EquiLend Delves into Collateral Trading and Exposure Management

Collateral trading and exposure management have become important issues to financial institutions concerned with efficiency and balance sheet costs. By creating flexible and dynamic processes that take advantage of new trading markets for collateral, EquiLend continues its mission of solving these kinds of complex industry challenges as a trusted technology partner.

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EquiLend has recently launched two new products serving the collateral market: a Collateral Trading service that facilitates collateral upgrade/downgrade trades, and EquiLend Exposure, a tool that provides industry views on availability, funding and potential fails. These features deliver important standardization of services, technology and data analytics across the industry.

EquiLend Collateral Trading

The idea of a collateral trading marketplace is to take labor-intensive funding trades, in particular high-touch term upgrade/downgrade transactions, and apply a strong dose of automation within the EquiLend ecosystem. As more funding transactions have become automated, trading desks have focused on the 20% to 25% of high-value trades. EquiLend's Collateral Trading service takes this one step further by automating these high-value transactions. The service provides pre- and post-trade optimization and a network for market participants to access real-time exposure comparisons.

While a smaller sector than securities lending or repo, the collateral trading markets are significant in their own right. Market estimates suggest that there are $500 billion of average outstanding balances on upgrade/downgrade trades, and the figure is growing quickly. On the high-quality liquid asset (HQLA) side, there is a good mix of US Treasuries and other sovereigns such as gilts or Japanese Government Bonds (JGBs). On the downgrade side, the collateral is predominately equities. Swapping HQLA for other fixed income or equities is a profitable trade for those who want to take advantage of the funding spread differential. Receivers of HQLA might be satisfying regulatory requirements, swapping an asset they find hard to finance for those that are easily monetized or satisfying client demand.

Once a trade has been agreed on EquiLend Collateral Trading, settlement is largely conducted via tri-party, though a few counterparties still prefer bilateral. Substitution on trades done via tri-party is only constrained by the collateral schedule. For bilateral trades there may be limits on the number of substitutions given the manual effort needed, similar to other bilateral transactions. Pre- and post-trade management can be facilitated within the Collateral Trading system itself.

The Collateral Trading module will initially handle all substitutions through automated interfaces. In a second phase of implementation, full Straight-through Processing (STP) will be incorporated along with collateral classes beyond sovereigns and Treasuries. In a third phase, there will be integration with other post-trade functions including the EquiLend Exposure service.

While the concept of automating collateral trading has long been one of the "Holy Grails" of securities financing, it wasn't possible until the release and integration of NGT, which created a platform for full automation.

The impact of automation will shorten the latency between trading and settlement, which is expected to enhance liquidity along with market transparency. Standardized settlement information already embedded in NGT will additionally reduce fails. These are significant improvements for the collateral trading marketplace, which has previously been a patchwork of manual and electronic settlement agreements. An important outcome is that liquidity can be extended deeper in the trading day. Feedback so far from EquiLend's client base has been very positive.

Building on the functionality already found in NGT, the Collateral Trading module will enable clients to continue to broadcast their intent, negotiate online, specify eligible collateral and substitutions parameters, allocate securities and manage settlement and post-trade record keeping. Traders won't have to spend valuable time on the phone before, during and after the trade working out details and then manually inputting transactions. This could move the 20% to 25% of manual financing trades closer to 10% to 15%.

EquiLend's collaboration with Stonewain on the EquiLend Spire offering, providing a front-to-back booking and optimization platform that is fully integrated with EquiLend's NGT, Post-Trade Suite, DataLend and other services, will also dovetail with the Collateral Trading service. EquiLend Spire's collateral management functionality – pulling in positions across businesses and booking centers – will centralize positions from around the firm, creating a golden source data repository. This provides critical information to traders as they evaluate collateral trading opportunities. Indeed, knowing what the positions are and where they are held is more than half the battle for efficient collateral optimization practices. Traders are pushing to utilize their inventory the best they can – to "sweat the assets" – and EquiLend Collateral Trading helps them achieve this.

EquiLend Exposure

The second development is EquiLend Exposure. Firms increasingly need to view collateral exposures to counterparties in real-time for holistic balance sheet optimization. EquiLend Exposure was initially envisioned to help middle office more efficiently observe how positions were flowing through systems, primarily for the purposes of fails mitigation, but it has grown to facilitate much greater functionality.

Better real-time information on collateral is critical to optimizing the balance sheet, and this is where EquiLend Exposure makes a big difference to the industry. Leveraging off of existing NGT participant-to-participant networking capabilities, counterparties can now see each other's collateral market value projections. Traders can make a side-by-side comparison of what is in their system versus what is in the counterparty's system, including valuations and exposure numbers. This is the ultimate form of reconciliation. When variances threaten to create a fail, operations teams can raise the alarm well before it becomes a problem, and dispute resolution can happen before it becomes a fail at much less expense.

Other benefits of real-time collateral exposure extend across a range of regulatory, funding and geographic requirements. As some examples:

- The Central Securities Depositories Regulation (CSDR) in Europe is creating a new mandatory buy-in regime that could become very expensive for industry participants. As EquiLend Exposure identifies potentially failing trades, firms will have earlier information to stop CSDR buy-ins from occurring. It also helps ensure collateral is placed correctly to facilitate settlement of borrows/loans.
- Real-time data feeds that receive collateral allocations and confirmations from tri-party agents can show instruments validated by collateral type, including breakdowns by pre-paids, pending activity and settled contracts. This data can be organized by viewer preference across function, enabling easy troubleshooting of any reconciliation differences.
- EquiLend Exposure can inform on an intra-day basis if margin calls or other pending activity is settled or still outstanding – not only for traders and middle office but for credit officers as well.
- Transactions that require collateral to be delivered to a lender first in order for them to release a borrow require extra monitoring to avoid fails. Knowing there is other eligible collateral in-house to deliver in real-time – even if it is higher quality than specified by a schedule – and substituting it in can save the trade.
- Early information on trade settlement fails conveys an information advantage, including potential changes in supply and demand. Securities finance desks can incorporate this information into decision making on availability and pricing.
- When combined with EquiLend Spire, EquiLend Exposure will allow for seamless integration with inventory records. The post-trade functionality in EquiLend Spire combines with EquiLend Exposure for monitoring margin calls, trade differences, and reconciliation.

UMR and funding costs

Uncleared Margin Rules (UMR) may provide a boost for EquiLend NGT and EquiLend Exposure with a focus on equities as margin. Typically, permitted collateral has tended toward fixed income and cash but market expectations are for those schedules to broaden and include certain liquid equities. As that occurs, the flow of collateral demand from derivatives businesses will increasingly involve the stock loan desk. Exposure calculations will have to include those equities, and the same might be said of expanding acceptable collateral for CCPs. Equities have always been seen as more liquid than many asset classes, albeit more volatile. With the right haircut, there is a place for equities in the acceptable UMR and CCP collateral universe.

Response to EquiLend Exposure has been overwhelmingly positive in the funding space. For broker-dealers, the biggest benefit comes when using the data to manage funding and internal RWA costs. Real-time access to movements in tri-party accounts and the ability to fine tune collateral allocations has been seen as transformative. For agent lenders, the ability to validate collateral movements, verify that collateral conforms to schedules and see pricing from an independent source moves the ball forward on risk management.

The Future of Collateral Management

Collateral management continues to be an evolving space, and banks, dealers and agent lenders must all consider what a combination of market factors and technology means for their business. As the technological backbone of the industry, EquiLend is focused on delivering standardized solutions that benefit a wide range of market participants.

The new product entries by EquiLend in the collateral space have implications for how the industry will adopt and process collateral trading and exposure data. In Collateral Trading, the ability to engage in a more liquid and longer collateral upgrade/downgrade market may expand capacity across the range of beneficial owners, agent lenders and borrowers of these assets. In EquiLend Exposure, EquiLend figures could replace those used by a firm's own internal calculations; already as part of the onboarding process, EquiLend validates that EquiLend Exposure calculations mirror the client's internal systems. Over time, EquiLend Exposure may become the industry golden source for assessing exposure risk and feeding back to internal liquidity and funding models.

EquiLend seeks to help the entire market achieve better price discovery, avoid settlement errors and optimize funding and regulatory risk. While each firm will maintain their own competitive advantages, standardizing core aspects of trading and post-trade processing offers a utility-style benefit for the entire industry, saving time and money on widely used technology and data analytics services.

SUPPORTING

ALL YOUR COLLATERAL NEEDS

EQUILEND SPIRE
POWERED BY STONEWAIN

EquiLend Spire is a best-in-class technology-driven hub leveraging EquiLend's many automated trading and post-trade services to optimize inventory management, cash and non-cash collateral, trade distribution through electronic trading algos and trading desk P&Ls. Users gain enhanced reporting, insight and control to better manage their business.

EQUILEND COLLATERAL TRADING

EquiLend Collateral Trading is designed for funding or fi nancing desks to eff ectively trade collateral. The tool allows for a centralized way for clients to execute and manage trade structures with their counterparties.

EQUILEND EXPOSURE

EquiLend Exposure offers clients real-time visibility and management of counterparty intra- and end-of-day exposure, optimization of collateral usage and reduction of unnecessary costs of settlement for borrows and loans.

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