Seizing the challenge of modernisation

Collateral is under pressure in the current market, but technology is primed to resolve this challenge, says EquiLend associate director for post-trade solutions Gabi Mantle

In February 2022, as the Central Securities Depositories Regulation (CSDR) washed in, the regulator's enthusiasm for the project was clear. Borrowing and returns rose significantly, indicating that, regardless of preparation, there was even more demand for intra-day liquidity — with the pace of change challenging easy comfort with the familiar. Uncertainty has remained around the possibility of achieving perfect settlement — and eliminating late matching or settlement fails — and this has fuelled stronger demand for cover to address settlement inefficiencies. This dependency on same-day cover reinforces the need for collateral to be moved around quickly and efficiently.

The securities finance industry's inability to adhere to 100 per cent settlement rates originates largely from dual centres of concern: the complex nature of mobilising collateral, and conflicting settlement schedules across global market participants — free of payment (FoP) and delivery-versus-payment (DvP) for example. The potential threat of latency in the trade lifecycle, adding CSDR penalties to the bottom line, means margin is at stake. The bottom line is that the risk needs to pay off.

Aside from inflexibilities in current market structures designed to facilitate the transfer of collateral, the difficulties which threaten same-day settlement invite greater risk by putting a strain on available collateral. If collateral is not readily available, same-day borrows to facilitate intra-day liquidity become impossible. In responding to clients that need to facilitate same-day cover, free up collateral and increase settlement efficiency, our recent offerings — such as Settlement Monitor and enhanced Tri-Party Connectivity via EquiLend Exposure — have delivered greater efficiency, while also facilitating CSDR compliance for clients.

Collateral is key to maintaining intra-day liquidity. Without collateral, buy-side firms will not release their loans, which are all important to preventing hefty CSDR penalties. Sell-side firms need to be able to source the right collateral at the right time. Inventory management becomes ever more pivotal in maintaining settlement efficiencies, giving the collateral providers better visibility and control in mobilising collateral positions. Coupled with technology that facilitates efficient collateral deployment and margin coverage, collateral can be moved within tight market settlement deadlines.

To discourage market participants from shying away from doing business, cross-provider post-trade and collateral service providers are well placed to reduce settlement risk and to speed up the settlement process by helping to automate manual, time-consuming processes — such as calling in and booking of returns, as well as collateral agreement. In-house investment, which does not take in the bigger picture regarding how the industry is changing, invites greater risk by simply delivering a refreshed version of the current system. The real benefit will be a vision of the future where custodians manage a central digital ledger to enable instant transfer of collateral, heralding the removal of settlement windows across the global landscape. EquiLend recently announced its 1Source initiative, designed to eradicate reconciliations using distributed ledger technology. Our decision to focus on this issue derives from the findings of a working group of industry leading firms that share the same concerns in this area.

The sector is at a tipping point. Regulators are pushing change into reality, with service providers and fintech companies providing the tools. Even those forward-thinking firms that are investing in their own technology solutions risk isolating themselves from the future of the industry where interconnectivity will be king. It is a drumbeat we have long marched to.

The technology possibilities for the financial sector are vast, and the junior talent entering the sector further drives an expectation for high-level technology and operations which run with ever greater speed and efficiency. A patchwork of legacy systems, and attachment to those ways of working, delay but do not hold back positive change. CSDR is one of many regulatory initiatives that we, as an industry, must respond to. There are already more coming down the line, including 10c-1. Our choice at EquiLend to invest in supporting future initiatives with new technology, such as so-called blockchain or digital ledger with 1Source, ensures we can continue to offer the promise of reduced risk and greater efficiencies across the board. There is no risk in modernising. However, there is significantly greater risk in remaining with the status quo.

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