The evolution of

Collateral Management

A journey to modernizing the collateral infrastructure in Canada

BMO

HOOPP
Healthcare of Ontario Pension Plan

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Collateral Management Defined

Historically defined as:

The process of managing assets pledged by one party to another to mitigate credit risk between the parties and to minimize the effects of potential default.

Presently the definition can be expanded to include:

... the effectiveness and efficiency in utilizing a single piece of collateral, to most benefit the organization.

Regulatory Evolution

2010

JUL 2010
Dodd-Frank Act enacted under the Obama administration in response to the global financial crisis

2010/2011
Basel Guideline for Total Loss Absorbing Capacity (TLAC)

2013

JAN 2013
OSFI adopts Basel III LCR

SEP 2013
Basel & IOSCO publish margin requirement standards (non-CCP OTC derivatives (UMR)

2014

MAY 2014
OSFI adopts NCCF

OCT 2014
OSFI adopts Basel III NSFR

2015

JAN 2015
Canadian banks required to begin reporting first LCR

2017

MAR 2017
UMR Variation Margin rules completed

2018

SEP 2018
OSFI adopts Basel Guideline for Total Loss Absorbing Capacity (TLAC)

OCT 2018
OSFI Leverage Requirements

2019

2019
Basel Capital Adequacy Requirements

2020

JAN 2020
Canadian banks required to begin reporting first NSFR

NOW

FUTURE
Basel III Reform

FRTB 2024

Leverage Requirements in effect

T+1 initiative (NI 24-101)

First phase completed SEP 2016

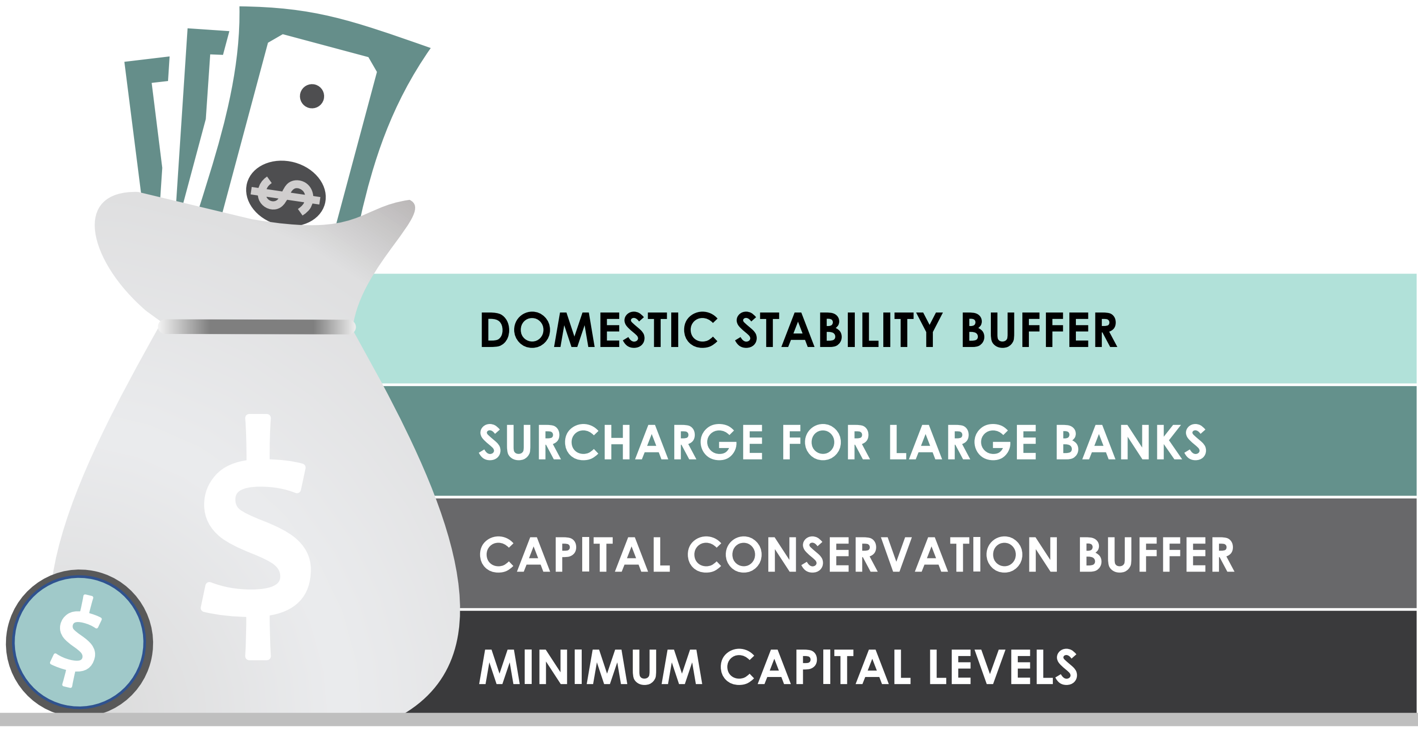
To date, post-GFC regulations (Dodd-Frank Act, Basel, UMR, etc.) have increased collateral requirement by $1 trillion across global financial institutions

UMR Initial Margin rules phased in

Final phase completed SEP 2022
(after COVID-19 delays)

NSFR Requirement led to a move of ~5-10% from <6m MMKT funding to >6m MMKT

Potential new regulatory requirements could have adverse impacts on collateral management causing unintended market consequences.



Regulatory Impacts and concerns

Sell-side Concerns

Regulation drives collateral management.

Intraday collateral monitoring in terms of operational movement and valuation of collateral during market volatility.

BA market disappearance, ($91B of C$ investment) which will increase demand of other C$ products in Canada.

Disintermediation rises as clients seek interest away from banks resulting in shadow banking.

Shared Concerns

Optimizing the use of collateral to meet regulatory requirements and generating returns.

More collateral is required from both sides.

Higher quality collateral is in demand.

Central Bank intervention, while beneficial in a time of crisis, can limit the fluidity of collateral.

An increase in margin call requirements, caused by market volatility, and limitations on infrastructure creates challenges for C$ collateral to circulate.

Buy-side Concerns

Minimizing collateral requirements.

More collateral needed in IM/VM, which increases the cost of trading derivatives.

Segregated assets: unable to use assets held in custodian accounts.

Swap dealers are reluctant to accept C$ collateral (in other jurisdictions).

Higher legal, technological, and operational costs.

Potential drag on returns.

Industry challenges

- inadequate infrastructure
- insufficient technology
- cost of collateral
- settlement delays
- risk framework
- lack of consistency across regimes

Focus Areas

Operational Efficiency

to settle trades without delays and minimize failed trades across the street

Intraday Collateral Movement

to be able to price and value intraday collateral, driving robust risk management practices

Clearing

directly reduces interconnectedness, thus protecting market participants in the event of default

Triparty in Canada

to provide seamless collateral management bringing together repo, securities lending, and margin management

How do we get there?

Collaboration among market participants

Establish and improve infrastructure
(e.g., legal, technology, and settlements)

Promote consistency across Canada, and influence globally

Promote education and awareness

Prioritize thought leadership on collateral management

thank you

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Healthcare of Ontario Pension Plan