Para Bellum Advisors

INFRASTRUCTURE · MULTI-ASSET PORTFOLIO

Counterparty Credit Risk Reduction – Derivative Book Rationalisation

SCENARIO TYPE	Infrastructure – Multi-Asset Portfolio (Operating Phase)
ASSET CLASS	Diversified infrastructure – transport, utilities, renewables, social infrastructure
RISK FOCUS	Counterparty concentration, downgrade-triggered collateral shock, forced unwind risk, liquidity compression, governance breach
PRIMARY OFFER	Derivatives Portfolio Review™
RELEVANT SERVICES	Derivatives Portfolio Review™ · Hedge Rebuild™ · Derivative book rationalisation · CSA renegotiation · Novation sequencing · Liquidity impact modelling

THE SITUATION

A mid-sized Australian infrastructure fund (AUD 6.8bn AUM) held 11 assets across toll roads, airports, regulated utilities, renewables, and social infrastructure. Built over a decade, the portfolio accumulated derivatives one asset at a time – each acquisition came with its own project debt, each debt package with its own swap stack, each swap with whichever bank led the financing.

By early 2023, the fund held AUD 2.05bn notional across interest rate swaps, cross-currency swaps, and commodity hedges spread across five banking counterparties. The exposure looked diversified when viewed deal by deal – but at portfolio level it had drifted into a structure that only works while credit ratings stay stable and CSAs remain benign.

The fund had a counterparty concentration policy on paper: no single counterparty should exceed 35% of total derivative notional. In reality, Bank A sat at 48.8%. The breach had been there for years. It did not feel dangerous because Bank A was highly rated – and the organisation treated the breach as a paperwork problem, not a risk. Then the credit cycle moved.

HOW THE TRAP FORMS

When rating pressure hit in March 2023, the derivative portfolio did not blow up economically – it repriced operationally through CSAs and policy triggers. Independent amounts switched on, thresholds dropped, margin workflows accelerated, and the board was suddenly looking at a hedging book that required same-week cash and a forced decision clock.

Credit events do not always create losses – they create forced actions. And forced action under time pressure is where infrastructure portfolios lose money: not through market direction, but through loss of control.

A downgrade triggers margin mechanics. Policy turns into a mandatory unwind timetable. Dealer economics show up at the worst time – gross mark-to-market is not what you receive; dealers apply funding and credit adjustments when you are a forced seller. The board stops asking whether the portfolio is hedged and starts asking why it was in breach for four years and how much collateral the book can demand under the next downgrade.

WHAT TYPICALLY BREAKS

The book was built in acquisition mode, not operating mode Swaps were executed to get deals done. Nobody was tasked with optimising the system at portfolio level. Concentration limits exist in policy; aggregation and reporting do not enforce them in practice.	**CSAs are legacy and inconsistent** Different vintages, different thresholds, different margining frequencies. Old CSAs look cheap until triggers fire – then they become messy, unpredictable, and expensive to exit under time pressure.
Downgrade triggers treated as theoretical Until the margin call email arrives with a 48-hour deadline and no pre-approved playbook to follow. At that point, pricing power shifts entirely to dealers.	**The decision clock creates value destruction** The closer you are to a policy deadline, the worse the economics you accept. Forced seller status hands the dealer a pricing advantage on both terminations and novations. The same trades would have cost materially less without the clock running.

THE STRUCTURAL INSIGHT

This was not a derivatives valuation exercise. It was an execution programme under governance pressure – with sequencing and negotiation leverage doing the heavy lifting.

The book was reconstructed into a single portfolio view: counterparty exposure by notional, tenor and instrument type; netted versus non-netted exposure under each CSA; downgrade triggers and their collateral impact; and – critically – which trades were economically painful to move versus cheap to move. You cannot reduce exposure until you know which exposure is movable without gifting value to dealers.

Exits were treated as sales, not terminations. In-the-money positions were novated first, using those economics to fund moves that would otherwise be expensive. Concentration was reduced through organic notional reduction where possible – debt amortisation naturally shrinking swaps – combined with targeted novations where economics were least punitive. CSA renegotiation was treated as a capital-efficiency problem alongside the counterparty restructuring, ensuring the new book did not create permanent collateral drag through punitive replacement terms.

The result was a pre-approved playbook: minimum counterparty standards, watchlist triggers, portfolio aggregation reporting, and escalation mechanics for rating events – so the next credit cycle does not require improvisation.

INTENDED OUTCOMES

- Immediate liquidity control – downgrade triggers and collateral requirements mapped before the next two-day deadline email arrives, eliminating surprise margin demands.
- Policy compliance without value donation – sub-threshold counterparties exited and concentration limits restored without paying forced unwind economics where structured sequencing could reduce cost.
- Single-point-of-failure risk reduced – dominant counterparty concentration back inside limits so one credit event cannot destabilise the entire hedge ecosystem.
- Collateral and operational burden stabilised – no restructure that replaces credit risk with permanent collateral drag via punitive CSA resets on replacement counterparties.
- Repeatable portfolio discipline – a standing counterparty architecture and operating playbook that scales with future acquisitions rather than requiring reinvention under stress.

WHERE THIS APPLIES

Works best where a derivative book has been accumulated over multiple acquisitions with no portfolio-level counterparty design; concentration limits are being breached or closely approached; rating triggers in existing CSAs have not been stress-tested for liquidity impact; and new counterparty onboarding would force a CSA reset that locks up meaningful collateral.

Less relevant where derivatives are small, short-dated, and already governed under modern symmetric CSAs with multiple investment-grade banks; the fund runs a dedicated margin pool and treats collateral volatility as operating infrastructure; or active compression, netting, and decision-grade counterparty dashboards are already in place.

TYPICAL ENGAGEMENT PATH

Derivatives Portfolio Review™ – Counterparty and CSA Trigger Review. Secondary: Hedge Rebuild™, novation and termination sequencing, CSA renegotiation, counterparty diversification, downgrade playbook design.

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Illustrative case study for discussion purposes only. Details have been anonymised. Outcomes depend on portfolio structure, counterparty documentation, market conditions, and accounting constraints. Not investment advice.