



EUROPEAN CENTRAL BANK

EUROSYSTEM

# Substream 1: Triparty Collateral Management

Status Update

CMH-TF 20 September 2017

# Scope

- **CMHA 1 - Messaging for Triparty Collateral Management :**
  - *Differences in message types across TPAs, and differences in how these messages are used (interaction between TPAs and users), drives down efficiency in collateral management.*
- **CMHA 12- Source/move collateral to/from triparty agents :**
  - *Complexity for sourcing/moving collateral from domestic markets to the custody network of a TPA hampers triparty collateral management*
- **CMHA 15- Common Triparty processes for interaction of TPA's with UCMS ( collateral allocation and risk control)**
  - *Workflows differ significantly in triparty arrangements for interaction with users, hampering triparty collateral management.*
- **CMHA 19-Triparty framework/interoperability**
  - *Triparty frameworks/interoperability arrangements are not (yet) available for mobilising securities involving different TPAs, CCPs and (I)CSDs.*

# Objective and Deliverables

### To analyse:

- **Differences between the triparty models** (used by the Eurosystem as a starting point and beyond) particularly in the area of messaging.
- **Harmonisation of the message flows and message content, which would help to simplify the use of triparty services** from the perspective of market participants with a single set of procedures which all eligible TPAs should adhere to.
- **The procedures would put a particular focus on the workflows and the messaging** (as well as the data fields and the content of these data fields) sent to / from the TPA.

# Progress to Date

- As a first step, **the substream have reviewed and updated a stock taking exercise on existing triparty services** with a particular focus on the 3 triparty models used on a cross-border basis by the Eurosystem
- **A series of differences have been identified** and an overview table has been prepared focusing on the real differences between the 3 cross-border models (which may be related to TPA processes or central bank arrangements)
- **Work has commenced on establishing a list of agreed terminology** for triparty collateral management
- **A list of business processes is also being defined** together with a description of each business process.

# Triparty - Initial Considerations

- **Members are considering how harmonisation should be achieved through the definition of a unique and sole model in term of business processes, workflows and messages.**
- **it is necessary to consider the impact for the entire security industry (CB, TPA and Users) in view of an ISO 20022 adoption for all collateral management services provided by TPAs, and not just those services relying upon interaction with Central Banks.**
- So far, no interdependencies with other workstreams have been identified.
- With regard to prioritisation it is considered too early to conduct a prioritisation without having further analysed and / or identified new issues.

# Triparty Collateral Management Terminology

| Triparty Collateral Management Terminology     |  |
|--|--|
| Name   | Description  |
| Triparty Agent (TPA)                           | The triparty service provider (referred to as “triparty agent” or “TPA”) responsible for the processing of instructions on behalf of both collateral giver and the collateral taker  |
| Triparty Collateral Management Services (TCMS) | Triparty collateral management services (TCMS) provided by triparty agents (TPAs) allow counterparties to optimise the use of their portfolios of securities when collateralising credit and other exposures across different products and instruments (e.g. repo, securities lending, central bank credit, secured loans, and exposures arising from over-the-counter transactions). As part of their daily operations, TPAs provide services such as collateral (auto)selection, valuation and substitution, optimisation of the composition of the triparty pool (“allocation cycles”) and corporate actions processing   |
| Triparty Securities Lending Services (TSLs)    | Triparty collateral management and settlement services for bilaterally-agreed loans of securities  |
| Triparty Securities Lending Services 1 (TSLs1) | TSLs1 provides settlement and valuation of a securities loan as well as the related collateral management for the duration of the trade. The simultaneous exchange of the loaned securities against collateral enables the settlement of both sides of the transaction.  |
| Triparty Securities Lending Services 2 (TSLs2) | TSLs2 provides collateral management and valuation services but not the settlement of loaned securities, as the latter is done bilaterally.  |
| Collateral Management Transaction              | A transaction created by the triparty agent upon receipt of the deal information from the two trading parties. A transaction is created, can be changed and is terminated.   |
| Lifecycle of Collateral Management Transaction | When a transaction is initiated, agreed on by both parties, accepted and declared valid by the triparty agent, the lifecycle of the transaction starts. The transaction will normally last as long as the underlying deal. At the end of its lifecycle a transaction is closed.  |
| Collateral Management Instruction              | The trading parties will request the triparty agent to perform certain instructions on the collateral management transaction. An instruction can be to initiate a transaction, modify the terms of a transaction, or close a transaction (non-exhaustive list of instructions). The triparty agent will send feedback on the requested instruction.  |
| Lifecycle of Collateral Management Instruction | The lifecycle of a collateral management instruction starts when the user of the triparty service sends an instruction message. At receipt of the instruction message, the triparty agent will process the instruction and assign a status (that is, valid or rejected). At each step in the lifecycle of an instruction a different status will be assigned. For example, an instruction can be valid for processing or rejected because it is incorrect. If an instruction needs to be matched (for example, two initiation- instructions from party A and B need to match) it can have a status matched or unmatched. Other statuses describe the sufficiency or eligibility of the collateral. |
| Initiation                                     | Creation of a Collateral Management Transaction.   |
| Termination                                    | Closing of the Collateral Management Transaction.  |
| Principal/Exposure Adjustment                  | Change of principal/exposure adjustment.   |
| Transaction Amount                             | The intended amount of the triparty transaction.   |
| Value of Collateral Held                       | The total value (after haircuts) of posted collateral for the transaction.   |
| Total Collateral Required                      | The sum of the collateral required to fully collateralise all exposures.   |
| Total Exposure Amount                          | The total exposure amount to be covered by collateral.   |

## Triparty – Identification of Heterogeneities

### > Approach (Example 1)

| No. | Process                                  | Process Description  | Model 1 Summary   | Model 2 Summary   | Model 3 Summary  | Differences  |
|-----|--|--|---|---|--|--|
| 2   | Increase of Triparty Collateral Exposure | An instruction sent by a trading party to its triparty agent to instruct the agent to perform a specific action on a collateral management transaction. It is also sent by an account owner to an account servicer where the account servicer manages the account at the triparty agent on behalf of the trading party. In response a message is sent by the triparty agent after the receipt of a collateral instruction from its client. The Receiver is either the collateral taker or the collateral giver or their account servicer. This message provides valuation results as well as the status of the collateral instruction and the status of the proposed collateral movements (cash and securities). | <p>The request to increase the triparty collateral exposure is sent from the counterparty to the TPA (using an MT527 containing the field 22H:CINT/INCR).</p> <p>The TPA then informs the central bank if the TPA has successfully increased the triparty collateral exposure of the counterparty.</p>  | <p>The request to increase the triparty collateral exposure is sent from the counterparty to the TPA and the central bank (using an MT527 containing the field 22H:CINT/PADJ).</p> <p>The TPA then informs the central bank if the TPA has successfully increased the triparty collateral exposure of the counterparty.</p>                                   | <p>The request to increase the triparty collateral exposure is sent from the counterparty to both the TPA and the central bank (using an MT527 containing the field 22H:CINT/PADJ).</p> <p>The TPA then informs the central bank if the TPA has successfully increased the triparty collateral exposure of the counterparty.</p> <p>An MT558 is used to confirm the status of the instruction (released for future processing/rejected).</p> <p>The credit is granted upon receipt of an MT569 containing the amount of the collateral effectively held (field :19A::COVA/3!a15d).</p>                       | <p>The messaging and workflow used across the three models is heterogeneous.</p> <p>In Model 1 the collateral taker informs only the TPA of the request to increase the global amount.</p> <p>In Model 2 and Model 3 as the instruction is sent to the TPA from both the collateral giver and the collateral taker, the instruction must be matched. An MT558 Instruction Status message is sent from the TPA to the Collateral Taker in Model 3 documenting the Instruction Status.</p> <p>In Model 3 the increase in the credit is granted upon receipt of an MT569 message. In Model 1 and 2 the increase in credit is granted upon receipt of the MT558.</p> |
| 3   | Decrease of Triparty Collateral Exposure | An instruction sent by a trading party to its triparty agent to instruct the agent to perform a specific action on a collateral management transaction. It is also sent by an account owner to an account servicer where the account servicer manages the account at the triparty agent on behalf of the trading party. In response a message is sent by the triparty agent after the receipt of a collateral instruction from its client. The Receiver is either the collateral taker or the collateral giver or their account servicer. This message provides valuation results as well as the status of the collateral instruction and the status of the proposed collateral movements (cash and securities). | <p>MT527 is sent to the TPA only to request a decrease in the triparty collateral exposure.</p> <p>The TPA forwards the instruction to the central bank to check if the counterparty may decrease its triparty collateral exposure.</p> <p>After the check of collateral sufficiency the central bank sends an MT527 either rejecting or approving the request (sequence A, field 25D::REST either DKNY or CONF).</p> | <p>MT527 instructions and MT558 confirmations applicable used for decrease of global amount have exactly the same formats as those used in the context of the increases of the triparty collateral exposure.</p> <p>However the MT527 used for requesting a decrease of the triparty collateral exposure amount will be executed without matching at TPA.</p> | <p>The decrease of intended collateral amount is done using a price adjustment instruction with a MT527 containing the field 22H:CINT/PADJ.</p> <p>The central bank ensures that the new intended amount is sufficient to cover all the outstanding credit operation of the counterparty before sending the MT527 to the TPA.</p> <p>An MT558 is used to confirm the status of the instruction (released for future processing/rejected).</p> <p>An MT569 will reflect the new intended amount (field :19A::TRAA/3!a15d) and the new amount of the collateral effectively held (field :19A::COVA/3!a15d)</p> | <p>The messaging and workflow used across the three models is heterogeneous.</p> <p>Matching of decrease instructions is required in Model 3 only.</p> <p>In Model 1 the collateral giver may request the decrease via the TPA only.</p> <p>In Model 2 counterparties do not have to send decrease instruction to the TPA and thus decreases will be executed without matching at the TPA</p>  |

## Triparty – Identification of Heterogeneities

### > Approach (Example 2)

| No. | Process  | Process Description   | Model 1 Summary  | Model 2 Summary  | Model 3 Summary  | Differences  |
|-----|--|---|--|--|--|--|
| 7   | End-of-Day Reporting on Flows (Securities Movements)   | A message sent by an account servicer (account servicing institution) to an account owner or its designated agent provide the details of increases and decreases of holdings which occurred during a specified period, for all or selected securities in the specified safekeeping account or sub-safekeeping account which the account servicer holds for the account owner. | One MT558 message is sent per allocation (increase / decrease, substitution, etc.). Accordingly there could be several messages per claim number. Only claim numbers for which a transaction has taken place will be reported.   | The MT536 is sent to the central bank on a per collateral account basis (one statement per collateral counterparty account at TPA)   | End of Day reporting on flows is done using MT536 messages.  | Model 1 provides end-of-day reporting on flows via the via a different message to that used by Model 2 and 3.  |
| 8   | Compulsory Decrease of Triparty Collateral Exposure Due to Revaluation                                   | A compulsory decrease of the Triparty Collateral Exposure amount following a change in the eligibility status or valuation of the underlying securities collateralising the triparty transaction.   | <p>1) Upcoming ineligibility / missing or significant decline in price combined with no possibility of substitution/ re-allocation at TPA can lead to under-collateralisation;<br/>-&gt; TPA sends an MT558 instruction for compulsory decrease of the global amount to NCB</p> <p>2) NCB determines that the instruction is valid; checks sufficient remaining collateral (at NCB), cancels / replaces collateral amount and updates credit line of the counterparty;</p>   |  |  | This is a specificity of Model 1. Both Model 2 and Model 3 consider this as being identical to process 3 above (relying upon the usage of the MT569)   |
| 9   | Compulsory Decrease of Triparty Collateral Exposure Due to Deduction of Up-Coming Corporate Action Event | A compulsory decrease of the Triparty Collateral Exposure amount due to an upcoming corporate action event.   | <p>1) Upcoming Corporate Action (e.g. interest payment / reduction in value) combined with no possibility of substitution/ re-allocation at TPA can lead to under-collateralisation;<br/>-&gt; TPA sends an MT558 instruction for compulsory decrease of the global amount to NCB</p> <p>2) NCB determines that the instruction is valid; checks sufficient remaining collateral (at NCB)</p> <p>3) If the remaining pooled collateral is not sufficient to cover the overall NCB exposure of the counterparty<br/> <ul style="list-style-type: none"> <li>• NCB initiates a margin call to the counterparty and sends an MT527 "Suspension" instruction to the TPA (until pooled collateral is sufficient)</li> <li>• As a result, the TPA withholds the cash from the Corporate Action</li> <li>• Upon successful margin call, NCB sends an MT527 "Suspension Termination" instruction to TPA</li> </ul>                     Note: If the Termination message is sent after the scheduled payment of the Corporate Action, TPA transfers the cash resulting from the corporate action to the NCB's TARGET2 RTGS account in order to ensure sufficient collateralisation</p> <p>In both cases, the Collateral Exposure Amount stays reduced and can be increased again during the business day by the Counterparty.</p> | N/A.<br><br>In Model 2 NCBs can handle the possible occurrence of a cash position in co-ordination with the triparty agent through specific automated measures in place that will avoid in all instances the commercial bank money settlement agent risk for the collateral-taking central bank. | N/A.<br><br>In Model 3 the triparty revaluation process already takes into account whether a cash position is reported. The cash position is to be ignored unless it is in central bank money. | Used in Model 1 only. Model 2 automatically transfers the proceeds to the collateral taker in the case of collateral insufficiency. Model 3 only takes the cash value into consideration if it is in central bank money. |



### Next Steps

- **Review the overview table which identifies the differences between the 3 models**
- **Build a comprehensive list of agreed terminology for triparty collateral management**
- **Identify differences in messaging flow between the models which a common technical platform could harmonize or not (CMHA 1)**
- **Extend the analysis to the Triparty processes beyond Central Banks activity to cover all Triparty Agents (CMHA 15)**
- **CMHA 12 will be worked with a Target of the 25th Oct**
- **CMHA 19 will be worked with a Target of the 20th Nov**