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Collateral RFPs: 14 points to consider

Martin Seagroatt and Jonathan Cooper of Broadridge provide a 14-point checklist for choosing the right collateral management system

So what happens when a firm realises they need to invest in a new collateral management system? Either they have an outdated collateral management system that is unable to meet their needs or they are still using manual methods (spreadsheets, emails and even paper ticket) that cannot scale.

New regulations, increased focus on labour costs and a continuing effort to squeeze the best economics out of collateral have forced many companies to consider buying a collateral management system from solution providers such as Broadridge.

Selecting a new collateral management system is not an easy decision. How do you differentiate the vendor systems (and vendors) out in the marketplace? What about buy versus build? The weight of the regulatory burden has made it more onerous and expensive to keep in house systems up to date. This is therefore shifting the market towards buying rather than building.

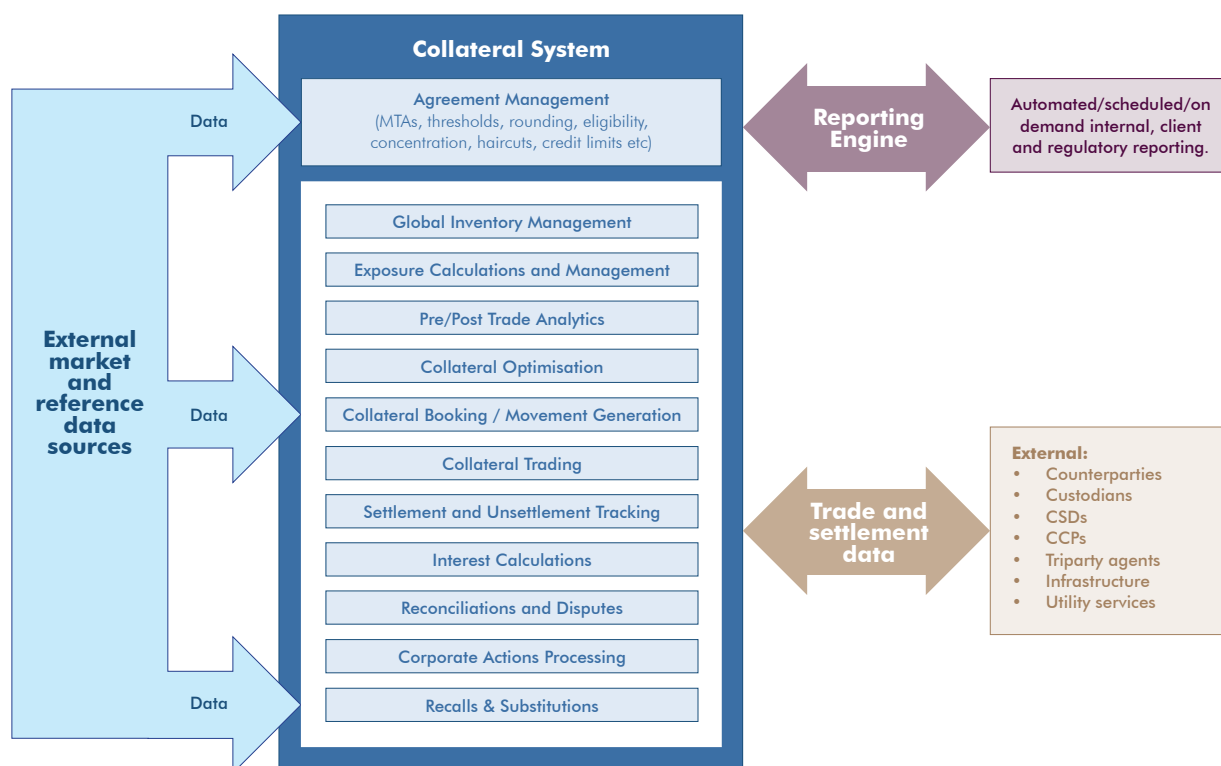
Many institutions are now coming to the conclusion that the costs and resourcing demands entailed by regulatory compliance are best shared across multiple clients of a vendor that can manage these wide ranging step changes on their behalf.

Request for proposal

However, not all vendors are created equally. Functionality may sound alike, but is it really? Enter the request for proposal (RFP). This is the document sent to potential collateral management solution providers to determine if their system does what you need it to do.

Will it manage cleared and non-cleared derivatives? What about repo and securities lending exposure? Can it handle multiple agreements across currencies with the same counterparty? What about vendor risk? Who does the implementation? What will it cost?

Figure 1: Typical Collateral System Functional Areas



Creating an RFP can be tricky. While RFPs may look alike, they need to reflect the firm's needs and priorities. Where to start?

The following checklist provides some ideas around how to create an RFP that will allow you to compare 'apples with apples' and avoid some of the common pitfalls that make the process of vendor selection more time consuming than it needs to be:

ONE Define your operating model. Is this a front office function, operations or both? Is this an opportunity to pivot internally?

TWO Decide which functional areas are important to you—this can differ widely for different types of firms. Figure 1 shows a map of some of the generic, high-level functional areas supported by collateral systems. While it can be tempting to include everything, particularly whatever functionality is mooted as 'the next big thing', try to work out what will actually benefit your business model. For example, a mid-sized buy-side firm may get enough benefit from basic single 'cheapest to deliver' collateral optimisation tools rather than implementing complex bespoke optimisation algorithms.

THREE Work out what is realistic within your timeframes—if regulatory compliance is important by a hard deadline, then getting a vanilla system in place can be a good move. You can then build it out with more advanced functionality and customisation using a phased approach following initial compliance with mandatory regulatory deadlines.

FOUR But—think strategically—avoid tactical solutions with multiple systems bolted together if you can. Try to evaluate your long-term vision and goals around what your collateral operating model should look like. Then select a vendor that can offer a future proofed solution.

FIVE Decide on the product scope of your system. Are you looking for an enterprise-wide, cross-product solution to manage inventory and exposures for securities lending, repo and derivatives in a single system? Or will it be a more siloed system that simply manages collateral for one or two business lines? Different vendors have varying advantages in this respect, particularly around the complexities of margining securities finance transactions and managing non-cash collateral.

SIX Consider running a shorter RFP first to filter down vendors. With a recent increase in collateral vendors entering the market, this allows you to narrow the shortlist down to four or five key vendors. This in turn can save time reading through lengthy RFP responses from many vendors.

SEVEN Keep it simple—too much information can be confusing. Write your RFP in a way that allows you to make it easy to compare vendors and that matches your actual requirements.

EIGHT Is it worth using a scoring mechanism that allows you to objectively compare vendors? One way to do this is to:

- Split functionality into mandatory versus 'nice to have/optional' and weight the scoring accordingly.
- Use a five-point scoring mechanism for whether the vendor offers the functionality: (i) In live use at a client; (ii) requires minor customisation; (iii) is on the vendor's product roadmap; (iv) requires significant bespoke gap development; (v) the vendor does not and will never support the functionality.

NINE Try to avoid asking multiple questions within one question. Often that makes it hard for you to break down whether the vendor supports your requirement or not.

TEN Don't be afraid to encourage comments. It allows the vendor to go off script a bit but some questions simply aren't 'yes' or 'no'.

Figure 2: Example of a Vendor Comparison Scale (Note: in this rating scale, a high score for price means a cheaper solution/lower cost of acquisition)



ELEVEN Think about integration points—as the collateral ecosystem becomes more integrated there are more touch points with, for example, triparty agents, central counterparties (CCPs), market utilities used for messaging or margin reconciliation, and custodians/central securities depositories (CSDs). Don't neglect feeding to/from internal systems, including books and records, exposures, legal agreements, settlements, compliance, risk and others.

TWELVE Try to focus on a holistic view of a vendor based on your unique requirements rather than just functionality. This can include:

- Does the vendor have a global footprint? With collateral management now a mission-critical activity, can they offer 24/7 'follow the sun' support in the event of a major issue?
- How many similar projects has the vendor implemented in the past? Do they have a mature project management methodology with lessons learned from past projects?
- Does the vendor have a strong research and development and regulatory monitoring capability? This is particularly important in the current environment. Vendors are no longer just technology partners but are also expected to offer a consultative approach to adapting to new regulations as a value-added service. Evaluating the quality of a vendor's thought leadership content can provide a good way to check this.
- Can the vendor build out new functionality quickly? How willing is the vendor to customise? In terms of the vendor's client base, will you be a small fish in a big pond or a large fish in a small pond, or somewhere in the middle?
- Does the technology provider have staff with the expertise and experience to understand your business?
- With information security and cyber-security a key issue, does the vendor have strong procedures in place, including an externally audited information security policy?
- Bear in mind that some smaller vendors may not have reached a level of maturity as an organisation to tick the boxes of information security policies, global support and financial stability to support a mission critical activity such as collateral management.
- Quantifying and visualising your data can help to make sense of the different vendor strengths and weaknesses. Figure 2 shows how three hypothetical vendors could score on different criteria. Visualising the data can help you to spot trends you may have missed when looking at raw data in a table.

THIRTEEN Think about hosted versus systems that reside within the firewalls. This is not just about ease of upgrades and maintenance but has a profound impact on security. Organisations will answer the question differently depending on their needs and objectives.

FOURTEEN Finally, remember it is during the demo where you will really get a feeling for the vendor. The RFP should be used as an initial guide, where if you have non-negotiable requirements you can strike vendors off your shortlist.

However, elements such as system look and feel/usability can only be established during a product demonstration. Demos also allow you to get a feel for whether you can see yourself establishing a personal rapport and trust with the vendor.

Selecting a vendor will always entail risks due to the complexity of the collateral management process and the level of information asymmetry between the customer and the vendor.

With tight regulatory deadlines and the now critical importance of collateral management, choosing the wrong system can have a significant impact on business performance.

However, having a clear definition of your firm's requirements and then running a well-thought-out RFP and selection process can mitigate a lot of these risks.

It is worth remembering that many collateral management vendors now offer a consultative approach to software sales and can help with defining operating models and system requirements. Engaging with them early on in the process can provide many benefits. **SLT**



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