



# Tri-Party Collateral Management case study

Volanté's market leading integration software was utilised to accelerate the delivery of a leading investment bank's tri-party collateral management solution.

## Background

Classical collateral management for non-exchange cleared OTC derivatives involves the day to day calculation of variation margin (VM) with an OTC trading counterparty; netted at end of day over a range of asset classes to determine exposure to a trading counterparty (typically this is single currency).

To cover this net exposure, collateral needs to be pre-agreed between parties and posted. The collateral can be of varying types, e.g. Cash collateral or Government Bonds from G7 or G20 countries, preferably as liquid as possible. Once determined the collateral is posted to the counterparty's custodian of choice, e.g. Clearstream, Euroclear or Bank of New York Mellon.

Note that for higher risk trading, Initial Margin (IM) may also be posted prior to any trading takes place.

## New Collateral rules

Stemming from the 2008 financial crisis and derived from the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (BCBS-IOSCO), new rules to ensure appropriate collateral is in place to offset any losses caused by a counterparty default.

Thus from 1 Sept 2016 new regulatory collateralization rules for both VM and IM came into play for the US, Canada and Japan, applicable to entities with a notional turnover of 3 Trillion USD or EUR -defined as the Aggregate Average Notional Amount (AANA) of non-centrally cleared derivatives over a 3 month period Mar-May 2016; Please refer to:

[www.bis.org/bcbs/publ/d317\\_summarytable.pdf](http://www.bis.org/bcbs/publ/d317_summarytable.pdf)

for a detailed explanation. Approximately 25 organisations are impacted in this first wave. The new regulation requires use of new BIS-IOSCO "GRID" rules for the calculation of the required IM. However, the calculation using the GRID method was viewed as expensive and did not reflect changes in market conditions, soaking up trading funds and thus a new risk based model was proposed and the standard Initial margin model (SIMM) was agreed by regulators, improving the cost of such collateralization by up to 10x.

Refinements are expected but it is now a widely accepted model for IM calculation. When issues arise with risk calculations (sensitivities) the trading organisation – AcadiaSoft is an agreed and trusted arbiter of the IM calculation where disputes happen between parties.

## Tri-Party Collateral Management (TPCM)

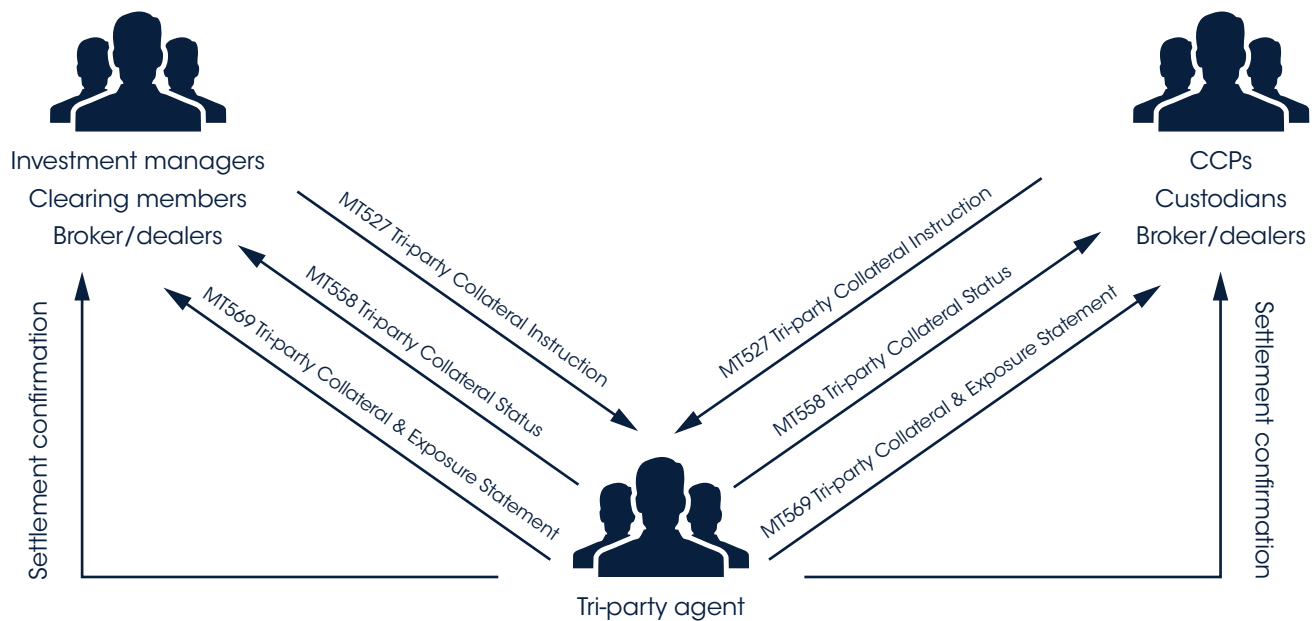
Evolving from this and to help mitigate the risks, the Tri-Party Collateral concept arose where trading parties use segregated accounts at an agreed mutual tri-party custodian to manage the margin collateral. In case of one party default then these funds can be released to the counterparty owed. The Tri-party custodians are provided eligibility criteria and will manage funds between segregated accounts according to particular trading counterparty. Essentially the use of the tri-party custodian simplifies and helps reduce the operational overheads of managing collateral with multiple trading partners.

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### How Volante helped

Volante provides support for an extensive range of financial standards and in this case, Volante was asked by the organisation to develop specific support for the SWIFT MT messages required for TPCM. These included the SWIFT messages for managing collateral movement at the nominated custodians:

- MT527 Instruction from Bank to Custodian - the issue is that all custodians have slightly different rules in the MT527 format – Volante was able to easily model and then apply the relevant format validation for particular custodians.
- MT558 Acknowledgement back from Custodian – notifications of segregated account postings
- MT569 Statement of collateral holding values to bank
- SWIFT TPCM financial message flows can be seen below;



Volante helped the bank by quickly creating mappings from the existing formats used by the bank to the custodian specific SWIFT MT message variations expected. This both reduced the project's cost and significantly accelerated the bank's rollout of their solution. Ongoing maintenance of the solution will also be easier, with the bank utilising Volante's ongoing support for SWIFT message standards changes.

### How does this impact your organisation?

It is expected that by Sept 2017 and every year onwards as the AANA values reduce, more entities will be impacted and can be expected to utilise TPCM. As was the case for our client, the challenge was managing the messages and integration to the current custodians (JPMC/BNYM/Euroclear/Clearstream). By using Volante's technology this challenge was simplified as well as enabling an accelerated rollout of the bank's TPCM solution.

If your organisation will be impacted, then come and talk to us about how Volante's technology can help reduce the challenges of implementing Tri-Party Collateral management.