New directions in collateral management

Gael Delaunay, Clearstream's global head of collateral management, speaks to Bob Currie about the resurgence of GC Pooling, collateral mobilisation and extending triparty collaborations into new jurisdictions

As one of the largest post-trade market infrastructure companies globally and a provider of triparty collateral services for more than 30 years, Clearstream has been on the frontline in driving measures to promote collateral mobility, to tap underutilised pools of collateral and to deliver greater safety and technical efficiency to collateral movements and settlement.

Since joining Clearstream last October as global head of collateral management, Gael Delaunay is charged with carrying this momentum forward and crafting a collateral management ecosystem that meets the needs of the future. In doing so, he brings more than two decades of experience in post-trade financial services, having previously served at The Bank of New York Mellon as head of collateral management for Europe.

Prior to this, Delaunay held senior relationship management roles for securities services and cash management at J.P. Morgan and BNP Paribas' Securities Services.

Monetary normalisation

Delaunay comes to the Deutsche Börse-owned market infrastructure specialist at a time of monetary readjustment when an extended period of low interest rates and abundant liquidity — supported by central bank asset purchase programmes (APPs) initiated after the 2008-9 Global Financial Crisis and reinforced through major balance sheet expansion during the Covid crisis — has been displaced by an aggressive phase of monetary tightening and initial steps to unwind central bank APPs.

With the ECB's aggressive tightening of interest rates, this has triggered a steepening of the yield curve and has opened the door for renewed interest in GC Pooling and special repo.

From Q3 2022, Eurex and Clearstream have noted a steady flow of banking participants returning to their CCP-cleared repo marketplace — some of which had been absent for some time, given the ready access to funding through central bank liquidity support programmes. In the second half of 2022 activity was predominantly in longer maturities, but during 2023 there has been a significant rise in GC trading volumes in shorter maturities, from overnight up to one week. In line with this trend, GC Pooling balances have risen by more than 200 per cent over the past 12 months.

For October 2023, Eurex Repo recorded a major increase in daily GC Pooling volumes, up 191 per cent to €212.6 billion, with special repo activity up 34 per cent YoY to €247. 9 billion. In aggregate, total average daily term-adjusted repo volume increased 78 per cent YoY in October to €460.5 billion.

For the first half of 2023, Eurex Repo's overall outstanding volume increased by 62.9 per cent YoY, with the GC Pooling market up by 89.6 per cent and the Eurex Repo market expanding by 50.4 per cent.

This reactivation of GC Pooling as a liquidity management tool has benefited from the supportive push of higher interest rates, reduced excess liquidity and more attractive GC Pooling rates offered to the market.

A comprehensive revision of the ECB's Targeted Longer-Term Refinancing Operations (TLTROs) in October 2022 resulted in repayments of around €300 billion in November and around €450 billion in December 2022, which reduced excess liquidity. By mid-2023, approximately half of the aggregate €2 trillion in funds loaned to European banks under the TLTRO III programme had been repaid, with the remaining TLTRO III operations due to mature at the end of 2024.

For cash lenders, new players have been attracted to special repo and GC Pooling channels as government-backed deposit schemes have seen their deposit rates reduce significantly. "Cash providers are less motivated to deposit cash with their central banks given they can attain a higher yield on their cash investments by entering into secured repo transactions with Street-side counterparties, while benefiting from the operational efficiency and risk management features offered via a triparty programme," says Delaunay.

More broadly, Delaunay's suggests that a wider range of large institutional investors — including European pension and insurance funds, sovereign wealth funds, public authorities such as debt management offices, central banks and supranationals, and increasingly UCITS funds — are using, or intend to use, GC Pooling and special repo to generate improved risk-adjusted return on their asset holdings.

With this in mind, Clearstream is working closely with the Eurex team to bring more buy-side firms into GC Pooling. Through ISA Direct and ISA Direct Indemnified, Eurex Repo and Eurex Clearing aims to combine the benefits of direct clearing access for buy-side firms with the advantages of traditional sponsored access via a clearing member. This creates a principal-client relationship between the buy-side firm and the CCP, but with a clearing agent performing additional service functions to enhance the clearing solution.

Delaunay also identifies a sizeable pool of corporates that are active in funding markets as cash providers and would benefit from this triparty repo programme as a safer and more efficient mechanism for realising a yield pick up on their cash holdings. “It is noteworthy that some corporate entities continue to lend cash on an unsecured basis,” says Delaunay. However, the collapse of Silicon Valley Bank in March of this year — and historical bank defaults going back to the Global Financial Crisis and before — provide a lasting warning of the potential risks associated with unsecured lending.

Regulatory capital

For bank counterparts, there is also an incentive to trade and finance through CCP-cleared channels, given the advantages this affords in terms of managing their regulatory capital. Commercial banks are looking to manage their regulatory capital requirements as efficiently as possible, including their Net Stable Funding Ratio (NSFR), Liquidity Coverage Ratio (LCR) and Risk-Weighted Asset calculations under the Final Basel III Rules. As this rule set takes effect, banks may be confronted by higher regulatory capital costs as they adapt to the revised calculation methodology required under these Basel III Endgame obligations. Published in 2017, these Final Basel III Rules came into effect on 1 January 2023 and will be

phased in over a five-year timeframe, although some jurisdictions may slightly compress or extend this implementation timetable.

Among its prominent requirements, these Final Rules impose an output floor, applying a lower limit on RWAs based on the revised standardised approaches in the framework. This will limit the regulatory capital benefit that banks can obtain from use of internal models to evaluate credit risk and market risk. RWAs linked to credit valuation adjustment risk and operational risk must be calculated using standardised approaches under the Final reforms.

"This change may result in banks being required to allocate substantially more regulatory capital against their trading and financing activities — an increase that may be a multiple of their previous regulatory capital cost," explains Delaunay. As they seek to minimise balance sheet impact of these business activities, banks are increasingly looking to CCP-intermediated trading and financing relationships as one favourable option, which also adds the benefits of netting. A second, he notes, is that many bank counterparties are exploring opportunities to make greater use of pledge-based collateral agreements, given the regulatory capital cost advantages that this may offer to their collateralised trading and financing activities."

Removing collateral fragmentation

In parallel, Clearstream continues its journey to help clients to mobilise collateral more efficiently and to reduce collateral fragmentation across geographies and product silos. This was a primary rationale for the release of Clearstream's Global Liquidity Hub in 2009 and a focus that endures into the 2020s. "Where we can, we will continue to break down silo-based approaches to collateral management and to reduce fragmentation," says Delaunay. "Where we cannot do so immediately, we will offer bridges to support collateral mobilisation and transfers."

Continuing this tradition, Clearstream delivered a project in 2022 known as Collateral Mobility designed to centralise all cleared repo activity under its international platform and set of accounts. This set the premise for migrating the central bank pledges alongside the ECB's project to harmonise the payments, securities settlement and collateral management systems for the Eurosystem. In doing so, the ECB has replaced its legacy TARGET2 payments system with a new real-time gross settlement system, labelled T2, which was launched on 20 March 2023. In doing so, it aims to consolidate T2 with the Eurosystem's TARGET2-Securities (T2S) securities settlement system onto a single platform and, in April 2024, it plans to release the delayed Eurosystem Collateral Management System (ECMS).

The ECMS is a centralised collateral management facility for Eurosystem central banks that will replace collateral management operations currently conducted at national level on the systems of 19 eurozone central banks. By launching the ECMS platform, the ECB aims to consolidate and modernise monetary policy collateral management operations across the Eurosystem.

Through its Collateral Mobility project, Clearstream has transitioned collateral management activities for German domestic business previously conducted on Clearstream's German CSD Xemac platform onto their ICSD CmaX platform that supports its international triparty collateral management business situated in Luxembourg. Consequently, the CmaX platform centralises all triparty collateral management services in Deutsche Börse, from straightforward repos, securities lending, CCP margining, structured trades — and central bank pledges in the near future — onto a single platform.

In doing so, Clearstream aims to provide standardised operational procedures and interoperability across the services offered by its Luxembourg-based ICSD and its CSD in Germany. For users, the aim is to offer efficient mobilisation, optimisation and allocation of collateral across their international and domestic activities from a single pool of securities accounts.

In line with this objective, Clearstream will also introduce a series of enhancements to its collateral programme, offering additional flexibility in optimisation logic from full rebalancing to a more granular set-up completing the already large array of services. In combination with the uncleared repo flows in central bank money that are soon to arrive, Clearstream aspires to make the secured financing market safer and more efficient.

By the end of 2023, Clearstream will add ESG scores to its collateral optimisation capability, enabling users to apply additional sustainability criteria alongside other eligibility factors in defining their collateral schedules and optimisation methodologies.

This optimisation capability is complemented through the release of

OSCAR, a tool for collateral eligibility negotiation and collateral screening that Clearstream launched in 2023 in partnership with Brussels-based fintech Intelli-Select. This collateral solution, named Own Selection Criteria with Automated Reasoning (OSCAR), utilises Intelli-Select's software, applying artificial intelligence strategies to evaluate collateral eligibility profiles when working with collateral baskets.

This streamlines the process for developing and negotiating individual collateral baskets by applying AI techniques, including knowledge representation and reasoning (KRR), machine learning and structured natural language processing (NLP). OSCAR generates a digital version of a collateral schedule which can be agreed with trade counterparties through a smart online interface, reducing a process that may previously have taken several hours potentially down to minutes.

Building on this capability, Clearstream is working with Intelli-Select to develop additional functions. It recently launched marriage brokering, which helps with the identification of trading counterparties based on specific client profiles and trade axes, thereby creating new potential trading opportunities. Trade proposition, which is scheduled for release during the first semester of 2024, evaluates the buckets of underutilised assets that the client holds on CmaX and will identify potential eligible counterparties from the list of firms that have signed up for the marriage brokering service, here again adding value for Clearstream clients by suggesting trading ideas to place underutilised assets.

Through Collateral Mapper — a module of Clearstream's in-house built Xact web portal, Clearstream offers a client dashboard that provides an integrated view of a firm's collateral holdings on CmaX. This provides detailed analytics on collateral usage and identifies opportunities for users to further utilise equities not currently held at Clearstream to enhance optimisation of their Clearstream collateral baskets — and thereby free up high-quality assets. This solution has been available since March 2023 to support optimisation of clients' equity holdings and Clearstream plans over the coming months to extend this coverage to a wider range of asset classes.

Canadian Collateral Management Services

In May, Clearstream and TMX Group — the Canadian exchange and post-trade infrastructure operator that owns CDS, the Canadian central securities depository — announced plans to launch a Canadian Collateral Management Services (CCMS) that delivers the benefits of Clearstream's international triparty solution to the Canadian market.

Released in the third quarter of 2023, the new CCMS facilitates optimisation and collateralisation of securities finance activities in the Canadian market, establishing Canada's first domestic triparty capability.

The roll-out phase of the CCMS supports the activities of market participants in Canada's secured funding market, providing an automated collateral management process across the SFT lifecycle, while facilitating the transition to next-day securities settlement for Canada in May 2024.

This arrangement with TMX is a forebear to further efforts from Clearstream to further market partnerships globally, enabling market infrastructure in other markets to employ Clearstream's global collateral management technology and systems to deliver domestic triparty and associated collateral management functions.

This builds on a collaborative approach that has been integral to the Global Liquidity Hub since its launch in 2009, enabling market participants in locations including Australia, Brazil, Canada and South Africa to benefit from an international collateral network established through links between Clearstream Banking in Luxembourg and the domestic CSDs. Through this hub, users can access a diversified network of counterparties across these locations, enabling them to collateralise exposures across this network using Clearstream's international collateral management solution while their assets remain in the domestic market.

In concluding, Delaunay notes that this changing collateral management environment is driving new collateral paradigms, marking a return to some of the market characteristics and standards prevailing before the Lehman crisis — particularly with reduced access to central bank liquidity motivating firms to extend their secured financing activities with Street-side counterparties.

This new dawn for secured lending is shaped by new regulations, participation from new market players and by long-established market infrastructure providers, such as Clearstream, supporting this evolution with new solutions and innovation.