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Collateral Manager of the Year

BNY Mellon

Over the past year, regulatory developments have continued to shape discussions around collateral management. While margin rules for non-cleared derivatives were delayed until September 2016, the Basel III liquidity coverage ratio (LCR) came into effect in January. In both cases, BNY Mellon clients were prepared ahead of time and well placed to seize market opportunities.

Revenues generated by the Asia-Pacific collateral business experienced a huge year-on-year increase, particularly in the Japan market, which continued to be a strong growth driver for the firm.

A core business of the US bank involves the provision of liquidity support for financial institutions through a tri-party collateral management platform. One Asia-based head of equity products at a global bank that uses the firm's tri-party service says: "BNY Mellon has a proven track record in the US and Europe. They are dedicated to developing Asian markets. We chose them because of their reputation and strength. Their platform is 24-hour accessible, and we are able to borrow securities from any markets on it without having a physical presence in that market. It gives us great convenience."

Challenges of global regulation

Globally, a combination of Basel III, Dodd-Frank and the European Markets Infrastructure Regulation has significantly increased the demand for high-quality collateral. The Basel III LCR, which requires banks to hold an amount of highly liquid assets to cover a 30-day stress event, has posed great challenges for market participants to manage liquidity.

BNY Mellon has helped clients to address the challenge in two ways. On the one hand, it provides dollar cash for Japanese banks through a cross-currency repurchase agreement (repo) on a term basis. Clients borrow dollars by collateralising their Japanese government bonds (JGBs) with BNY. It also helps global broker-dealers to borrow JGBs from Japanese institutional investors to address their short-term liquidity shortage and comply with their LCR requirement.

While some collateral managers are providing similar services in Japan, BNY Mellon is unique in providing the service through a trust intermediary. The working process involves two parts. Firstly, it uses the trust bank to source eligible collateral, such as JGBs. And secondly, it helps clients manage their collateral using their tri-party platform – a patented technology aimed at reducing clients' operational complexity.

"We are one of only a few foreign banks that has a trust bank in Japan which can act as a counterparty in transactions with clients, whereby the trust bank and the client will use BNY Mellon as an independent tri-party collateral manager and custodian," says Filippo Santilli, Hong Kong-based managing director at the firm. "One benefit of using a trust is that collateral provider clients can enjoy a 'bankruptcy-remote' structure under the trust. Big global players typically have a credit limit or concerns of trading with regional smaller bank asset owners. By using the trust, they would face a trustee – ie, trust bank of BNY Mellon – rather than the local counterparty asset owner, making the collateral provider more comfortable with trading with the asset owner."


Filippo Santilli, BNY Mellon

Given that the demand for high-grade collateral is increasing, the bank counts many large JGB holders as clients, including Japanese insurers, pension funds and government entities. As the yield on JGBs is at a record low – two-year and five-year paper were yielding 0% and 0.06% respectively on August 28 – the opportunity to earn extra yield has aroused considerable interest from local institutions.

"There are huge amounts of JGBs trapped with Japanese asset owners that yield almost nothing. However, other counterparties will still be keen to receive such JGBs as they are highly liquid and LCR-friendly. By lending JGBs, the Japanese investor can earn a margin which turns their negative return into profit, and it helps borrowers to manage their liquidity. We created a healthy circle that benefits every participant and it has enjoyed great success," says Santilli.

Despite the Basel Committee on Banking Supervision (BCBS) and Iosco extending the deadline for margining non-cleared derivatives to September 2016, BNY Mellon has worked closely with Japanese regulators, banks and law firms to implement operational and process flows to segregate initial margin.

The US bank puts a great emphasis on Japan, as significant legal barriers stand in the way of implementing the BCBS/Iosco regulation. Under Japanese law, initial margin is operated on a title transfer, rather than a pledge transfer model – adapting a Japanese Isda/credit support annex framework to a pledge mechanism is therefore more complicated than in Hong Kong, Singapore or Australia, which operate under an English law pledge model.

To resolve this problem, the bank is developing an innovative structure via the trust bank, to allow for segregation using title transfer between the counterparties. "Our operational model has been very successful in the US and Europe for years. That's why we are taking the lead in Japan in bringing that experience here and trying to achieve a good solution for all market participants," says Santilli.

Over the past 12 months, the bank also included offshore renminbi cash in repo transactions in its tri-party programme, a move to better meet clients' financing needs by supporting a wider range of collateral. **AR**