

Collateral management



Risk: Does moving to a central clearing house address the industry's concerns?

Helen Bramley: In light of recent events, it may be viewed that a central clearing house would have provided information on the net exposure of the major dealers and could have ensured the posting of additional collateral as the market conditions moved. Clearing houses also generally allow netting, increasing efficiency of capital and therefore reducing liquidity pressure. To some extent, moving to a central clearing house would lessen the burden on credit departments as it would monitor its participants' credit rating and provide the benefit of removing counterparty risk. However, this move has the potential to reduce the risks to its participants and creates a concentration of risk management responsibilities, which could itself disrupt the market. It is therefore vital that there is clear regulation, control and transparency and standardisation of contract terms for all participants.

Risk: What are the new challenges facing collateral management in 2009?

HB: If it wasn't clear before, it is now: proactive collateral management plays a critical role as a risk mitigation tool. Managing counterparty risk has always been a necessity. However, stable markets generally made it a lower priority. Not surprisingly, in volatile markets all participants need a much clearer view regarding all counterparty risks. We expect that 2009 will include tougher collateral agreements with reduced thresholds and more restrictions on eligible collateral by excluding less liquid assets. Furthermore, it can't be assumed that independent amounts will be automatically paid by the buy side. When they are paid, it's debatable where the funds will be held and if they will be segregated or excluded from the variation margin. With risk concerns expected to continue, improving exposure management via streamlined internal processes and systems is now a mandatory requirement. Collateral inventory will need to be more proactively managed to handle the increasing complexity of underlying trades. Increasingly the demand is to analyse overall exposures, identify counterparty relationships, investigate risks such as payment delays, credit rating changes and liquidity positions and, perhaps most importantly, understand the contractual relationships on an aggregated enterprise-wide and trading entity level.

Risk: How will regulation affect collateral management?

HB: Regulators have increasingly called for major efficiency improvements in the credit default swap market to reduce the

possibility of systemic risk. The industry will be required to take further steps to limit the domino effect of lagging and uncertain post-trade processes in the event of a counterparty default or failure. This includes the use of legally enforceable netting and master collateral agreements between counterparties where possible. The Major Dealers in the Operation Management Group made commitments in the July 31, 2008 letter to the Fed, including the accomplishment no later than December 31, 2008 of: achieving weekly interdealer reconciliation of collateralised portfolios exceeding 5,000 trades; and provision by firms of adequate resources to identify and resolve portfolio differences on a timely basis. They also committed that by December 31, 2008, they would collect and report metrics regarding their portfolio reconciliation activities to the supervisors. This pledge has placed collateral management under further regulator scrutiny, creating the need for systems to capture metrics to report areas of dispute and possible risk.

Risk: What new flexibilities will providers need in their systems to remain competitive?

HB: Asset managers and dealers need the ability to minimise collateral and related movements by assessing the exposure of all open derivative positions and collateralising the entire exposure on a per-client basis. Collateral optimisation is a key focus. Cross-collateralisation can reduce the capital charge that a bank needs to allocate for its exposures while providing operational efficiencies. Lombard Risk is focused on several areas to increase its competitiveness: scalability to meet future demands; more effective communication with other systems – confirmation platforms, settlement engines and trade management systems to reduce operational risk by linking technology and business activities and robust collateral servicing and optimisation – real time is vital; full 'post-trade process' automation. Today's market players require the capability to price, book and confirm collateral for collateralised transactions immediately.

Risk: What differentiates your technology from that of competitors in the market? ?

HB: Colline® is an innovative collateral management solution that automatically aggregates and nets overall collateral obligations, which minimises the collateral a counterparty is required to post and reduces the risks and costs associated with derivative transactions. Colline® is the only collateral management system that includes both customer and counterparty self-service. Self-service grants secure direct access to collateral statements, trade files and reconciliations, further streamlining the margin management process. Colline's flexible graphical management dashboard manages the entire process via natural, business-driven workflows to manage collateral agreements, margin calls and available collateral inventory right through to settlements. Margin calls are checked against predefined tolerances and configurable business rules. Colline takes full advantage of technology to achieve straight-through processing, which enables direct receipt of collateral bookings from downstream applications. Colline also includes an intelligent trade-matching engine that facilitates fast, frequent and accurate reconciliations that can be automatically scheduled to occur on daily basis and emailed upon completion.