# MEMORANDUM

TO:   File No. S7-06-11

FROM:  Iliana Lundblad

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:  October 24, 2011

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On October 6, 2011, Heather Seidel, Nancy Burke-Sanow, Tom Eady, David Liu, Jeffrey Mooney, Iliana Lundblad, Leah Mesfin, Tyler Raimo, Adam Moore, Alison Duncan, Andrew Blake, Pam Kesner, Doyle Horn, Ken Riitho, Chester Hill, and Jasmin Sethi from the Division of Trading and Markets met with Christoffer Mohammar (TriOptima), Michael Modlock (TriOptima), Sofia Rosenkvist (TriOptima), Patrick McCarty (ICAP) and Jim Newsome (Delta Strategies).

The discussion topics were: (1) the Commission's regulation of SB SEFs and (2) demonstration of TriOptima's technology related to portfolio compression.

# Introduction to TriOptima's credit portfolio compression service triReduce

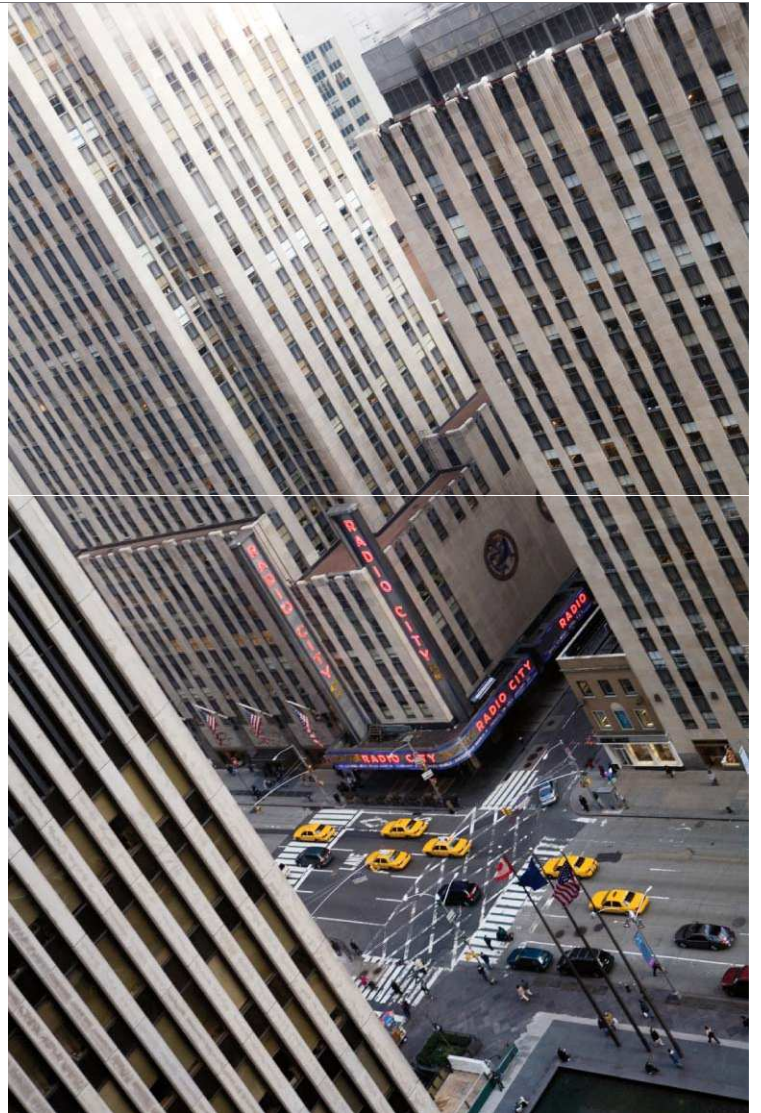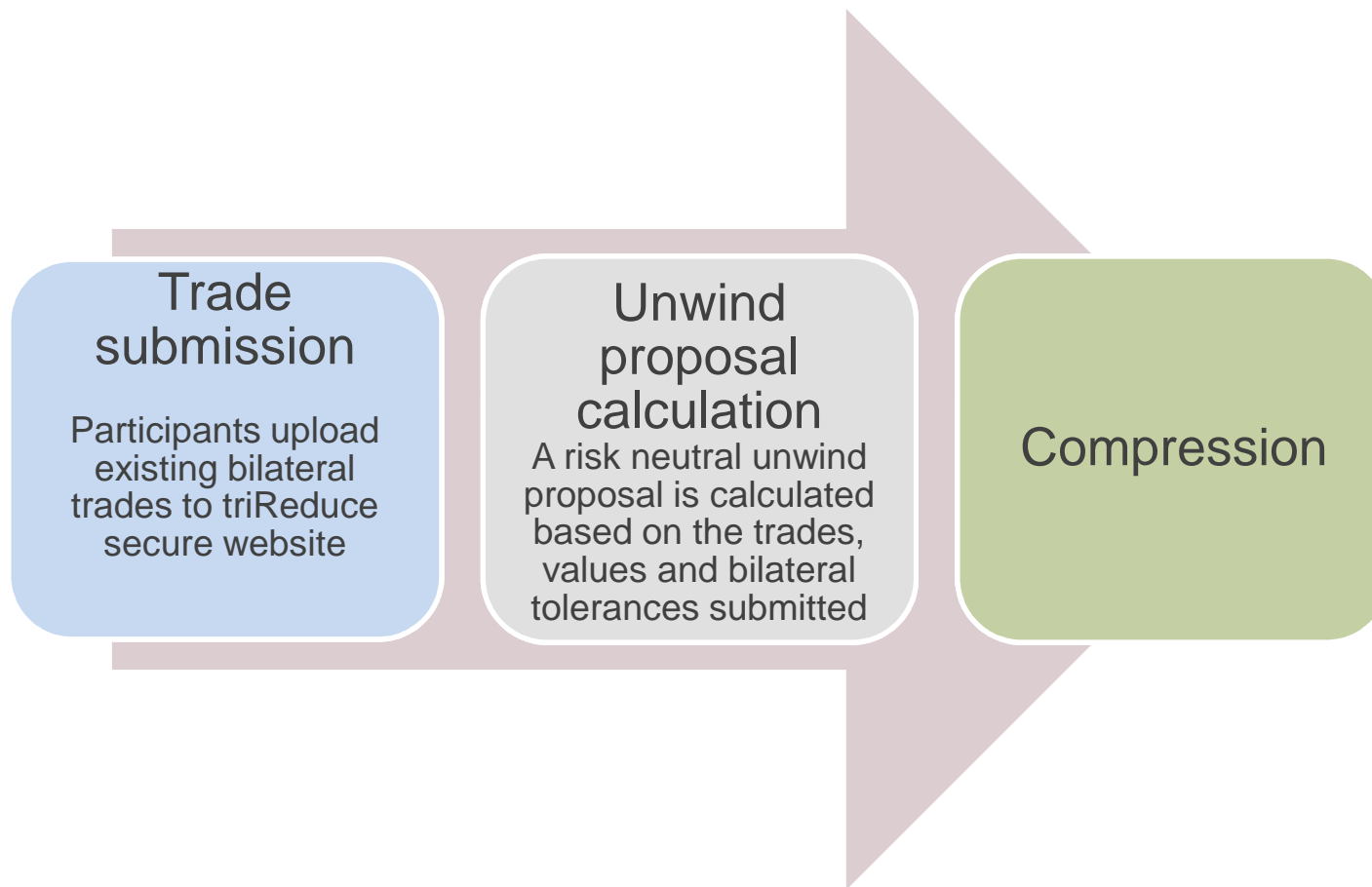**Securities and Exchange Commission**

**October 6th, 2011**

# Agenda

- How triReduce works

- Demonstration of triReduce website

# Introduction

- triReduce does not

  - Present any systemic, market or operational risk

  - Enable price determination

  - Execute trades

  - Provide a platform where participants make bids and offers

  - Change participants' market risk

  - Provide a "many-to-many" matching of buy and sell orders

- Not involved in new trades – only replacement trades

➢ ***triReduce is not a clearing agency or an execution facility***.

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# How triReduce works

# Process overview

**Trade submission**

Participants upload existing bilateral trades to triReduce secure website

**Unwind proposal calculation**

A risk neutral unwind proposal is calculated based on the trades, values and bilateral tolerances submitted

**Compression**

# Compression cycle description

- Participants enter into a service agreement with TriOptima

- triReduce selects product type and compression cycle timeline on an ad hoc basis and participants sign up to those cycles in which they wish to participate

- triReduce participants submit existing bilateral trade portfolios and tolerances

- The submitted trades are linked to identify a subset of trades submitted by both sides

# Compression cycle description

- triReduce calculates a risk neutral unwind proposal using bilaterally set tolerances and existing bilateral trades submitted by participants

- The unwind proposal:

  - only includes proposed terminations or replacements of existing bilateral trades and only in relation to existing counterparties

  - can only be accepted/rejected by the participant holding existing bilateral trades

- Participants assess unwind proposal and decide whether to accept or reject

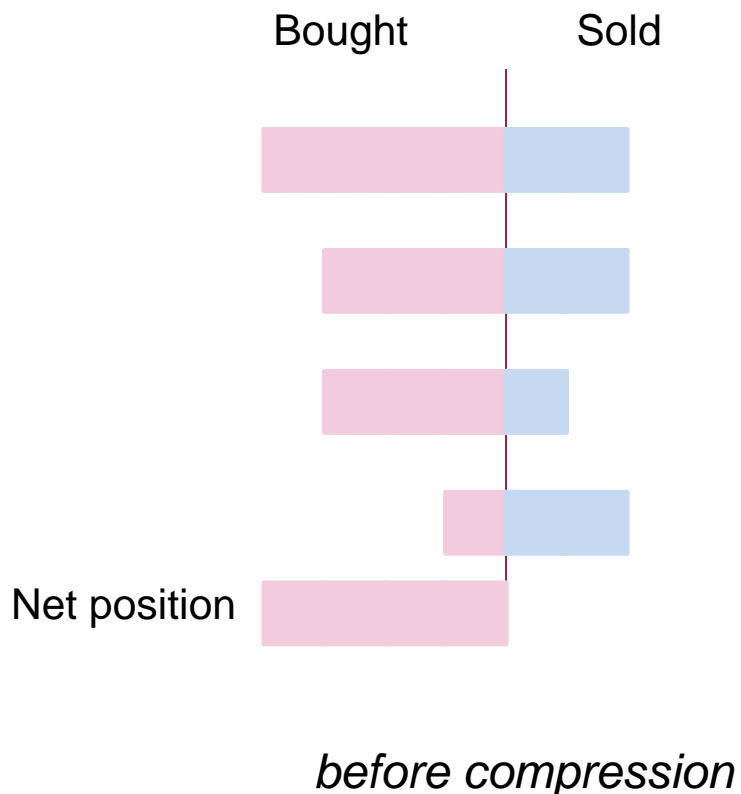**Tri**Optima

# Compression cycle description

- If ANY participant rejects its unwind proposal, it fails for all participants and existing trades continue unaffected

- If ALL participants accept the unwind proposal, every participant is legally bound by the compression transactions described in unwind proposal

# Comparison to new trades

| Action | New trade | triReduce replacement |
|---|:---:|:---:|
| Created by matching bids and offers | ✔ | ✖ |
| Trading interest - purpose to take on a market position | ✔ | ✖ |
| Changes market risk | ✔ | ✖ |
| Price discovery function | ✔ | ✖ |
| Reported for industry metrics as new business | ✔ | ✖ |

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# Compression calculation

Bought          Sold

Net position

*before compression*

- Uses each participant's existing bilateral trades, risk values and tolerances

- Is market risk neutral – triReduce algorithm has minimal flexibility

- Is within counterparty exposure tolerances preset by each participant

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# Compression calculation

Bought      Sold

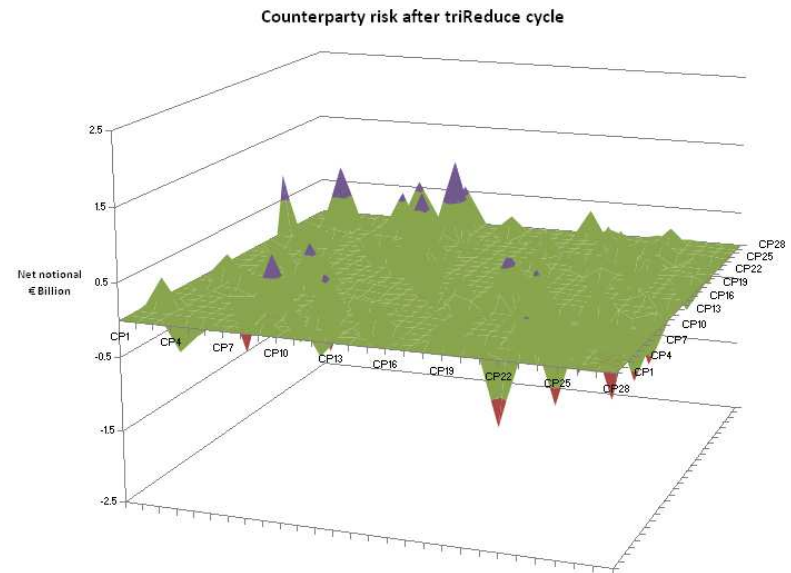Net position
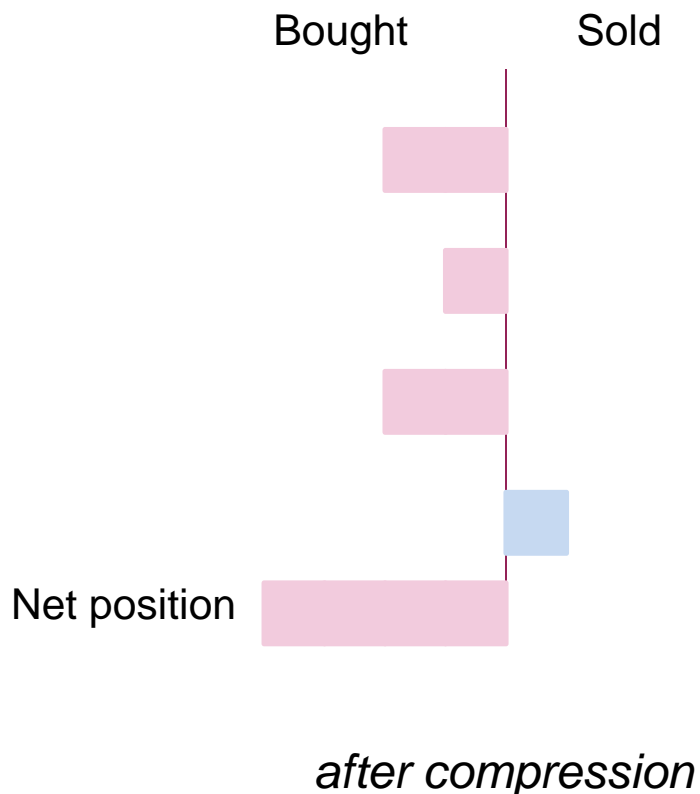
*after compression*

- Does not involve assumption or transfer of risk for a price

- Participant specific results – no bids and offers made available to other participants

- No trading interest – purpose is not to take on a market position

# Credit reduction through compression
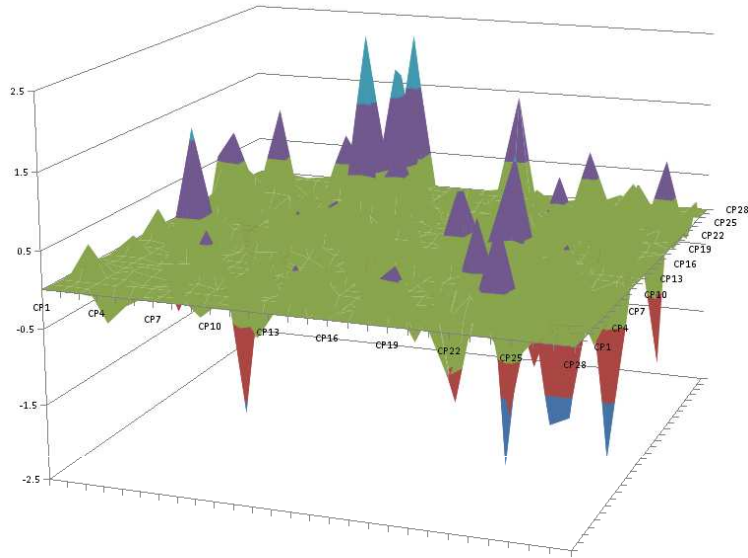


Pre compression
credit exposures
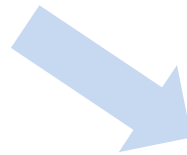
Post compression
credit exposures

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# Demonstration of triReduce website

# Risk overview

- No adverse effects on participants
  - All major decisions and data inputs are made by participants
  - Participants can withdraw at any time or reject compression proposal and return to status quo ante

- No adverse effects on market
  - Participants' market risk does not change
  - Price has no role in a compression cycle. MtM is only used for delivering counterparty exposure /risk neutrality and not made available to a participant's counterparties (or any third party)

- Trades are held by participants throughout the cycle

- Netting/execution does not take place on triReduce platform
  - Trades are terminated or replacement trades executed by participants away from triReduce system

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# Comparison to swap execution facility

**triReduce**

| Action | | SEF | triReduce |
|---|---|---|---|
| Participants make bids and offers | | ✓ | ✗ |
| "Many to many" matching of buy and sell orders | | ✓ | ✗ |
| Platform for acceptance of bids and offers | | ✓ | ✗ |
| Result affect participants market position | | ✓ | ✗ |
| Result in assumption/transfer of risk for a price | | ✓ | ✗ |
| Price discovery function | | ✓ | ✗ |
| Continuous operation | | ✓ | ✗ |
| Cycle based operation | | ✗ | ✓ |

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# Summary

- triReduce does not

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# Thank You