The new world order

Automation, STP and sound risk management through the use of technology are key to ensuring the triparty markets work efficiently in the modern era, says Martin Seagroatt of 4sight Financial Software

The triparty process is an area that creates a number of operational headaches for market participants. While many aspects of triparty trading are automated and real time, there are still components of the trade lifecycle that result in operational complexity and significant manual effort.

Many legacy technology systems or workarounds using spreadsheets do not offer sufficient functionality to support the triparty trading process. This results in unnecessary costs and a strain on operations.

There is also a trend emerging for more corporate treasurers to move into the triparty repo markets. This allows them to take advantage of the credit risk benefits of collateralised investments and additional yield opportunities in the current low-interest rate environment.

Collateral management is a new concept for most corporate treasurers. This could result in treasurers needing technology solutions that they can deploy quickly and easily with a minimal IT footprint to support the reverse repo lifecycle.

The main pain points experienced by the market around triparty trading centre around the following key areas:

- Operations;
- Reconciliation;
- Risk; and
- Allocation and optimisation.

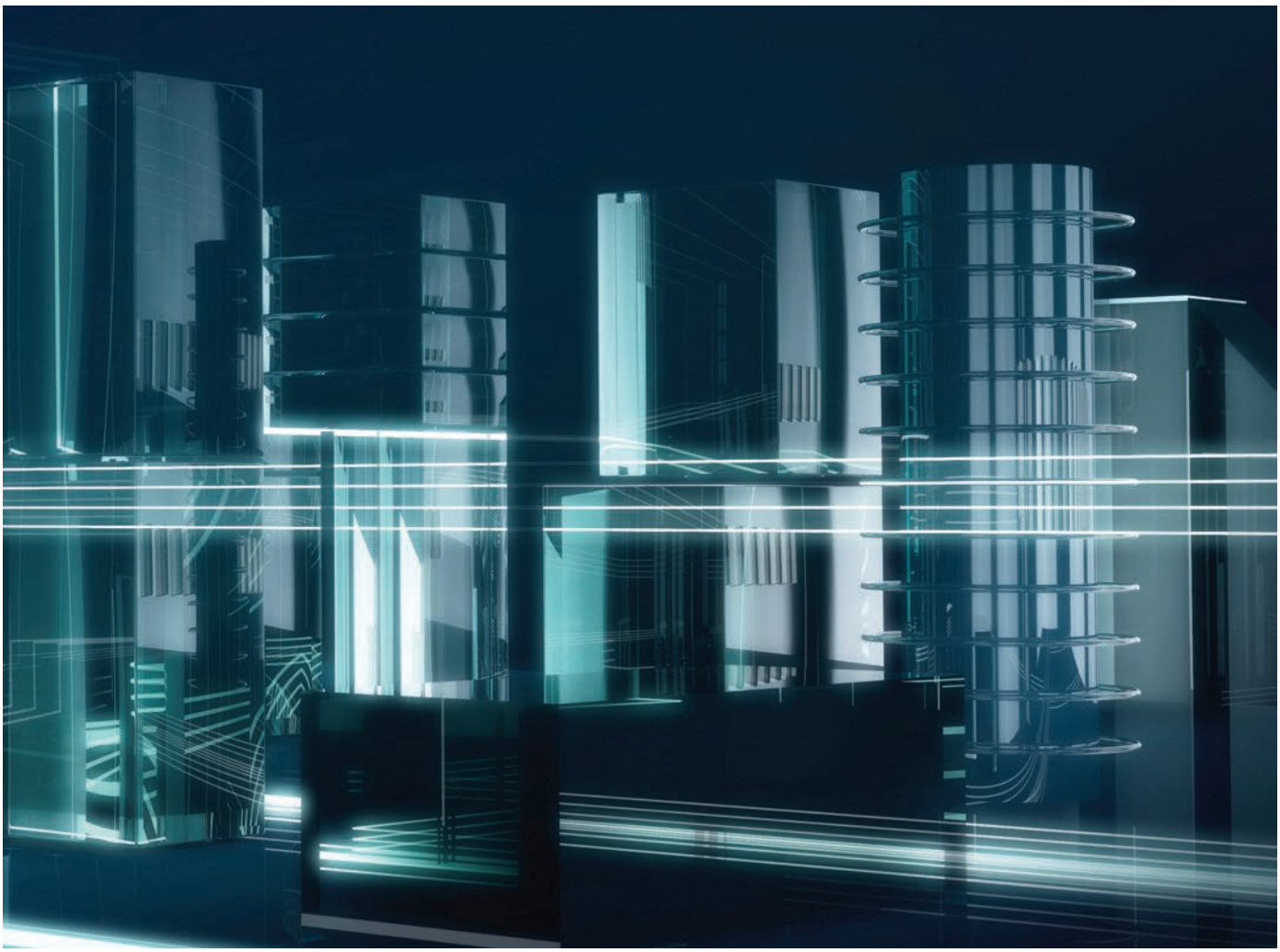
Operations

Various elements of trading via triparty agents place a strain on operations teams, leading to needless manual intervention and pockets of heightened operational risk. For example, the processing of request for value (RQV) SWIFT messages can often be cumbersome. Many firms currently use systems with little or no straight-through processing (STP) around the sending and receipt of messages. For each RQV, the firm must both notify the triparty agent and then monitor the status of each message.

To solve this problem, 4sight has enhanced its triparty module in the 4sight Securities Finance solution. The new features allow users to see which RQVs need to be booked, changed or cancelled in order to be 100 percent covered. The system can help users to easily identify triparty collateralised trades, streamlining the booking process.

Many firms do not currently have the capability to automatically match collateral allocations with their respective securities lending and borrowing or repo trades. They simply book a basket of collateral against multiple trades. Automation of these processes offers the ability to identify the underlying credit risk of trades, based on a clear view of the collateral allocated against each counterparty.

The 4sight triparty module now allows triparty collateral allocations from the triparty agents to flow directly into the 4sight system. The system



then automatically matches them to their respective securities borrowing and lending or repo trades.

This reduces the manual effort spent matching trades. It also maintains reference data integrity, unifying information on agent, schedule and security type and resulting in a much clearer picture of overall risk.

The system also offers automation of repo cash movements and a cash netting engine to reduce settlement movements, costs and fails.

Long box visibility and reconciliation

In the triparty trading process, it is important to be able to reconcile what you have allocated or been allocated with your RQV and exposure. Furthermore, the ability to reconcile what you still hold in your long box is useful from a collateral efficiency point of view.

Previously, reconciliation between the triparty agent and books and records systems was relatively manual and time consuming. To address these visibility gaps, 4sight has introduced closer real-time integration with triparty agents and automated SWIFT MT535 message processing.

This results in improved clarity and reconciliation of what the user thinks they have in their long box versus what is actually in their long box, and what has been allocated.

Another major operational burden involves checking what allocations have been made against eligibility schedules. This is currently a very complex process, with no easy way to reconcile this apart from manual checking. The checking of concentration schedules is often even more operationally difficult.

Many agent lenders have a fiduciary duty to their clients to thoroughly reconcile received collateral against eligibility and concentration rules as part of their contractual agreements.

Automation around this process allows the flagging of exceptions and breaks.This is far more efficient than a time consuming process of reviewing hundreds of lines of collateral, often using a ‘four-eyes’ checking process.

Technology systems must also offer a high degree of granularity in setting schedules. This will facilitate the full capture of subtle nuances of the types of collateral each client will accept along with often multi-faceted concentration rules.

Allocation and optimisation

Systems that offer sophisticated collateral allocation algorithms to support the triparty process are fundamental to trading efficiently via triparty agents.

According to a recent Federal Reserve report, Key Mechanics of The U.S. Tri-Party Repo Market: “A well-functioning triparty repo market depends on the ability to efficiently allocate a dealer’s securities—the collateral in the transaction—to the various repos that finance those securities. In the US, collateral allocation currently involves considerable intervention by dealers, which slows the entire process.”

“Ideally, the allocation process maximises the amount of financing that can be obtained from a given pool of collateral, or minimises the dealer’s all-in net cost of financing, including the effect of haircuts. The use of the clearing banks’ automated allocation systems, and the avoidance of ‘manual overrides’, is therefore promoted by the sophistication of the optimisation algorithms used in these systems.”

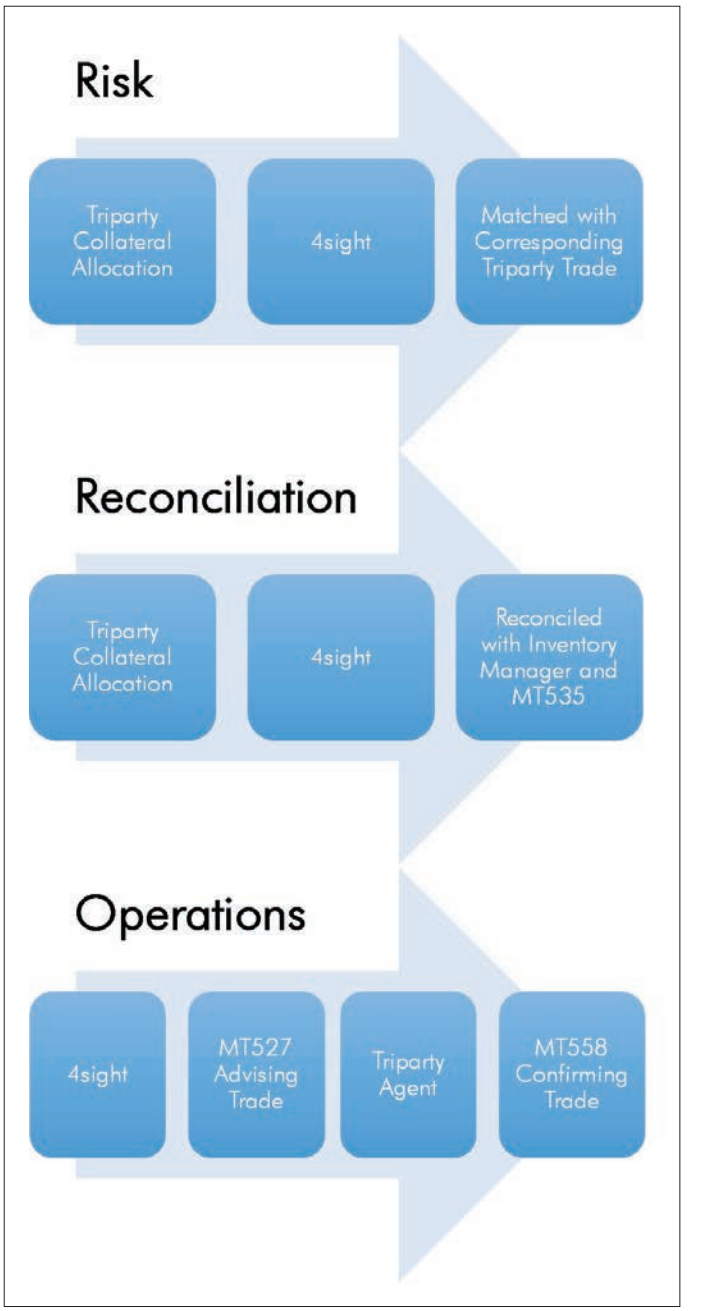
From a cost efficiency perspective, the ability to identify and then ‘sweat’ idle assets sitting in the long box enables the extraction of maximum value from the collateral pool.

From the borrower perspective, increased visibility over the triparty long box allows the firm to bring back collateral that has not been used by the triparty agent at the end of the day.

In a world where collateral costs are increasingly important, this means that the collateral pool is working as hard as it can for the firm.

Finally, as the collateral ecosystem becomes more integrated, the ability to view holdings across multiple triparty agents and central securities depositories is becoming increasingly important.

Being able to locate, mobilise and optimise collateral effectively on a cross triparty agent basis can offer major economic benefits. Effective technology solutions are key to this process.



Risk

The automation of manual processes can result in a significant reduction in operational risk and human error. There are a number of other ways risk management can be improved in the triparty collateral management process. Automated reporting around the triparty process can help to align risk with finance and can vastly improve understanding of credit risks in the trading book.

From the lender perspective, a better understanding of the collateral being received allows a focus on exceptions and a widening of schedules into riskier asset classes with confidence that the added risk can be controlled and monitored.

> “Automated reporting around the triparty process can help to align risk with finance and can vastly improve understanding of credit risks in the trading book”

Finally, on a systemic basis, a well-functioning triparty market acts as a key component in the plumbing of the financial system. Automation, STP and sound risk management through the use of technology are key components in ensuring the triparty markets work efficiently in the modern era of high-velocity collateral mobilisation. **SLT**

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