In one of the biggest changes to the derivatives industry since the financial crisis of 2007–08, the Basel Committee on Banking Supervision’s framework for phasing in the exchange of margin on non-centrally cleared derivatives has brought about a need for new systems and technology to handle greater complexity in processing transaction data.

Because of this, managing collateral effectively has become an increasingly important discipline, requiring additional resources and computational power. Recent lobbying efforts from the industry to raise counterparty exposure thresholds for initial margin (IM) requirements have fallen short. Compliance preparations are driving a need for connectivity among data systems to ensure effective monitoring, as all firms expecting an aggregate average notional amount of more than $8 billion – even if their counterparty exposure falls below the $50 million threshold – are required to at least have monitoring systems in place.

As a managed services vendor specialising in transaction management technology, SmartStream has developed an agile and stress-tested collateral management system that is adaptable to changing market conditions and regulatory developments.

### Beyond phase one

A day of chaotic trading marked the first compliance deadline of September 1, 2016, covering the US, the European Union, Japan, Australia, Hong Kong and Singapore – the result of documentation and operational backlog. Upcoming September deadlines each year until the final ‘big bang’ in 2020 – expected to affect more than 1,100 buy-side firms – will bring successive tiers of counterparties into the fold. For firms within scope of IM, a sophisticated collateral management tool is a necessity – especially for those with a complex portfolio or who are anticipating regulatory arbitrage opportunities.

While aligning systems in preparation for IM requirements in September 2020 is a tactical solution for some, what began as a compliance burden also presents an opportunity to forge a strategic direction beyond collateral management – enhancing cash and liquidity management, reference data, reconciliations, corporate actions and expense management.

“One of the interesting things we see is that those who have already completed the move on phase one are actually looking and needing more interconnectivity between internal as well as external systems,” says Jason Ang, collateral management program manager at SmartStream.

When it comes to IM requirements, adaptability is another key factor in effective management of operational risks – particularly in an evolving regulatory environment. A higher degree of automation can help make the process more manageable, moving towards an exception-based approach to processing margin calls so firms can focus their resources more effectively.

With this goal in mind, connectivity between front- and back-end systems plays an important role in streamlining the process, while maintaining a clear audit trail and the ability to add in approval steps where necessary. For this – based on a high-level view of creating efficiencies and managing risk – a holistic approach is more effective than a less integrated solution.

### Scaling up

Increasingly, buy-side clients are requesting a turnkey cloud-based solution to avoid having to worry about hosting, when and how to upgrade, or hiring database experts – allowing financial firms to focus on their competitive and comparative advantages. One positive consequence of the phase-in for smaller players is that systems are already in place that can easily handle their data.

“One of the key points that we’re bringing in from the tier-one side as well is the fact that we don’t co-mingle data, because data protection and data integrity is very important,” says Ang. Doing so ensures additional operational risks are not introduced through the addition of new systems to handle new requirements, particularly when scaling up transaction volume.

“We have been working with a number of our clients for more than 10 years now, and that includes clients in Japan, Hong Kong, Singapore, all the way down to Australia and New Zealand,” says Radha Pillay, SmartStream’s regional sales director for Asia-Pacific, noting that the firm continues to expand its solutions in the region as the phase-in brings smaller players into the regulatory regime. At the same time, these systems are already being deployed among large institutions at a scale that ensures a certain level of stability and reliability for a rapidly growing number of smaller clients – easing regulators’ potential worries relating to implementation, and helping to make markets safer for all.