MEMORANDUM

TO: File No. S7-06-11

FROM: Adam Moore

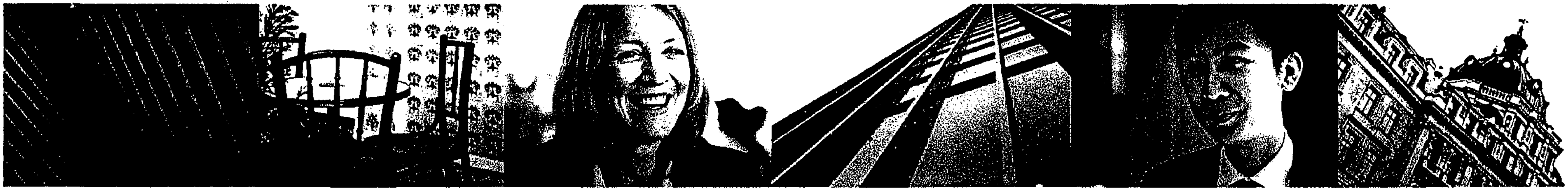
RE: Implementation of Dodd-Frank Wall Street Reform and Consumer Protection Act

S7-06-11 – Registration and Regulation of Security-Based Swap Execution Facilities

DATE: February 27, 2012

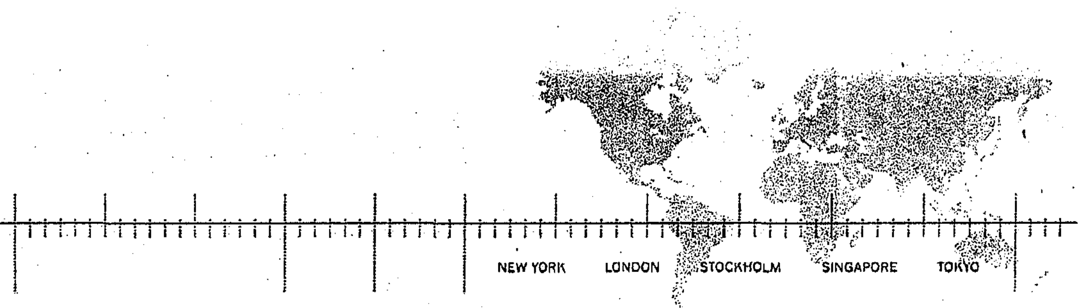
On February 23, 2012, representatives from the Division of Trading and Markets, Heather Seidel, Peter Curley, Nancy Burke-Sanow, Tom Eady, Ken Riitho, Neil Lombardo, Leah Mesfin, Iliana Lundblad, Heidi Pilpel, Sarah Schandler, Tyler Raimo, Neil Lombardo, Charles Sommers, Michael Bradley, Darren Vieira, Adam Moore, Chester Hill, and Jasmin Sethi, met with Raf Pritchard (TriOptima), Per Sjoberg (TriOptima) and Patrick McCarty (ICAP Plc).

The topics discussed included: (1) the Commission's proposed definition of security-based swap execution facility and (2) TriOptima's portfolio compression services.



Bulk risk mitigation services

TriOptima



Summary

- Bulk risk mitigation services
  - Do not permit market participants to trade security based swaps
  - Do not broker security based swaps
  - Do not become a counterparty to any swap
  - Do not ”clear” or ”settle” security based swaps
- Participants are responsible for effectuating the accepted proposals coming from post trade risk reduction services
- We filed a comment on July 7, 2011 that suggested the SEC adopt a non exclusive safe harbor in the SB SEF and Clearing Agency rules for post trade risk reduction services.

Post trade risk reduction services

- Icap's post trade risk division has a number of bulk risk mitigation services that enable market participants to manage undesired secondary risk emerging from existing OTC derivatives
  - triReduce – portfolio compression service for IRS, CDS and Commodity swaps, reducing outstanding notional, counterparty credit and operational risks
  - triBalance – a portfolio risk balancing service
  - RESET – a basis risk reduction service, i.e. mismatched interest rate swap notional on individual fixing dates
  - ReMATCH – a service for reduction of default risk arising from mismatched maturities in off-setting CDS
- Of these services, triReduce and ReMATCH handles security based swaps

TriOptima's triReduce service
Key facts

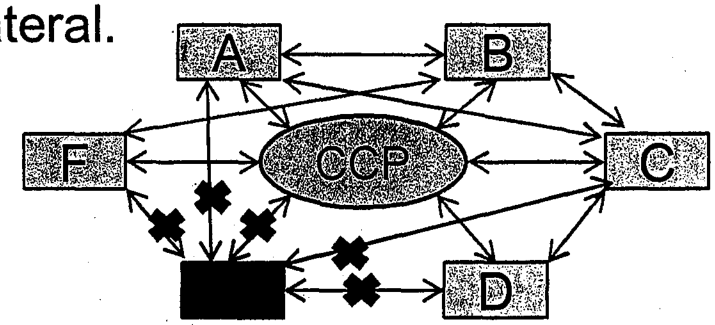
- TriOptima's triReduce service eliminates gross notional as well as counterparty credit risk, in interest rate, credit and energy derivatives by closing out swaps contracts not contributing to the net market risk position.
  - TriOptima has significantly impacted outstanding notional in OTC derivatives and is used by 197 banks/legal entities across the market.
  - Gross notional removed from the system 2007 - 2011:

Period	Credit	Rates
2011	$5.6 trillion	$56.4 trillion
2010	$8.5 trillion	$45.8 trillion
2009	$14.5 trillion	$26.6 trillion
2008	$30.2 trillion	$14.8 trillion
2007	$10.0 trillion	$7.6 trillion

- **Total gross notional eliminated** since inception in 2003: **$249.9trillion**

TriOptima's triBalance service
Key facts

- TriOptima's triBalance service reduces large-scale systemic risk for OTC derivatives both vs CCPs as well as bilateral.



  - The first thing CCPs and dealers do after a default, is to macro hedge the market risk positions that opened up
  - triBalance turns this re-active process into a pro-active, recurring and industry-wide process
- triBalance reduces these portfolio risks by creating rebalancing trades to offset existing bilateral risks, but which in aggregate is market risk neutral.
- When piloted in Nov 2011, triBalance achieved a total risk reduction of nearly 40%* for the LCH cleared IRS population for 8 major clearing members.

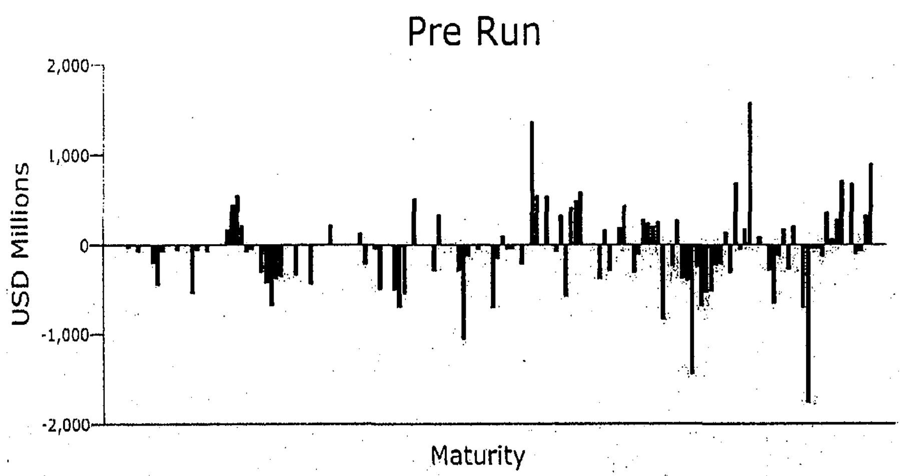
* Exposure reduced to 5.4BEUR from 8.7BEUR.

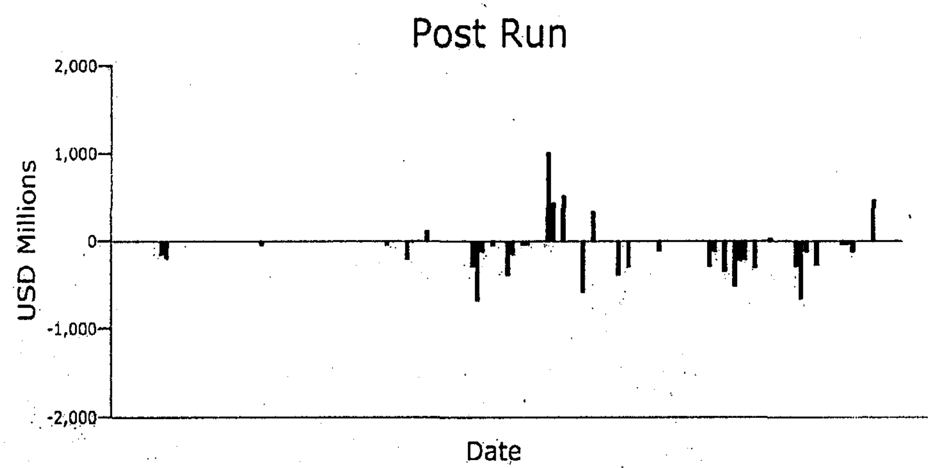
Key facts about RESET

- RESET focuses on basis risk mitigation in interest rate derivative portfolios, where basis risk is an unavoidable secondary risk due to mismatches of pay and receive notional needing to be fixed on each individual day.

- RESET represents significant volume and its use is widespread across the market:
  - Total notional volumes processed over the last 3 years: $525 trillion.
  - 352 client banks and 2320 individual users (2010).

- Typical IRS portfolio fixing exposures:





Key facts about ReMATCH

- ReMATCH redresses the problems of the build-up of illiquid risk in the single name CDS portfolios.
- Significant risk management challenge:
  - Only the 5 year point of the curve usually has meaningful liquidity (80% of volumes).
  - In consequence, many default risks and curve exposures become un-hedgeable.
- Effectiveness:
  - reduces un-hedgeable risk positions on individual maturity dates without change to the net risk per reference entity.
  - has reduced over $460B in mismatched notional to date
  - typically reducing 20-30% of such mismatches each cycle

Bulk risk mitigation services

- Common for bulk risk mitigation services is that they provide the participants with a proposed "compound transaction", where the compound transaction
  - Must be accepted in full by all participants, or it won't be effected
  - Is multilateral, i.e. more than two parties
  - Is market risk neutral
  - Is designed to reduce secondary risks emerging from existing OTC derivatives
  - Is the output of a cycle/project that extends over a couple of days

Compound transaction

- The components of this compound transaction can be
  - Terminations or revisions of existing transactions
  - New or replacements for existing transaction
- It should be noted that these components are not individual transactions, they only form a part of the compound transaction
  - The cash-flows of a normal swaps are not individual transactions either.
- The service provider is not a party to the compound transaction; nor is it involved in settlement of the compound transaction

Market risk neutrality

- The fact that the compound transaction is market risk neutral means
  - The parties are indifferent to at what price the component trades are executed
    - P&L impact is zero or kept below an insignificant amount
    - To avoid this random P&L noise, most component trades are executed at close to market prices
    - These market prices are in most cases established several hours before the completion of the compound transaction
  - There is no profit motive
    - No bids and offers are entered, instead parties provide tolerances and/or targets for secondary risk reductions

Regulatory implications

- Price transparency
  - The values of the components of a compound transaction cannot be compared to prices on real transactions (arms-length, risk transferring transaction between two parties in a competitive market)
  - Reporting values of the components would be misleading to the market
- CFTC came to the same conclusion in the Real-Time reporting rule
  - The definition of "publicly reportable swap transaction" in § 43.2 does not, at this time, require the public dissemination of swaps that are not executed at arm's length. Accordingly, certain swaps between affiliates of a corporate group and portfolio compression exercises are not subject to part 43. The Commission believes that not requiring such transactions to be publicly disseminated precludes the public dissemination of transaction and pricing data that could misinform the market and create an inaccurate appearance of market depth.

Regulatory implications

- Transaction reporting
  - The total notional involved in a compound transaction can be very high
  - The components should indeed be reported to repositories, but it must be possible to classify them as part of a market risk neutral compound transaction
  - If not, the market would be mislead when assessing the activity and market depth of real market transactions

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