



## Winning the fight against the crisis

*As the world of banking, funding and financing deals with the ongoing challenges of the COVID-19 pandemic, Richard Glen, head of collateral management, and Banu Apers, head of securities lending and borrowing, outline how collateral management continues to evolve at Clearstream in the new digital age and why safer markets require safer infrastructure*

For opticians, 20/20 means perfect vision. However, even those with perfect visual acuity couldn't have predicted the full scale of the pandemic that has swept the globe throughout 2020 and now presents new challenges that could potentially remain for many years to come, as the new normal.

Crisis management resonates with many across financial markets, and banking has adapted well to the current COVID-19 readiness situation. In 2020, global banking continues to evolve under the watchful eye of its college of regulators, and the industry has taken huge leaps forward as it has looked to adapt and comply with the likes of the Dodd-Frank Act, Basel III and European Market Infrastructure Regulation (EMIR). Crisis management and risk mitigation come hand-in-hand with safer markets, and collateral has been the common theme that has underpinned all regulatory initiatives since the outset of the financial crisis. In fact, investment in collateral management in the meantime has become a strategic objective for both banks and non-banks alike.

## Safety first

When the rearranged GSF Summit took place in Luxembourg in January 2009 under the motto 'going beyond fragmentation', the traditional mechanics of safe markets and collateral management were discussed at length. In times of market uncertainty, counterparties considered the emerging trend of bundling collateral in central liquidity pools to make markets and the wider financial sector safer. They debated how market infrastructure could help to unlock trapped inventory and thereby support banks to mobilise collateral both swiftly and effectively in good times and in bad. Safer markets ultimately required safer infrastructure.

This seemed like a sensible objective. Within this context, however, the 'R' number started to rise. At this point in history, the 'R' number represented the rate of release of new regulation that would ultimately change the financial industry forever. In Europe, there was EMIR, then the Uncleared Margin Rules (UMR). This was followed by the

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Let's wind the clock back to September 2008 when wholesale banking entered a new age. Liquidity tightened dramatically in the aftermath of the default of Lehman Brothers. Central banks and policymakers took immediate action and injected enormous amounts of cash as they attempted to stabilise wholesale markets. For the first time in its history, Clearstream's GSF Summit, a leading global conference for securities financing, was postponed in 2008 as traders, treasurers and securities financiers across the industry tried to make sense of what subsequently became the new normal.

Securities Financing Transactions Regulation, the second Shareholder Rights Directive and now the Central Securities Depositories Regulation (CSDR).

In the collateral management business, regulation drives change and when we think back to the messages from the 2009 GSF Summit, it is not only the location of that collateral and the ability to access liquidity that remains important; it is also the mechanics that make up the collateral management workflow that remain a source of constant discussion and now evolution.

## The dawn of the digital age

As the UMR programme originally mandated by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) now reaches the fifth and penultimate phase, albeit delayed, in 2021, it brings a number of counterparties into scope that have never previously mobilised securities inventory or collateral to the extent that they will need to. In fact, many still underestimate the huge amount of operational and technological competence required to mobilise collateral effectively. Investing in this type of process during a normal business cycle, let alone a pandemic is both costly and complex, and this is why market participants continue to place their trust in partners such as Deutsche Boerse Group and Clearstream who continue to invest in industry infrastructure for the benefit and resilience of the wider marketplace.

Whilst 2020 will be memorable for the wrong reasons, in the financial sector it has truly seen the dawn of the digital age in wholesale banking. The technology that companies such as Deutsche Boerse Group deploy has not only allowed its employees and service providers to work safely and securely from home across all locations, it has also allowed it to support its clients in mobilising their global collateral pools seamlessly throughout, across different locations, time zones and investment venues. Whilst people cannot travel, collateral always needs to remain mobile, and mobilising and monitoring assets effectively in times of crisis relies heavily on automation and real-time processing. It also requires investment in capabilities that are designed to improve both existing and future collateral processes.

For the likes of Clearstream, this includes developing cross-border collateral management processes in Europe as we look to help market counterparties optimise assets for financing as well as to minimise intraday credit usage in our Luxembourg and Frankfurt hubs as well as across other sub-custodian locations. It also includes collaborating with fellow market participants in the Americas, Asia and Africa.

In securities lending, we also continue to invest in our ASL and ASLplus products which offer clients end-to-end automation when borrowing or lending securities. Whilst the settlement discipline regime mandated by CSDR seems to be delayed, we continue to discuss readiness with clients to ensure that they have access to critical liquidity if needed.

Separately, we're also supporting market participants by investing in the future of collateral management. This includes the cloud-based user experience offered by CloudMargin as well as new digital collateral partnerships such as HQLA<sup>x</sup>. The number of use cases for the mobilisation of assets, both in book-entry and tokenised form, for collateral upgrades and margin pledges continues to grow, and the need to navigate a fragmented collateral ecosystem is driving digital innovation and more importantly, investment in digital trust.

## Innovating with data

Digitisation is also creating new opportunities for data. In collateral management, much of the complexity is driven by the huge amount of data that risk managers use to determine or assess eligibility of assets. Since the outset of the financial crisis, the industry has come a long way but continues to evolve. In 2008, new innovative functionality included the ability to dynamically apply increased haircuts to stale prices or to flexibly layer different eligibility rules together to create sophisticated collateral profiles for multiple asset classes.

In 2020, clients are looking to apply further filters to dynamically manage a number of different scenarios and trigger points as well as coordinate dialogue with different stakeholders both internally and externally. These include not only minimum prices and volatility ratios but also liquidity scores. With the growing importance of specific regulatory criteria, such as those required to manage cleared or uncleared margin requirements or access to central bank liquidity, the sophisticated nature of eligibility management will continue to evolve. As we edge towards the end of 2020, new investment parameters, particularly those focusing on environmental, social and corporate governance (ESG)

criteria, will continue to drive innovation in collateral management. We believe there will be a continued focus on 'green' data as well as end-to-end common domain models as the industry seeks to harmonise and standardise many of its antiquated legacy systems.

## Moving to a new European standard

Whilst data and digitisation create opportunities for banks to manage risk, balance sheet and exposure requirements more effectively, the ability to unlock new collateral and liquidity pools remains a key objective for clients and service providers alike. The keynote speaker at the 2009 GSF Summit was Luc Frieden, minister for finance and budget in Luxembourg, who spoke on 'winning the fight against the crisis'. This was at a time when Europe was at a crossroads. Markets were in lockdown, contagion spread from a localised outbreak to a truly global phenomenon. Even countries were no

Bundesbank, Banque de France and Banca d'Italia into a single collateral management platform covering the entire eurosystem towards the end of 2023. With further harmonisation of the existing TARGET2 and T2S process planned in parallel plus the inclusion of Eurobonds as collateral within T2S, collateral managers and triparty service providers face several compelling challenges both in terms of operational and technical complexity. Legacy systems and processes will require upgrades; clients and market participants will have to adapt to new messaging interfaces, new reporting and new processes that impact not only collateral management but also asset servicing and settlement.

However, in the long-term, new digital solutions that offer harmonisation and standardisation are positive for financial markets, and the changes will encourage participants to deploy new data and operational workflow to promote collateral mobility which, as the GSF Summit predicted,

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longer too big to fail. Safer markets required safer infrastructure. (All of this sounds very familiar.)

The rollout of TARGET2-Securities (T2S), whilst originally designed to harmonise and reduce the cost of settlement processes in Europe, was now focused on the safe haven of central bank money and central bank liquidity. Now, as we enter the new CSDR era, focus continues across the Eurosystem on a renewed push for harmonisation and standardisation. The Single Collateral Rulebook for Europe (more conveniently known as SCoRE) seeks to merge the legacy collateral management systems of the likes of

go beyond fragmentation. With new technology and innovative expertise coming to the forefront across both the vendor and middleware space, the future looks bright for banking, funding and financing.

A little while from now, when we look back on the current pandemic era and the lessons learned and we jointly reflect on the message from Luc Frieden in 2009, bankers and financiers will gather together, hopefully physically, and re-affirm that safer markets need safer infrastructure and that together, the world will be a safer place as a result.