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Smaller firms face decisions ahead of latest Margin Rules

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By Trevor Negus, senior product manager, TLM Collateral Management at SmartStream

Trevor Negus, senior product manager, TLM Collateral Management at SmartStream, tells Luke Jeffs about the various options facing firms that need to comply with the last phase of the Uncleared Margin Rules.

The last and most impactful phase of the Uncleared Margin Rules (UMR) takes effect in September and smaller firms coming into scope for the first time need to think now about how they are going to prepare for the regulation.

Similarly, large firms that have already ensured their compliance and that of their large to mid-sized clients are faced with a new set of challenges as the next wave of regulation brings into scope hundreds of smaller firms.

SmartStream has long worked with buy and sell-side firms to help them with various middle and back office functions such as reconciliations but the firm has come to the fore in recent years as UMR has swept across the industry.

SmartStream and its many clients have learned key lessons from the earlier rounds of regulation but the sixth and final round in September does present some new challenges.

Negus said: "There are different pressures depending on what kind of firm you are. If you are a phase six firm coming into scope, then the pressures are different to those of a large bank or broker that's been in scope for a while but is obviously having to take on these new phase six clients.

"For the phase six firms themselves, they have to prepare in terms of calculating their AANA, determining how they are going to calculate their initial margin, what their custodial arrangements are going to be, the documentation that needs to be put into place and whether they need a collateral system, and what reporting system they put in place. Now, some or all of this, they may decide to outsource or they may decide to manage that internally, so that is what phase six firms need to be thinking about."

The top banks and brokers can draw on their experiences from the preceding five rounds of regulation, including the latest wave in September 2021, but this next round represents a ratcheting up of existing requirements.

Negus said: "For the larger firms, it's mostly a question of increased volumes and costs so they will need to onboard a lot of new agreements, process more margin calls and settlements, and, with that, comes more reporting. With increased volumes, comes increased costs, so they will have more custodial overheads, they will have to source more collateral so the question is how do they solve these greater volumes and greater costs?"

SmartStream thinks that automation based on standardisation is a key theme for all clients.

Negus said: "From my perspective, I think firms should be automating as much as possible, and to achieve automation, they need the building blocks for that, so that is things like standardisation and digitisation as well as adopting standard industry initiatives like ISDA SIMM, the ISDA Common Domain Model and the ISDA Standard Legal Agreement Taxonomy. By adopting standards, it is far easier to automate."

He added: "The other big building block is connectivity. You need to connect internally with your up and downstream systems for reporting and settlement, for consuming or posting out to your inventory. And there's external connectivity so connecting up externally to utilities like AcadiaSoft, tri-party custodians or recs engines."

Different firms face different challenges and are therefore looking for different solutions.

Negus said: "The smaller, phase six firms are looking for a turnkey solution rather than the overhead of installing a large collateral solution and everything that comes with that. What they want is a solution where a lot of the IT overhead is handled externally so, with that in mind, we have a cloud-hosted solution called TLM Collateral that offers considerably lower installed costs."

He continued: "It comes with business continuity and full production support, while your hardware costs are much reduced though you can pay for what you need when it comes to hardware. You don't have to buy for the maximum volume you will be processing rather you can upscale and downscale as you need it so it's much more cost effective.

"As well as that you get auditing, archiving, service level agreement reporting and the test environment. All of that comes with the cloud offering, so all of that makes it much more turn-key for the clients."

Negus said the SmartStream cloud solution tackles security concerns by sitting in a private cloud which also side-steps performance bottlenecks associated with public clouds.

The SmartStream manager continued: "Clients can also customise the solution which is important for them should they need to make changes to the workflow or the types of reports they require, and all of that can be done via a private cloud solution."

Negus said the cloud solution is also interesting to larger firms however. “From a larger firms’ perspective, perhaps they are happy with an on-premise but we see cloud also being important for larger firms. For the larger firms, it’s more a question of connectivity. Because the collateral system is the heart of the middle office ecosystem, it needs to be connected up and that needs to be done through APIs.”

The next and last round of UMR benefits from the experience drawn from earlier rounds but it should not be underestimated. Firms need to engage with partners like SmartStream now to ensure they see no disruption to business as usual in September.