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# Collateral management – How market infrastructures can address the challenges

Looking at the latest developments in the world of collateral management, in an interview sponsored by the Depository Trust & Clearing Corporation (DTCC), *Risk* sits down with Ted Leveroni, executive director of strategy and buy side relations. In a time of unprecedented change and unparalleled challenges in the industry, among the topics on the table were how infrastructure providers can partner to address issues around clearing, collateral mobility and margin calls

**Risk:** To start, if you look at derivatives regulatory reforms combined with Basel III capital requirements, firms are seeing more and more pressure put on them in order to manage and access collateral. How is the industry responding to this?
**Ted Leveroni:** I think we're seeing an unprecedented amount of co-operation between different areas in the industry – infrastructure providers, vendors, individual banks, brokerage firms and investment managers. They're looking to re-engineer the entire process, front to back. That makes a lot of sense; you can re-engineer the entire process and then you can solve individual requirements along the way. It makes things more efficient, collateral-wise and operationally.

**Risk:** Looking at the US, with the introduction of the Dodd-Frank Act, what kind of experiences – and maybe lessons – are there to be learned from it?
**Ted Leveroni:** I think there is one big lesson: start preparation early – testing, lighting up your relationships and getting your contracts in order.

Getting on board in terms of capacity and then testing the various new relationships you're going to have – with the futures commission merchants, clearing brokers and your client business, and new clearing counterparties. You have to get on the front foot and start early. Four to six months in advance isn't enough time; you need much more time to prepare than that.

**Risk:** There has been a lot of debate around the risk of collateral shortage. In your opinion, is there enough collateral in the system?
**Ted Leveroni:** Overall globally, yes, there is probably enough collateral in the system, as a recent London School of Economics study, supported by DTCC, concluded. However, the research found that there are bottlenecks due to existing weaknesses in financial market infrastructure.

**Risk:** You mention these bottlenecks as preventing collateral mobility; could you expand on this and explain how the industry is addressing these problems.
**Ted Leveroni:** Essentially, if you look at it globally, you might have enough good quality collateral but, if your firm doesn't have access to it, then it is of little help. There are firms that hold a large amount of US Treasuries, which is very high-quality collateral, but if you can't access it or get it through a repo or a securities financing agreement, you're not going to be able to meet your collateral calls. It's those bottlenecks that are challenging and that DTCC and Euroclear are trying to help solve.


Ted Leveroni

**Risk:** With the introduction of clearing, firms are facing rising operational risks due to the significant increase in margin calls. How is the industry addressing this problem?
**Ted Leveroni:** Again it's about re-engineering a process. It's looking at the current solutions that you have and identifying areas of manual intervention or where there is a lack of transparency. Firms are looking to solution providers, or internally, to automate their internal processes.

They can create virtual collateral pools and see their supply and demand of collateral in one spot and then manage that collateral appropriately.

Then you have to add transparency to the process so you know when collateral actually does come in – you don't just assume collateral has come in. You know where all your collateral is, you know when it actually settles and you know in one way, holistically, what all of your collateral demands are.

**Risk:** You mention Euroclear, there's obviously a joint initiative between DTCC and Euroclear. Could you explain how this is addressing concerns around collateral mobility and also margin calls.
**Ted Leveroni:** DTCC and Euroclear are on the way to executing a joint venture, which will consist of a Margin Transit Utility (MTU) that is operated by DTCC and a Collateral Management Utility (CMU) that is operated by Euroclear.

They link together and address the two major impacts of these regulations: an increase in collateral calls prompts the need for operational efficiency, and an increase in collateral demand requires greater and more efficient liquidity provision. The MTU creates efficiencies in automation and straight-through processing in the margin settlement space.

It also creates transparency, letting you know when your collateral actually settles, which you can then use to optimise. You need to know what collateral you have on hand to help with funding costs and optimisation.

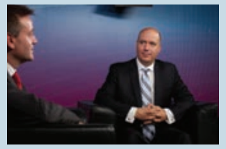
The CMU is a liquidity provision entity that brings 'collateral providers' and 'collateral users' together in a single pool, and allows for the breakdown of collateral bottlenecks across locations

**Risk:** There have been a lot of cross-border initiatives like this before. There have been significant hurdles because of national, political or economic reasons. Why do you think you will be successful where others have failed?
**Ted Leveroni:** I think it's a factor of being able to leverage and combine our pre-existing infrastructures to create greater efficiencies. Today, the challenges we are facing are greater and more global than they have been in the past, and this calls for a global solution.

In this regard, DTCC and Euroclear as global, trusted infrastructure providers are changing the way the roads are laid and how the streetlights are placed.

Our solution differs to those of individual banking institutions that are existing players in this space, but not the essential infrastructure, and I think that this is the difference. The infrastructure providers, by getting together, can create a more seamless solution than individual players.

**Risk:** What kind of time frame are we looking at here?
**Ted Leveroni:** We are looking to have the first phases of the MTU and the joint venture up and running late next year.



>> View the full proceedings of the DTCC-sponsored Q&A, *Collateral management – How market infrastructures can address the challenges*, at *www.risk.net/2372874*