Centralized collateral management becoming a reality

External Author

10/05/2019

Bimal Kadikar, CEO of Transcend Street Solutions, considers the opportunities and challenges facing financial institutions that are considering moving to centralized collateral management.

Collateral management has transitioned from an ancillary service to a core competency, largely as a result of the sheer breadth of activity from front to back office and horizontally across silos and asset classes. This has spurred a marked shift towards centralization of collateral management, providing organizations with a centralized view of inventory as well as funding and collateral optimization decisions.

But the move to a more efficient and centralized model is not without challenges. Inefficiencies and the cost of errors are magnified by the multiplicity of internal and external relationships that need to be managed and the requirement to control positions more frequently, even in real-time.

This requires a fundamental shift from managing assets only for margin purposes to managing assets for value, cost and balance sheet purposes.

Moving to a centralized collateral organization is a difficult step for many reasons and as a result, some firms are decoupling their business organization from their technology capabilities. They are instead focusing on building a centralized, horizontal technology strategy for inventory and collateral management.

In either case, the end goal may be the same – a holistic infrastructure that can yield the benefits of centralized collateral and inventory management coupled with sophisticated analytics and firm-wide optimization capabilities. Fortunately, today's technology enables this ultimate goal as well as the smaller moves in this direction.

Steps to collateral optimization

Regardless of the approach taken, there are a number of best practices for firms looking to increase the efficiency of their collateral and liquidity management:

1. Achieve visibility into inventory across multiple business lines and regions. This centralized view is extremely important.
2. Ensure all collateral schedules and legal agreements are easily accessible as these will impose constraints on decision-making.
3. Take a centralized view of different types of obligations and requirements to enable good decision-making.
4. Establish targeted analytics and Key Performance Indicators (KPIs) to measure and monitor progress of these initiatives.

These are vital foundational steps towards achieving an optimized collateral management environment.

Connected data: The key to better decision-making

Of course, bringing the data together is just one part of the process – the next step is to connect the data so that algorithms and analytics can be applied to it. Firms understand that the information is there for them to make better decisions, but they face a challenge in getting useable information and putting it to work.

The main obstacle, in most cases, is that they have built their operational structures and technology around specific areas of the business. To achieve a view across the whole enterprise, these businesses require co-ordination and connectivity across a large number of different internal and external systems – not easy to accomplish.

The solution lies in implementing a system that is easy to integrate and is targeted at connecting and harmonizing this data.

Avoiding costly re-engineering

There are sometimes negative connotations around the phrase 'legacy technology' but this is not always accurate. A firm's existing securities lending or repo or margin systems may be good, but they will more often than not have been built as separate systems. Rather than re-engineering all these systems, what the firm needs is a layer that pulls these disparate systems together to ensure they are seeing a holistic and harmonized view of inventory, positions and obligations.

Most firms have taken some steps to improve their inventory management, but there is a wide difference across the industry in terms of the strategies adopted to achieve this objective. Some organizations are trying to address the issue in a tactical way, fixing one system at a time to see whether this gives them greater visibility, but this approach does not have much longevity from a strategic perspective.

The larger organizations have usually taken a more strategic approach. Some see it as primarily an internal engineering effort, while others are talking to firms such as Transcend as they seek to harness real-time data, collateral and liquidity.

Regardless of the approach taken, being able to optimize collateral and liquidity decisions at an enterprise level has huge benefits. The sheer number of firms and analysts that have explored the scale of these benefits underlines the significance of the opportunity, and we find that most firms are actively taking steps towards achieving these capabilities.

Optimization models can be implemented with a rules-based approach or even using more sophisticated algorithms (i.e. linear and non-linear programming models). These all have a vital role to play in monetizing the connected data across the firm.

Scaling the benefits

Being able to optimize collateral across business lines is an obvious benefit, but there are also advantages to be gained from reducing internal errors and fail rates. In addition, funding costs will fall because firms will be managing their funding operations more efficiently: improving securitized funding leads to a reduction in more expensive, unsecured funding.

Whether or not firms embrace centralization across all aspects of their business, it is clear that rationalizing complex systems and harnessing fragmented data sets provides for informed, confident and compliant decision-making. And once centralized funding and collateral management are fully achieved, the benefits of efficiency, cost-savings and liquidity attain even greater scale for the firm.

