**Collaborating on Collateral**

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Collateral is becoming an increasingly important tool in the post-economic crisis world. Driven largely by the growing need for financing together with global regulatory requirements, collateral has become the buzz word and the vehicle of choice to help reduce credit risk. Couple this with the need for increased capitalization, whether Basel III, Tier 1 ratio's or clearing, and regulatory initiatives, such as EMIR and Dodd Frank, calling for a larger pool of assets for margining transactions, banks are forced to hold and manage a larger pool of high quality assets on their balance sheets. Collateral has always been vital to ensuring the smooth functioning of funding and capital markets and in turn essential for economic growth, but these changes are creating fundamental challenges for market participants' existing operating models.

Driven by the tsunami of regulatory changes, a potential ten-fold increase in margin call volumes could overwhelm market participants' current operational processes and system infrastructures.

To add further confusion, the new clearing requirements under EMIR and Dodd Frank will also mean the potential creation of multiple regional clearing venues per product, which will have a splintering effect on the number of margin calls and intra-day margin calls. Furthermore, the segregation of accounts required by new regulations, while improving the safekeeping of collateral, will add a complexity to the collateral management process that existing technology will find challenging to manage. Firms are concerned because the increase in collateral requirements, along with the subsequent increase in underlying margin activity, is expected to have an impact on costs and more importantly risk. Operational capabilities, settlement management, reporting and recordkeeping and dispute resolution, are just a few of the areas which will be affected.

In addition to the increasing number of margin calls, there is an expected increase in the demand for collateral from market participants on both sides of the Atlantic. Recognising this, a number of institutions and think-tanks have attempted to calculate the change in demand for collateral. The Bank of England estimated in 2012 that the amount of collateral needed to meet requirements posed by new regulations globally could reach $800 billion. A more recent study by the Bank of International Settlement estimates this to be around $4 trillion. That figure rises to $11.2 trillion in stressed market conditions, according to estimates of the US Treasury Borrowing Advisory Committee. As firms become more aware of the increase in the demand for collateral, a large number are realising they are unable to sufficiently mobilize and transform collateral or to determine the specific eligibility required to allocate the collateral against their exposures. According to a recent joint report by Clearstream and Accenture, as much as 15% of collateral available to financial institutions is currently left idle costing the industry more than €4 billion a year. Many firms unfortunately are unable to optimize their collateral, which could potentially create a gap between supply and demand. The inability to identify, move, or recognize available collateral in a timely manner in order to bring it to bear in times of market stress, could exacerbate collateral shortfalls, particularly as a prelude to or during a financial crisis.

There are currently multiple collateral management solutions encompassing anything from portfolio margining to collateral optimization attempting to address the different components of the collateral challenge. However, sell-side, buy-side and custodians alike have recognized that these

fragmented solutions only address certain parts of the problem which have left them struggling to cope with the efficient management of their collateral. Recognizing that the industry requires a solution to address both the scale and the efficiency of the collateral management challenge, DTCC has been working on a key initiative, Margin Transit, with all market participants, including dealers, custodians, buy-side firms and market infrastructures. The service Margin Transit will be open to all collateral processing providers such as custodians, international central securities depositories (ICSD), and collateral management vendors. Establishing links to all participants will facilitate the establishment of the first industry-owned, comprehensive, straight-through processing ("STP") solution for streamlining the management, settlement and reporting of collateral.

Collateral will continue to play a critical role in underpinning the efficiency and stability of the financial markets. The complexity and the global nature of the financial market calls for an industry-wide strategic infrastructure solution to address these challenges to avoid the unintended consequences of fragmentation. An industry utility which can foster cross-border collaboration and strategic industry partnerships is best placed to respond to the challenge of the changing environment for collateral.