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A PROACTIVE APPROACH

The latest letters to the New York Fed underscore how rapidly market practice standards have changed for OTC derivatives. Volatile markets, bankruptcies, takeovers and bailouts have demonstrated how vital it is to always know where counterparty credit exposure lies. Proactive portfolio reconciliation is now mandated, and this is where TriOptima's triResolve service comes in, says **Susan Hinko**

The collateral management process assumed paramount importance during the recent market disruptions. Credit officers immediately turned to the collateral department for an up-to-date assessment of their greatest vulnerability to counterparty credit exposure. While individual trading and risk management areas calculate their OTC derivative exposures, a firm's collateral department is the one place where all trading systems funnel information so that the firm can protect itself by calculating aggregate exposures and making collateral calls. Before the current exposure can be calculated, the trade populations must be reconciled, and it is impossible to act swiftly if the reconciliation process is still reactive rather than proactive.

Recognition of the need for regular proactive reconciliation was recognised by industry groups like the Collateral Framework Group* and the International Swaps and Derivatives Association's Collateral Committee who began the dialogue to change market practice. But in the past year, the US regulators have required that proactive portfolio reconciliation be implemented as the new standard for effective exposure management.

The introduction of TriOptima's triResolve portfolio reconciliation service in 2006 revolutionised market practice. By June 2009, with all Fed 16 banks, many smaller banks, asset managers, hedge fund managers, other buy-side institutions, and service providers



Susan Hinko

using triResolve, over 75% of all uncleared OTC derivative trades were being reconciled on the service. This covers 5.2 million trades (single-counted) from 1,750 legal entities across all asset classes including credit derivatives, interest rate products, equity derivatives, foreign exchange and commodities, as well as structured transactions and hybrids.

Accompanying the move to proactive reconciliation was the commitment by the Fed 16 dealers to increased frequency of reconciliation. By June 30, 2009 the Fed 16 dealers had committed to the NY Fed to reconcile *daily* all collateralised portfolios in excess of 500 trades between their firms and to submit reports on the results of their reconciliations to the regulators on a monthly basis. This seismic shift in standards for reconciliation was enabled by the adoption of triResolve across the dealing community.

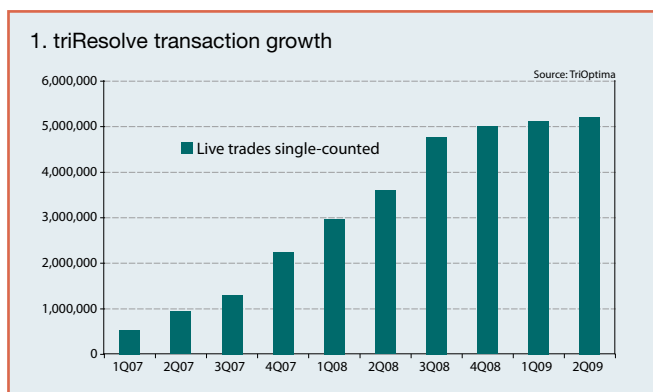
Proactive versus reactive reconciliation

Until triResolve was introduced, trade populations were typically reconciled by exchanging spreadsheets. Even as interdealer portfolios grew into the tens of thousands of trades and the number of collateralised relationships with all kinds of trading partners proliferated, portfolio reconciliations remained reactive, dispute-driven activities with understaffed firms overwhelmed with work.

As events proved, trying to reconcile the large portfolios that now number in the tens to hundreds of thousands of trades without an automated support system can take a lot of time, and the market can move before a resolution of trade population and mark-to-market (MTM) values is achieved. Collateral calls remain undocumented and unmet.

It is critical to adopt the proactive reconciliation approach before market instability puts pressure on the collateral process. Rather than waiting for something to trigger a collateral call, firms should ensure their portfolios are reconciled so dramatic changes in MTM exposures can be identified and focused on quickly.

Using the triResolve service, clients submit data on their bilateral relationships most often daily or weekly, and receive the results within the hour. The data is submitted for all OTC derivative



transactions between counterparties. triResolve only requires 10 key fields as a minimum for reconciliation, but clients can submit many more if they wish.

Most importantly, data can be submitted in any format the user chooses. TriOptima client service managers will map the client data into a normalised triResolve format, standardising it so that reconciliation is easier to perform. After the initial mapping is done, the client continues to submit data in its own format, frequently taking the data directly from the collateral management system. Automated data uploads have become the norm for most users.

Community benefits

The unique concept behind triResolve is the network community approach to proactive, regular portfolio reconciliation. The service is web-based and interactive, requiring no programming or software installation. It extends the reach of a firm's internal processes by involving its counterparties, providing immediate access to critical counterparty information and a forum for resolving issues with counterparties online.

triResolve replaces email, the current standard communication tool, with instant access to a single secure data entry point with a fully automated upload process. Trade discrepancies are resolved on the triResolve website through direct, online communication with the counterparty by commenting either at the trade level or relationship level. Scanned confirmations can be attached to a comment allowing easy resolution of differences.

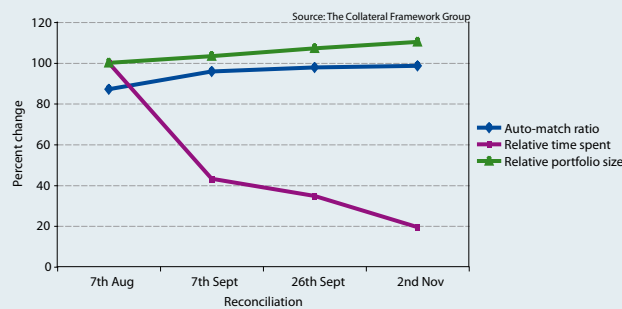
Users can reconcile with their counterparties as often as they want, either on a regularly scheduled or an *ad hoc* basis. The trade information is retained in the triResolve database from one reconciliation to the next so users can quickly identify trade discrepancies as they arise.

triResolve's sophisticated reporting functionality and advanced analytics provides information for senior management, for department analysis or for the recently instituted regulatory requirements. Senior front office and credit managers can have access to reports of the largest MTM exposures by counterparty or transaction type or age of dispute. Operations, trade control and collateral personnel can perform a drill-down analysis at any level of the counterparty relationship or the product portfolio to determine root causes of breaks.

With regular reconciliation, even as portfolios grow between counterparties, the number of hours spent on researching differences decreases dramatically and auto-match levels reach 98–99%. Chart 2 demonstrates one user's experience over just four consecutive reconciliations and offers a compelling illustration of the benefits of being proactive. It shows the reduction in hours spent reconciling the portfolio over three months and the change in auto-match rates even as the bilateral portfolio grew between the counterparties.

triResolve's matching algorithm helps solve the challenges of reconciliation by proposing matches for splits and structured trades that users can approve online as well. Once a match is recorded in the triResolve database, it remains as a persistent match until affected by expiration or a market event.

2. Benefits of proactive portfolio reconciliations



Commitments to the Fed on portfolio reconciliation

Since July 2008, the major dealers, Isda, the Managed Funds Association, and Sifma's Asset Management Group have signed a series of letters to the NY Fed addressing many of the market practice issues surrounding OTC derivatives including collateral management and portfolio reconciliation. As of July 2009, daily reconciliations among the Fed 16 dealers have been achieved as well as risk-based reporting of valuation differences to each dealer's local regulators. Additional commitments include the development of Portfolio Reconciliation Best Practices and a feasibility study on market-wide portfolio reconciliation that takes into account the challenges faced by smaller banks, buy-side participants and end-users.

As the importance of daily reconciliation has gained recognition among the banking regulators and the dealer community, there has been a noticeable increase in interest in and adoption of the practice by the buy-side, many of whom have turned to triResolve.

A triResolve user with the appropriate organisational infrastructure including a team of collateral professionals that can analyse and act on the information that triResolve provides is well-positioned to meet the standards that will be set by the best practices guidelines.

With the valuable input and collaboration of its users, triResolve continues to evolve to meet the needs of all its subscribers: sell-side, buy-side, large, small wherever they are located. Reconciling over 75% of all collateralised OTC derivatives trades in July 2009 and growing every month, triResolve is a service that has made a difference not only to collateral professionals but to credit risk managers, trading managers, and operations groups around the world. ☉

Susan Hinko is global head of industry relations at TriOptima

** Members of the Collateral Framework Group included ABN Amro, Barclays, BoA, Citi, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JPMorgan, Merrill Lynch, Morgan Stanley, RBS and UBS*

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A network community for ***controlling counterparty exposure*** in OTC derivatives

Join global dealers, regional banks and buy-side firms in reconciling your portfolios with the market leader **triResolve** from TriOptima. 75% of all outstanding OTC derivatives globally are reconciled regularly on **triResolve**.

triResolve provides a network community where you can resolve issues efficiently, quickly and easily. With proactive, regular reconciliation – monthly, weekly or daily – you get an immediate understanding of your counterparty exposures and can focus on the exceptions to minimise your risk.

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