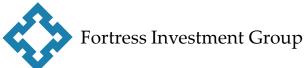
SCI Conference

Risk Management under Dodd-Frank

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Managing Market & Counterparty Risk

Managing market risks

- Analyze exposure levels necessary to conduct business
- Evaluate whether risk capital and appetite would support likely exposure
- Establish risk limits
- Monitor compliance with limits (requires appropriate position and risk systems)
- Identify and monitor bespoke risks (risks that are not fully captured by VaR or volatility reports)
- On a regular basis, discuss large exposure and bespoke risks
- Establish scenario analysis to evaluate p&l impact of certain scenarios

Managing counterparty risk

- Monitor counterparty exposure
 - Deposits, OTC margins, prime brokerage holdings, ...
- Avoid/reduce peak exposure
- Create redundancies across regions, products, creditworthiness of counterparty
- Monitor counterparties' credit spreads, news
- Define triggers for reducing counterparty exposure if counterparty deteriorates
 - · Assigning trades away; unwinding; buying protection on counterparty
 - Assignments require counterparties' consent; not in a cleared world

Uncleared and Non-Standard CDS

- How to deal with complex and less liquid CDS that are not cleared?
 - Banks
 - Sovereigns
 - Non-standard trades (non-standard documentation, bespoke CDOs) risks that is not DTCC eligible
 - Continue to transact as done in the past
 - Bilateral ISDA Master Agreement
 - Margin agreement with counterparty
 - Push-out provision under Volcker rule: structure of counterparty unknown; may create new market
 - Single-name trades regulated by SEC (cleared and uncleared)
 - Indices, tranches and structured trades regulated by CFTC

Hedging

Hedging at position level

- Sell/unwind position
- Enter into offsetting trade, keep both legs (later assign away as package)
- Transact proxy hedge (usually includes basis risks)
 - Hedge single-name exposure with CDS index on a beta basis
 - Bonds for hedging IR swap exposure (appropriate only short term)

Hedging the portfolio

- Determine key risks in the portfolio
 - Map portfolio to set of key risks (principal components)
- Determine which (liquid) instruments are closely related to these risks
- Transact hedges in order to mitigate portfolio risk

Best Practice for Managing Collateral

- Tri-party collateral agreement
 - Elect how collateral is held at custody account (bank deposit, FDIC insured bank deposit, money market fund)
- Daily margining
- Manage/limit rehypothecation of assets by prime broker
 - May impact funding costs