# Changes in Collateral Trading

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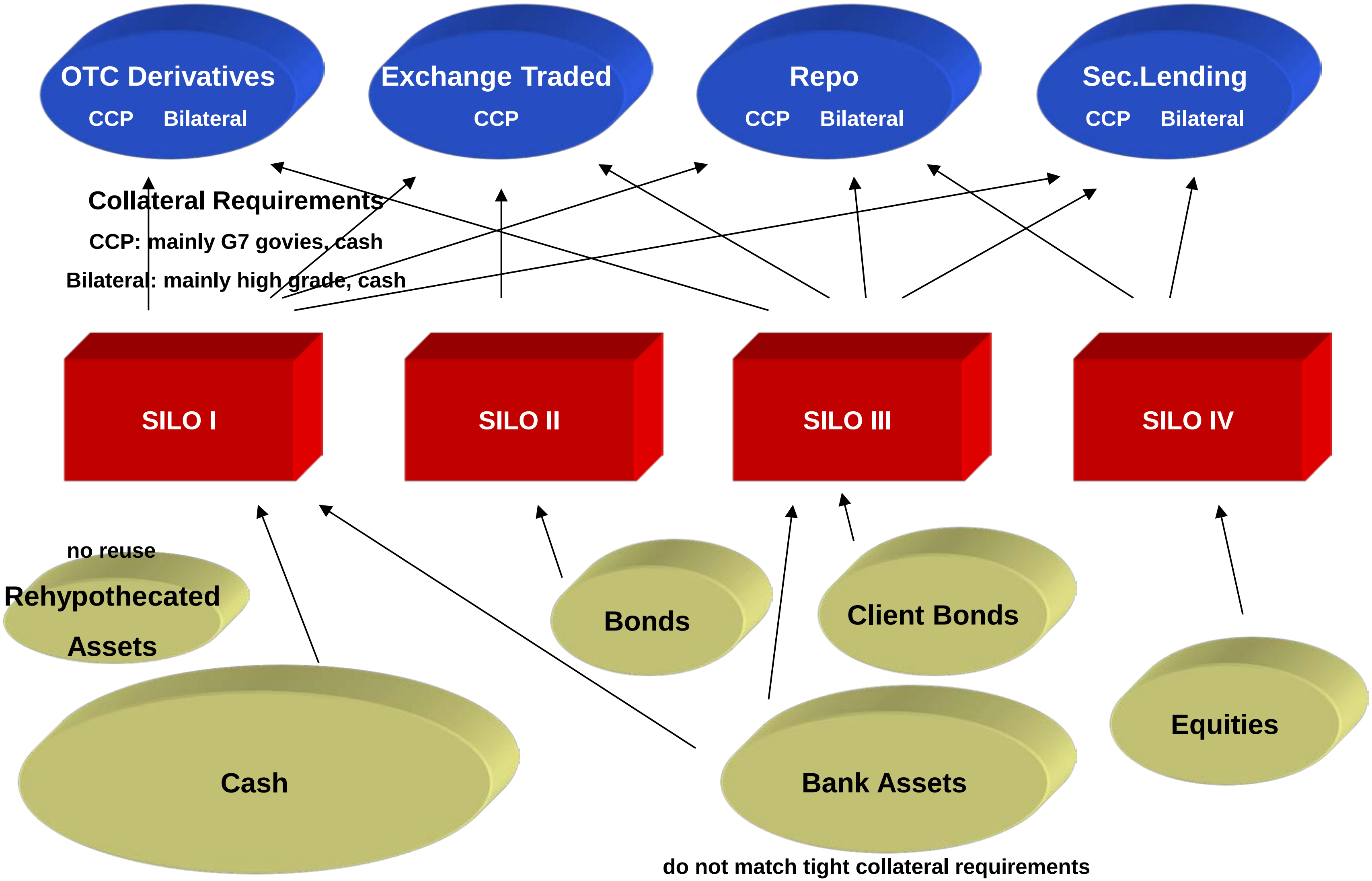
# Regulations, changing the World of Collateral and Liquidity

- EMIR: central clearing of OTC derivatives
  Banks will need more and higher quality collateral
- BCBS-IOSCO: margin requirements for non-centrally-cleared derivatives
  Banks will need to overcollateralise bilateral OTC derivative transactions
  Initial Margin may not be rehypothecated
- Basel III: liquidity ratios LCR and NSFR
  Banks will need high quality collateral for liquidity buffer
  Banks will need more "structural" term funding
- Basel III: leverage ratio
  Appropriate repo netting may be prohibited
- EBA: ratio of encumbered assets to total assets
  No or only limited reuse of received assets
- EU short selling: restriction on naked short sales
- MiFID / MiFIR: pre and post trade transparency

An environment of "full" transparency, standardization and low margins →

Banks are forced to cut costs and change their "**collateral banking**"

# Collateral Management – as it was or still is ?



# Changes for Banks in handling Collateral

- To cope with new requirements banks have to install an adequate model for **Collateral Management** segmented into:

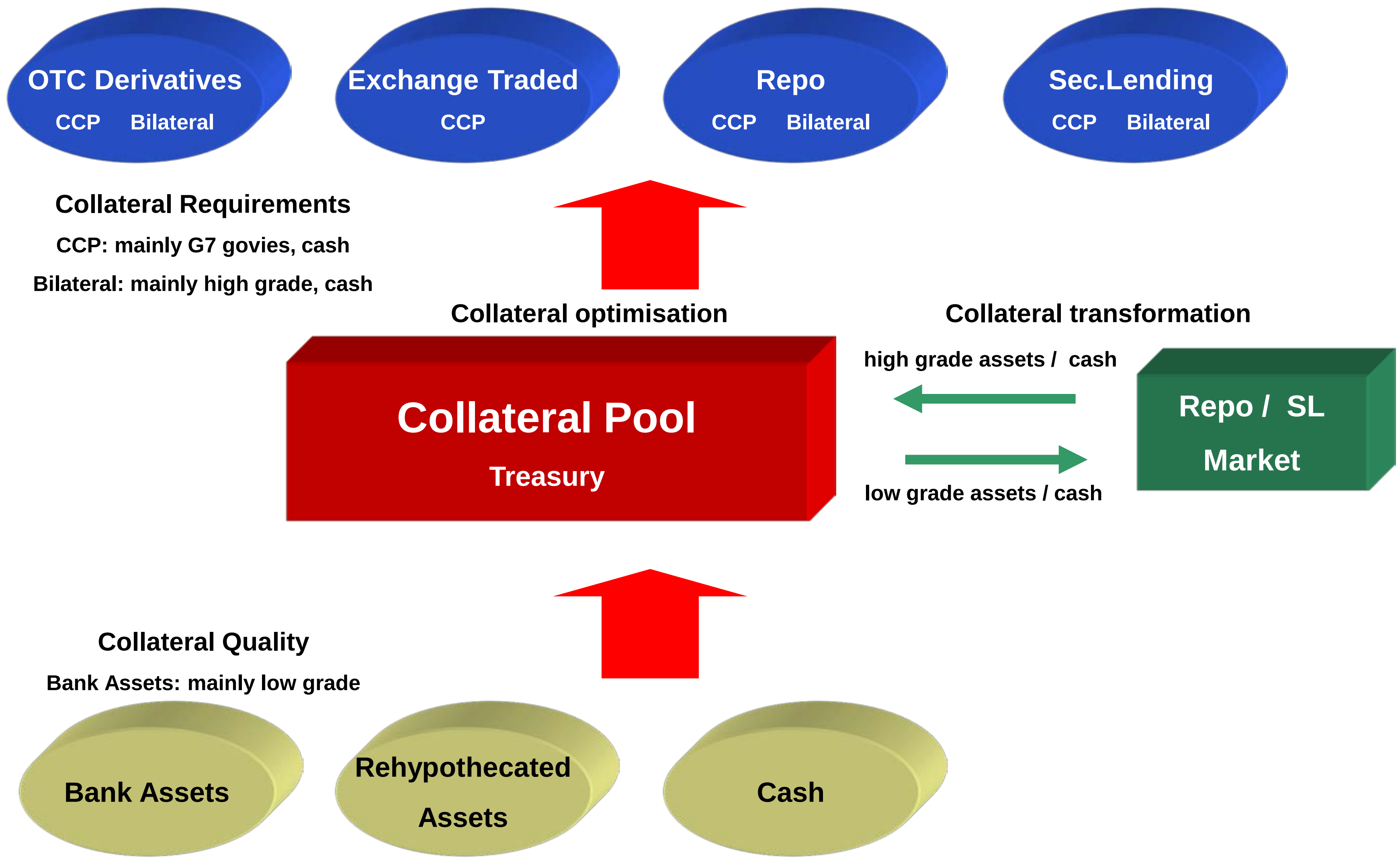
- **Collateral Management** - planning and optimisation of collateral (group wide)
  - defines preferred clearing´methods (bilateral, tri-party …)
  - specifies principles for collateral pricing
  - sets the technical standards for collateral eligibility

- **Collateral Trading** - group wide trading on a day-to-day basis
  - maintains the centralised collateral pool
  - picks the cheapest and most suitable collateral from the pool

- **Collateral Administration** - calculating daily margin calls
  - fulfilling daily margin calls
  - executing portfolio reconciliation
  - prudential supervision of threshold

- **Collateral Control** - limit, monitor and report of collateral risk
  - forecasting collateral flows
  - validating the internal collateral value
  - integration of collateral component into P&L

# Modern Collateral Management – Pooling of Collateral and Optimising Inventory



# Differences within a Group

- A central **group-wide** collateral pool under the mentioned approach, is possible in a branch structure. In case of separate legal entities which are supervised by national regulators, the indepedence avoids such a centralised business model. Investors enter the market with different perceptions on the credit of **connected legal entities:**

**Investor A**

**considers each legal entity separately. worse rating of mother company irrelevant**

**Investor B**

**rates under a group approach and different ratings of legal entities do count for the credit rating**

- **+ "General Wrong Way Risk" (e.g. Govt. Collateral members from same country does not count)**
  - **no benefit for mother company due to upstream lending restrictions**

**- liquidity access for better rated group aggravated**

**- "General Wrong Way Risk" trades rarely and very expensive**

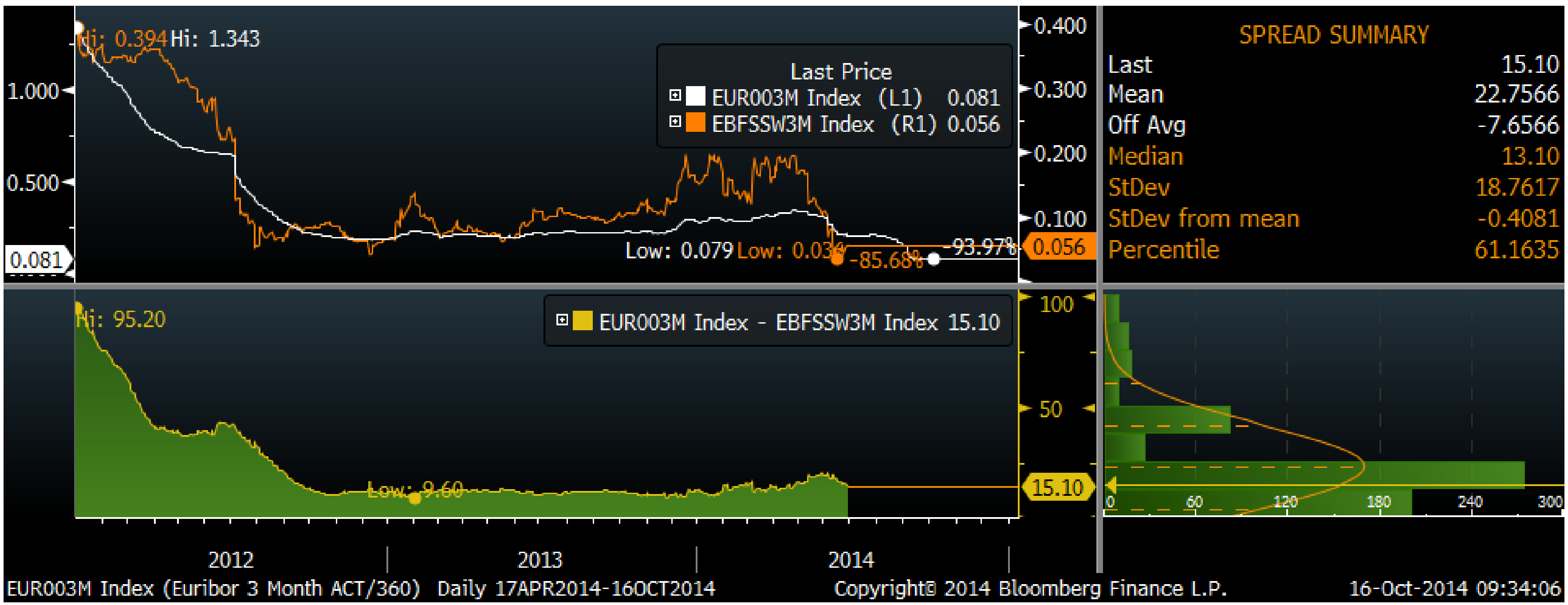
- **Collateral Trades with "Specific Wrong Way Risk"  are limited to central bank activities.**
- **Fragmentation within a Group compensated  through ECB**

# Euribor – Eonia Spread 2012 - 2014

- Massive spread tightening over the last 2 years

  Jan 2012: 95.2 Bps

  Oct 2014: 15.1 Bps -84.1%



# What will drive the Collateral Markets Tomorrow ?

- "Whatever it takes' policy of ECB
  - ECB has become 'Central Counterpart' in the Money Market and provides an artificial low interest rate and spread environment

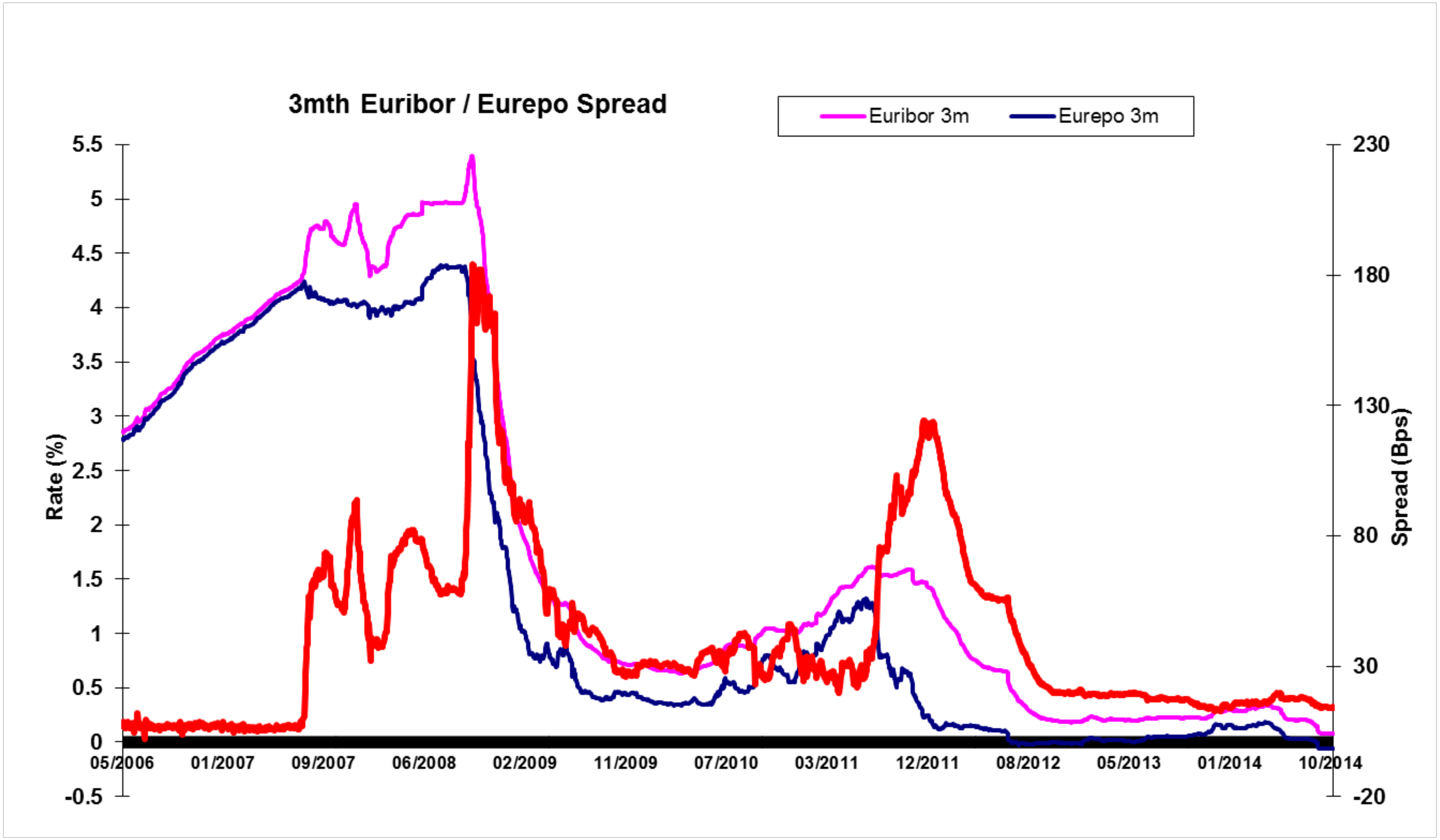
- Market confidence into Europe
  - Economic recovery
  - Acceptance of certain governments as collateral

- Regulations will significantly impact markets and call for strict resource management

- Financial Transaction Tax
  - Financial sector should contribute its share to cover costs of the crisis and raise public revenues
  - Stops speculative transactions and intermediation which destabilise the financial system

- Shadow Banking
  - Credit intermediation involving entities and activities outside the regular banking system

# Financial Market Crisis has changed the world of Collateral and Liquidity



# Discussion points for presentations 2.1 & 2.2

- Implications of new regulatory changes on collateral management on bond market liquidity and bond valuations
- Will some market participants become less active in collateral markets, resulting in unwanted concentration ?
- In current markets with strong support from the ECB, liquidity and funding is deemed to be ample. Is the liquidity premium correctly priced? Has fragmentation in euro area collateral markets receded? What else can be done?

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