

**TriOptima response to the CPMI-IOSCO
Consultative Report on**

*Resilience and recovery of central
counterparties (CCPs): Further
guidance on the PFMI*

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1. Executive summary

TriOptima welcomes the opportunity to present our views on the consultation of Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI.

Our comments are directed towards actions that can be taken pro-actively to minimize the unmatched book risk which gives rise to recovery measures on the part of the CCP. The intention is primarily to reduce the likelihood that any CCP would have to go through a recovery process and secondarily, in case such processes have to be invoked, to maximize the chances of successful recovery and sufficiency of the default waterfall.

The unmatched book risk can be significantly reduced pro-actively through a process of risk compression, or compression of equivalent net notional outstanding in a CCP.

CCP unmatched book risk is driven by the sensitivity of the defaulting member's derivatives portfolio to changes in underlying market parameters. Market volatility interacts with this sensitivity, leading to swings in the value of the portfolio.

In normal market conditions these swings in portfolio value are covered by daily transfers of variation margin between the counterparties. In the event of a member default, the ensuing swings in market exposure created by the defaulting member's open positions in the CCP need to be re-hedged. The difference between the market value at the time of default and the value at the time of re-hedging the positions is what consumes the initial margin and, if insufficient, the subsequent layers of the default waterfall. If this market risk sensitivity of the derivatives portfolio can be reduced substantially without changing the overall market sensitivity of clearing members – then the CCP unmatched book risk will have been substantially reduced for the system as a whole.

Reduction of this portfolio market risk sensitivity can be achieved through “portfolio rebalancing” - a form of post-trade risk compression:

- Portfolio rebalancing takes as input, on a multilateral basis (including one or more CCPs), the sensitivity of the derivatives portfolio exposures of counterparties to one another as a result of changes in a given underlying market parameter such as interest rate risk
- Through a multilateral all-or-nothing compound transaction between the counterparties (including the CCP) these counterparty risk exposures are rebalanced by offsetting the current portfolio sensitivity. The compound transaction is designed to minimize the portfolio sensitivity (and therefore exposures and collateral flows) while leaving the overall market value and sensitivity across counterparts of each

counterparty unchanged (the transaction in this operation nets down to zero and is market risk neutral)

By rebalancing counterparty relationships in this multilateral and recurring manner, the counterparties can have as flat a counterparty risk exposure to one another as possible –meaning that in case a default occurs, the unmatched book will already be substantially hedged and the open risk exposure minimized.

Such risk compression is a complement to existing portfolio compression but would not be the same form of post-trade risk reduction.

Substantial progress has been made at international level in harmonizing the global framework for financial market infrastructures (FMIs). Work has also progressed in the field of non-centrally cleared derivatives risk mitigation. However a key area of focus for the international regulatory community moving forward needs to be in the field of risk reduction between FMIs and their participants, and in the bilateral relationships between participants.

The attached white paper gives a comprehensive description of one such risk compression methodology as well as outlining the current regulatory uncertainty impacting a robust implementation.