Three pillars of collateral management

Trevor Negus, senior product manager, TLM collateral management at SmartStream Technologies explains how connectivity, standardisation and outsourcing provide three crucial supports when it comes to building an effective collateral management solution.

The growth of electronic trading in recent years has seen trading volumes surge. Surging too has been the demand for talent, which is needed to automate the processes that support trading. One result has been that collateral management has moved towards the top of the operational agenda. Uncleared margin rules (UMRs) and the EU's Securities Financing Transactions Regulations (SFTR) are providing an additional set of regulatory demands advancing the case for automation.

A successfully automated collateral management process rests on three pillars: connectivity, standardisation and the availability of hosted solutions.

Connectivity

Collateral management is not a standalone activity: to deliver maximum value it needs to be connected across the firm – feeding information forward to investor departments, legal systems and downstream settlement infrastructure and feeding back in information from the custody systems to inform of fails.

The limitations of paper correspondence and reporting are well documented. But the widespread connectivity needed to underpin this level of integration is challenging to achieve.

Broadly speaking, the benefit of electronic messaging and related functionality in facilitating both a variation margin and an initial margin process is accepted by most companies. Connectivity here has two dimensions: external, creating links with industry utilities, clearing houses, and custodians and internal, linking to functions like inventory management credit and operations

Achieving smooth collateral management also means breaking down business silos. It is no longer any good to have separate pools of collateral supporting OTC, repo and securities lending, in turn divided across Asia, Europe and the US. Today, the view of inventory must be consolidated and available in real-time rather than delayed by end-of-day batching processes.

Connectivity is also required to ensure that all divisions of the client firm – the senior management, say, or the team responsible for running credit risk reporting systems – know the status of a margin call and any credit, liquidity or operational problems that it has thrown up.

Standardisation

The industry has taken significant steps towards standardisation, through the work of ISDA, in particular. Specifically, the ISDA SIMM model seeks to simplify the initial margin calculation by standardising the model. There is work to standardise common asset definitions, facilitating a clear taxonomy when it comes to eligibility buckets. ISDA's common domain model, meanwhile, is working to unify as much data as possible that feeds into the collateral management process, removing the obstacles and hold-ups entailed by translation.

While firms appreciate the progress of the industry initiatives co-ordinated by ISDA, achieving standardisation internally – across trading systems and the operations infrastructure – remains a challenging process.

Outsourcing

The third pillar supporting effective collateral management concerns the outsourcing of collateral applications.

Smaller firms, in particular, have been drawn to the software-as-a-service model that leverages remote hosted solutions to streamline collateral management processes. The appeal of this route includes lower install costs, faster upgrades, and greater scalability. It comes with lower hardware costs and reduces IT support and inconvenience associated with maintaining an in-house solution. Finally, a remote hosted solution removes the bother of security updates, secures business continuity protocols, and smoothens the process of audit and archiving

In economic terms the shared operational costs associated with deploying on the cloud – which effectively shares costs across a large number of distributed users – are attractive, too. Security concerns associated with using cloud storage and processing, which for many users have provided an obstacle in the past, can be addressed by employing private, as opposed to public or multi-tenanted cloud hosting. ■