month. We are the market leader in counterparty risk optimisation and collateral management.

Reset: Reset provides leading basis risk mitigation services in the derivatives marketplace. We connect 2,500 counterparties, 145 banking groups across 38 countries. The Reset service is provided by TriOptima AB.

As the leading end-to-end post-trade solutions provider, OSTTRA is pleased to provide its comments to the BCBS Consultative Document on Guidelines for counterparty credit risk management (D574) (the “Consultation”).

We welcome the opportunity to respond to the Consultation and welcome some of its contents, specifically its recognition of the importance of good margining practices in non-centrally cleared markets.

Today OSTTRA, offer market leading trade processing services as well as portfolio reconciliation, cashflow affirmation, collateral management, risk calculations (PV, Initial Margin, XVA), multilateral compression, counterparty risk mitigation (rebalancing), and basis risk mitigation for certain non-centrally cleared OTC derivatives. These services help clients efficiently manage the trade lifecycle to meet a broad range of market and regulatory challenges, specifically optimising resources by lowering costs, minimising operational, credit, and basis risk, improving counterparty exposure management, streamlining collateral processing and settlement, and reducing systemic risk in their derivatives portfolios.

Executive Summary:

We welcome the Consultation specifically its focus on banking institutions to:

- Construct an effective CCR governance framework by adopting a combination of risk management techniques across credit, market, operational and liquidity risk disciplines; and
- Manage CCR by risk-sensitive margining as well as measuring, controlling and limiting CCR.

As part of its assessment, the Committee should also consider the significance of *reducing* CCR in an institution’s existing portfolio, and the utility of post-trade risk reduction services (PTRRS) in achieving this outcome. Today, PTRRS are widely used across the financial industry and their ability to significantly reduce risk in the chosen measure has been continually recognised by both industry participants, associations, regulators and central banks as outlined in OICV-IOSCO’s consultation report on post trade risk reduction services, CR/03/2023.

We urge the Committee to remind institutions of the contributory role PTRRS can play in reducing CCR and strengthening an institution’s overall CCR risk management and governance framework.

Please find our detailed comments to the proposed guidelines below.

Comments to Consultation

Operational risk:

- Institutions should be encouraged to develop and maintain an operational risk framework where breaks leading to a dispute on either VM or IM should be avoided to the extent possible. Third-party platforms and services offering streamlined and automated margin workflows such as triResolve Margin offer a cost effective and flexible solution to help manage such breaks.

Trade data:

- Use of a third-party reconciliation tool to identify and fix breaks in trade data is an efficient and effective way to avoid disputes by enabling efficient resolution of breaks.

- Use of a fallback calculation agent or a third-party independent valuation can be useful for effective dispute resolution

- Use of third-party analytical/KRI tools could be useful to monitor portfolio and trade trends.

Settlement risk:

PvP/DvP

- A large proportion of the market does not settle through a PvP/DvP mechanism. Where possible, institutions should settle through PvP/DvP arrangements to reduce risk and improve settlement efficiency and certainty.

VM & STM

- Where possible, settlement should take place in a timely manner with VM to avoid "collateral spikes" as trades settle. Such collateral spikes can be significant and lead to institutions being under collateralised as trades settle. STM initiatives in the market are set to address this and should be considered where possible/appropriate.

- Institutions should, where available, favour the use of settled-to-market where VM is no longer regarded as collateral but rather as an irrevocable payment from one party to the other, reducing the complexity of any legal claim upon default of a counterparty.

Credit risk:

- XVA, IM, PFE and capital calculations carried out by an independent third-party can help firms with (1) a benchmarked calculation and (2) easy access to stress testing, what-if scenario analysis, P&L explained and back-testing so that these metrics can be more easily forecast and optimised.

<u>Post Trade Risk Reduction Services (PTRRS):</u>

We note that the proposed guidelines focus on managing CCR through risk-sensitive margining as well as measuring, controlling and limiting CCR, but not *reducing* CCR in existing portfolios.

Reducing CCR in existing portfolios is equally important, and institutions should be encouraged to actively assess and use PTRR solutions, where suitable.

There are three different types of PTRRS prevalent in the market today: portfolio compression; portfolio rebalancing; and basis risk mitigation.

- **Portfolio Compression**

Portfolio compression refers to the practice of tearing up existing transactions between two or more participants and where applicable, depending on methodology used, replacing them with a small number of new contracts, without altering participants' market positions beyond very small, preset, tolerance thresholds. It aims to reduce the number of contracts outstanding, the gross notional value of contracts, or another measure of risk without materially affecting the market risk of the portfolios.

The PTRRS provider's algorithms look for a portfolio of trades with offsetting characteristics that can be netted off against one another, within preset tolerance thresholds, and so can be torn up in order to reduce the number of transactions and the gross notional amount outstanding.

Compression exercises can be carried out bilaterally between two (or more) counterparties but are more commonly done multilaterally, and are therefore arranged by a third party, between a network of counterparties. They are also scheduled to take place at specific pre-determined times, on a pre-determined currency, and for cleared populations on a pre-determined singular CCP.

- **Counterparty Risk Optimisation/ Portfolio Rebalancing**

Portfolio rebalancing involves inserting new administrative derivatives transactions into the portfolios of participants to reduce risks linked to those trades. These are offsetting administrative transactions that rebalance relationships between different counterparties when it comes to the portfolios' exposure to certain types of risk, such as interest-rate risk, while ensuring each participant's portfolio remains market risk neutral (other than very small tolerances).

In order to work efficiently, exercises need to be multilateral, and are therefore arranged by a third party, (rather than bilateral) so that offsetting transactions can be found among a broad network of counterparties, such that the total impact of all the transactions for each participant's portfolio is market risk neutral (other than very small tolerances). Overall market-risk exposure is not changed by these exercises, and the new transactions are collectively risk-neutral (other than within very small tolerances).

What this means in practice is that the new transactions reduce overall credit risk exposures between counterparties, and thus, reduce the size and volatility of margin and capital requirements that are costly to market participants.

- **Basis Risk Mitigation**

Basis risk mitigation is used when firms are concerned about P&L impacts from misaligned reset / fixing dates for swaps or expiry dates / strike prices (pin risk[1]) for options. These exposures create unwanted second order risk in their hedged portfolios. Basis risk mitigation services are aimed at reducing exposure to these second order risks. Basis risk mitigation services do not remove positions, instead it adds new administrative transactions to neutralise the second order basis risk of the existing positions. These offsetting new administrative transactions are aggregated so that they do not change the overall direction of the portfolio (other than within very small tolerances).

We would be happy to discuss our comments with BCBS, or any of their members at your convenience. If you have any comments or questions regarding this submission, please feel free to contact us.

Yours faithfully,

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[1] Pin risk is the risk to options traders that the underlying security will close at or very close to the strike price of expiring options positions held.