

What goes around comes around

From matters of compliance to risks to data collection, collateral management has an important part to play in the back-office lifecycle. SmartStream's Jason Ang explains

How can effective collateral management help reduce risk for financial institutions?

When looking into effective collateral management, you have to consider the full lifecycle of the process, which includes both mitigating credit risk and managing market risk. It's important to integrate those processes with settlement systems because credit risk isn't mitigated until the collateral is received.

We're also seeing management of market risk through the new initial margin regulations, so systems need to be able to handle that, and to manage disputes. Connectivity and speed of resolution are very important here, and having a holistic collateral management system—with partnerships for straight-through processing and connections to clearinghouses, messaging systems, and cash management and settlement systems—aid that resolution process.

The SmartStream Transaction Lifecycle Management (TLM) - Collateral Management system is designed to holistically manage collateral in this way. Even though we have many of our own components, like a reconciliation system, it's important to provide functionalities to connect clients with other systems as well. That's why TLM also has public application programme interfaces (APIs) that simplify interaction with internal and external systems.

What are the main regulatory benefits?

The attempt to harmonise regulations to prevent another credit crisis is key, plus there is a lot more transparency now. Market participants tend to be more engaged with each other. It is no longer the case that the big investment banks dictate how everything works; the conversations are not so one-sided.

Regulations are driving up the costs for everyone, and, if you're in a fully manual environment it can be challenging to think about how much work you have to do, and how much you have to figure out—especially if you have to do it by yourself.

Where the regulations are coming in, part of the work is coming up with a consensus as to what needs to be done, and working together with those who have the experience to do it. TLM is well

placed for that, given that we get input from our unique mix of clients, coupled with the experience of our business analysts who have run day-to-day operations in both buy-side and sell-side firms.

On top of this, obviously, is the execution and the methodology for development. An agile methodology allows us to focus not only on high quality, but also on fast time-to-market for new functionalities.

The idea is to get all the understanding of what needs to happen and get the solution out to clients quickly while maintaining very high quality. Quality matters because you can then execute with confidence and control costs.

Is regulation driving innovation in this space?

Absolutely, and I think that relates to the point of having the right connections, with access to the right experience, to be able to form a consensus when interpreting some of the regulations.

Even with the initial margin rules, which were quite straightforward, there were nuances that required operational experience, legal expertise and a large enough client base to get a consensus on how to execute a solution and bring it to market quickly.

SmartStream has a lot of clients, ranging from large investment banks to small hedge funds, service providers and fund managers. We can get a market consensus and implement a solution that works for everyone. If we had only buy-side clients, our perspective would be very different to if we had only large investment bank clients. These entities will have very different concerns.

The aim is to create functionality that is innovative and rich enough to deal with situations that arise. That reduces systemic risk, at least between our clients. We get input from every angle; everyone can see each other's point of view, and everyone benefits.

How important is collateral optimisation in the current regulatory and cost-conscious environment?

There are now more regulatory requirements than ever before. The likes of gross initial margin and gross variation margin require higher-quality assets, and at the same time, countries are

being downgraded. We're in a situation where there is a growing demand and fewer assets available. Everyone is looking not just at collateral optimisation, but at services around collateral and at asset management itself.

Players are thinking about rehypothecation rules and triparty agreements, and the cross-process environment is really driving how a lot of decisions are being made.

The SmartStream collateral optimisation application is designed to pragmatically evaluate available assets and the different eligibility arcs.

It then presents the best collateral allocation using linear programming. It takes into account eligibility, concentration rules and wrong-way risk, and any new regulatory regime can be programmed into the algorithm.

A part of it is also about feeding data from our system into another system, and then getting it back later, potentially to feed a cash management or asset allocation system.

SmartStream's public APIs allow clients to access data more easily, and our reporting suite can extract data from our system in a clear format, so that it can be used for other purposes.

What other benefits can data management and analysis offer?

We're seeing clients expressing that they need more information from the collateral system. This system is a source of assets for some clients, or agreement information, and there are projections they need to make based on things like margin calls, disputes and assets. It's also a place where over-the-counter trades usually reside, so people often use it for audit records. Having a comprehensive extraction process means getting all of that information to another location and allowing clients to run all kinds of management information system enquiries on it, so that the process-intensive work doesn't impact the speed of the production environment.

Equally, it's important to have real-time updates for some processes. For example a collateral movement could be transmitted immediately and used in cash management projections.

The need of information coming from a collateral system has become ubiquitous. Information is key. Institutions want the ability to look into the system if they need to, and the ability to marry together data from different systems. It's not just about providing a view into the data for stakeholders, it's also about efficiency, utility and transparency, and about making data available in a practical manner. **AST**

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Jason Ang, Programme manager for collateral management, SmartStream

