



## Gaining momentum

### **Proactive portfolio reconciliations are discussed by Henrik Nilsson, head of business development at TriOptima**

OTC derivatives trading volumes continue their extraordinary growth across asset classes. The escalating volumes, complexity of structures and increasing number of counterparties have presented new and urgent challenges to operations as well as counterparty risk management.

During the past year, portfolio reconciliation has gained much attention. The sub-prime credit crisis has heightened awareness about the importance of reconciling trade populations and valuations regularly with counterparties in advance of market turbulence.

Increased volatility and sudden illiquidity, coupled with an increased velocity in trading, resulted in significant valuation and trade population differences between counterparty portfolios. This in turn increased the number of collateral calls and valuation disputes. Counterparties who had begun to proactively reconcile their portfolios were in a much better position to make the daily collateral calls required by their legal agreements, manage the increased work-load in their collateral departments and understand their counterparty credit risk exposures.

It is essential that OTC derivatives dealers are able to mitigate counterparty exposures through timely exchange of collateral, since any unsecured exposures require capital reserves on the balance sheet. As unsecured exposures grow and capital becomes a scarcer resource, collateral management is increasingly becoming an issue for senior management. Regular portfolio reconciliation has also become a focus of regulatory interest (see BIS CPSS 2007 study on 'New Developments in Clearing and Settlement Arrangements for OTC Derivatives'), and an industry initiative by the Collateral Framework Group has been addressing the practical aspects of portfolio reconciliations.

Reconciled trade populations lead to several operational benefits beyond collateral management. By identifying and correcting legal entity mis-bookings and resolving any other discrepancies earlier rather than later, many settlement breaks can be avoided.

For buy-side institutions, generating monthly fund net asset values is significantly easier since trade data is reconciled continuously throughout the month. It enables buy-side institutions to produce accurate NAVs quickly.

### **An online community for reconciliation**

Until recently each market participant would perform portfolio reconciliations when collateral disputes arose either by exchanging spreadsheets with each other or using software packages with broader functionality. These solutions work for smaller volumes of data and counterparties but do not meet the challenges of large portfolios, daily collateral calls and increasing numbers of counterparties. Their limitations make it impossible to identify and analyse quickly the causes of portfolio discrepancies.

Recognising a growing need, the market has seen the introduction of alternative solutions by software vendors and service providers that address these limitations in varying ways. TriOptima has created its own solution, triResolve, which solves these problems with an easily accessible, networked workspace where counterparties research and resolve their differences online.

The triResolve web-based portfolio reconciliation service forms a virtual community where counterparties see a common view of the issues and can communicate with each other directly online, placing comments, uploading confirmations and assigning breaks. Currently, the majority of large OTC derivatives dealers use the triResolve service. Each week, portfolios of more than three million trades are reconciled, including data from the participating dealers and hundreds of their clients.

Now that the majority of dealers are actively using reconciliation software or services such as triResolve, there are emerging opportunities for buy-side institutions to reconcile a large portion of their trades with

subscribing counterparties, providing benefits for both sides. As the role of portfolio reconciliation expands across and within market participants, vendors also expand and improve their reconciliation software and services. From collateral dispute resolution to regular position reconciliation and valuation statement distributions, portfolio reconciliation is proving to be a flexible solution to many of the most challenging problems in post-trade derivative operations.

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This article originally appeared in issue 72 of Structured Credit Investor on January 23<sup>rd</sup> 2008