

A digital journey. The background is a dark blue space filled with glowing, interconnected lines and nodes, resembling a network or data structure. In the foreground, there are several glowing, 3D wireframe cubes in shades of orange and yellow, appearing to float and rotate. The overall aesthetic is futuristic and technological.

A digital journey

Maddie Saghir reports

Experts explain how the industry is looking to implement the latest technology and automation amid the evolution of collateral management

Collateral has been used for centuries providing security against the possibility of payment default by the opposing party in a trade. Fast forward to now, in 2020, and collateral management is evolving to keep up with the latest technology.

Broadridge Financial Solutions' Martin Walker, head of product for securities finance and collateral management, explains there are many ways in which emerging technologies are improving collateral management processes.

Examples include full collateral management activity integration across business lines, and ensuring collateral processes related to cleared trades

are as streamlined as the processes themselves and providing the tools to optimise the selection of collateral assets.

Walker explains: "However, ongoing technology advancements around artificial intelligence (AI) are leading the way. machine learning has helped advance exception management/based processing."

"AI is being used for completing automatic detection, reading unstructured data (emails, letters etc.) and breach straight-through processing (STP) which all will allow the operations staff to review the machine's analysis, saving time and resources," Walker adds.

SmartStream's Trevor Negus, global product manager, TLM collateral management, explains that collateral management solutions have needed to move to an exception-based approach.

"The phasing in of Uncleared Margin Regulations (UMR), has pushed volumes up, and the recent volatility has seen daily margin call volumes spike to record levels," says Negus.

As such, it is no longer possible to process calls manually, as firms need their users only involved when there is an exception.

Additionally, David White, chief commercial officer, CloudMargin, affirms that technology has played a dramatic role in improving just about every aspect of the collateral management process.

Technological opportunities

In terms of further opportunities that technology can provide in this space, Eoin Ó Ceallacháin, head of product marketing at Murex, notes that interoperability between market infrastructure and collateral management systems enables more optimal placement of collateral and reduces process friction.

"While in theory the global securities pool is a shared enterprise resource, it is often fragmented across different business lines, locations and systems, and significant business opportunity is lost as a result. Technology interoperability investments that expose settlement awareness and constraints upstream to the trading layer can unlock considerable new business opportunities," Ó Ceallacháin says.

Meanwhile, CloudMargin's White argues there is significant interest in centralisation and the ability to connect via a single platform to meet a client's needs. CloudMargin has been working toward this goal for several years, with out-of-the-box connections to a wide range of premier technology and market infrastructure providers.

Last year, CloudMargin partnered with AcadiaSoft to power its collateral management solution, establishing the industry's first platform to offer a full end-to-end UMR solution.

"Clients can calculate initial margin (IM) via schedule or International Swaps and Derivatives Association's Standard Initial Margin Model (SIMM), agree margin calls electronically, physically move collateral via third parties and

resolve disputes – all via one contract, login and user interface. We believe this partnership has a significant opportunity to not only solve the challenges that phase 5 and 6 IM rules present but also to drive efficiency across the industry more broadly," says White.

Additionally, efficient global inventory management is key, and SmartStream's Negus highlights that technology is able to provide this in real time.

"We have seen a squeeze in collateral over the last three months with firms needing to look at alternative collateral outside of what they usually post or accept. This has meant looking at a firm's overall inventory, rather than siloed by business line," he comments.

Negus continues: "That collateral needs to be accessible, and the system needs to know who is incurring the collateral cost in order to correctly charge back. Furthermore, running optimisation against the portfolio, allows the cheapest and most optimal collateral to be posted on the correct credit support annexes (CSA)."

However, Negus points out that one of the issues in the market is large firm's not accessing new functionality sufficiently quickly. He explains that the way to achieve this is to allow banks to upgrade individual components of the collateral system separately. According to Negus, if there is a change to one part, that part can be redeployed and upgraded, leaving everything around it static.

"The cost is low, and the benefits are immediate," he highlights.

Emerging trends

Looking at some of the emerging collateral management trends, the industry is certainly moving to the digitalisation of processes, while trying to keep costs down. Over at Broadridge, Walker observes three major trends and none of which are truly feasible without enhanced technology.

According to Walker, regulation and the search for yield are driving collateral and liquidity management together.

"No one simply looks at inventory or cash positions in isolation. As collateral management takes more consideration of the profit and loss impact of decisions related to collateral selection, we will see greater convergence

between collateral management and collateralised trading such as repo and securities lending. Finally, standardisation of processes across all the variations of collateral management is highly dependent on innovative technology," cites Walker.

Joakim Strömberg, product manager at CME TriOptima, comments: "The uncleared over-the-counter (OTC) derivatives market is a prime example of where technology is a huge opportunity, but also a great challenge. Unlike the cleared world, uncleared OTC trades are non-standardised."

"The goal for all market participants is to make the bilateral uncleared margin call process as cost efficient as possible. To help detect potential dispute drivers proactively across OTC markets, there is an increasing shift towards automation and machine learning."

Meanwhile, White observes that clients continue to face their ongoing regulatory requirements. He explains: "Many have a decreased appetite for risk while needing to address increased collateral obligations as the IM requirements continue to phase in."

According to White, these challenges are compounded by a difficult macro operating environment where margins have been squeezed.

"However, many firms, particularly the largest ones, have siloed technology and manual processes. The industry as a whole is starting to realise that addressing these two issues is no longer a 'nice to have' but a necessity. Smart collateral functions that remove legacy installed technology, move to exception-based processing and optimise collateral across all asset classes are looking not only to lower firms' risk but also positively impact profit and loss," he adds.

From a cost reduction perspective, Ó Ceallacháin notes that the simplification of operational and technology layers to manage enterprise-wide collateral processes across business lines must be up towards the top of the list. "Though not a quick-win it drives the biggest long-term cost reductions, while opening up new business opportunities at the same time," he says.

Future developments

Amid current technological developments in this space, industry participants are already moving to develop solutions further in the years to come.

Strömberg observes there is already a move towards firms looking at new ways to reduce and eliminate disputes by automating their margin calls.

He cites: "With market volatility increasing margin disputes, there is now an immediate need to streamline processes in order to help proactively resolve these issues."

"Expect firms that currently have siloed margin operations to start consolidating their collateral processes across different product types to increase efficiencies."

Meanwhile, Murex's Ó Ceallacháin believes that more and more interoperability between collateral management, securities lending and repo systems and processes will drive further efficiency in collateral processing, placement and transformation. "Integrating well with tri-party agents in both directions can enable even more optimal use of collateral," he adds.

Weighing in on this, Negus notes that firms are striving for as much automation as possible and this can be achieved through AI and machine learning – collateral management is a candidate here.

"To achieve this firms need data, and lots of it, and increasing volumes will only help that. Decisions made when sending calls, responding to calls, choosing and booking collateral can be learnt and this will allow firms to move toward full automation," explains Negus.

From White's perspective, there is a huge amount of potential for significant efficiency gains.

White says: "We [CloudMargin] believe technology and common reference are the enablers so a centralised place for all collateral participants – buy side, sell side, custodians, technology and other service providers – underpinned by cutting-edge microservices technology, would be a real game-changer for all involved and the wider derivatives industry."

Walker concludes: "Ultimately, we see collateral management emerging into a largely automated component of the trading and balance sheet management process as opposed to a series of separate semi-manual operational processes - just as the majority of trading in many asset classes has been automated and algorithm driven over the last decade."

The trusted solutions partner for today's financial services

Built on more than 40 years of industry experience with over 2,000 customers across the globe, we work with 70 of the world's top 100 banks, insurance firms, and telco operators. SmartStream solutions streamline operations, deliver cost-efficiency and enhance risk management through on-premise, cloud and managed solutions.

Discover what real middle and back-office transformation can mean for your business.

info@smartstream-stp.com
smartstream-stp.com



DIGITAL PAYMENTS
& INVESTIGATIONS
CASH & LIQUIDITY
MANAGEMENT
FEES & EXPENSE
MANAGEMENT
RECONCILIATIONS
COLLATERAL
MANAGEMENT
CORPORATE ACTIONS
PROCESSING
REFERENCE DATA
ENRICHMENT