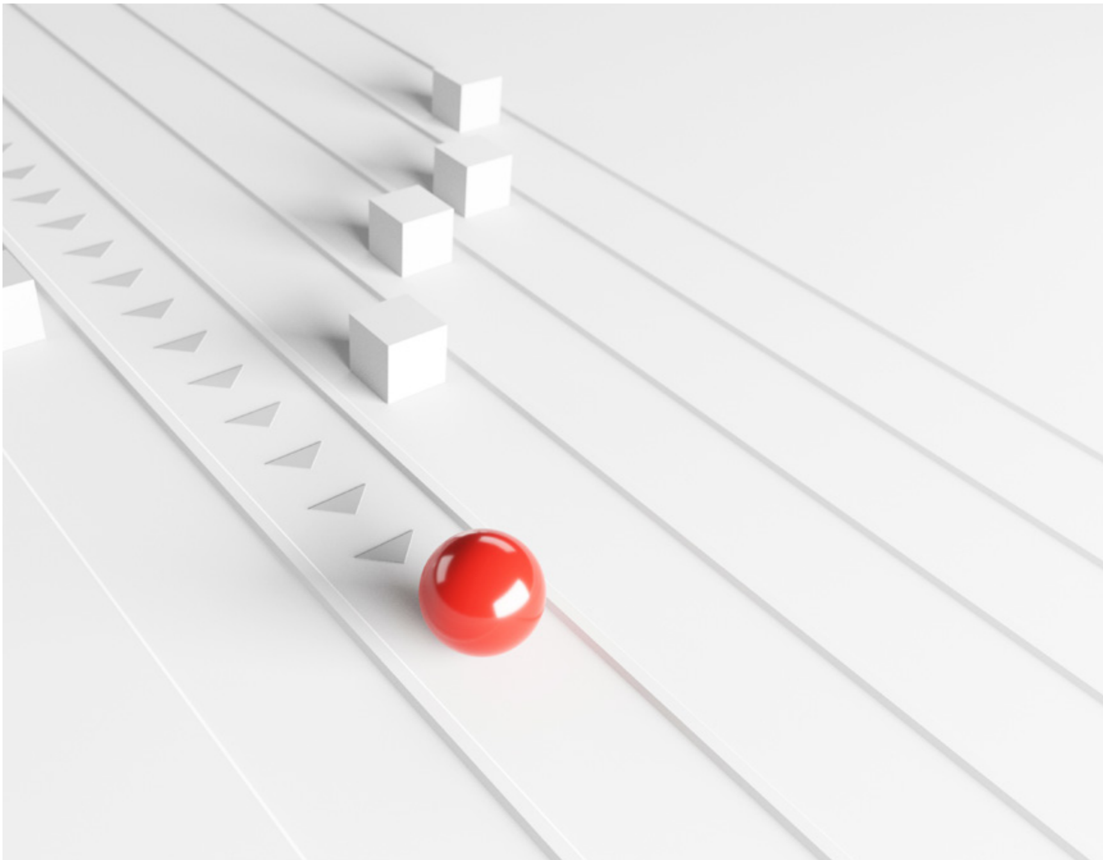

Clearing the way: Smarter collateral, faster markets

Richard Glen, solutions architect at HQLA^{X}, delves into three core transformative pillars, collateral mobility, settlement friction, and cash collateral, revealing how the partnership unlocks the true potential of securities as collateral

Collateral is the cornerstone of modern finance, the essential trust mechanism that underpins a vast web of transactions from repo to securities lending to derivatives. In the world of securities finance, the ability to mobilise collateral efficiently remains crucial for mitigating risk and ensuring market stability.

For decades, however, the process of managing and moving collateral has been a source of significant inefficiency. Assets are often trapped in disparate systems and locations, subject to a slow, manual, and risk-prone dance of back-office inputs and custodian transfers. This fragmentation has inhibited liquidity and forced market participants to maintain costly buffers of cash and securities.

The recent launch of the cleared initial margin product by HQLA^{X}, Clearstream, and Eurex Clearing represents a pivotal moment in this evolution. This innovative solution, powered by distributed ledger technology (DLT), is a direct response to these infrastructural inefficiencies.

It is not merely an incremental upgrade but a fundamental rethinking of how collateral should be managed and mobilised. By focusing on three core benefits — enhancing collateral mobility, reducing settlement friction, and mitigating the usage of cash as collateral — the collaboration is forging a more efficient and resilient future for the securities finance industry.

Accelerating collateral mobility

In a world without DLT, the physical movement of securities can be a cumbersome and time-consuming process. A firm might have a surplus of high-quality liquid assets (HQLA) in one custody location but be unable to use them to meet a margin call at a central counterparty (CCP) in a different jurisdiction without a complex and slow transfer.

This collateral fragmentation forces firms to maintain costly inventory in multiple locations, leading to capital inefficiency. The solution, developed in collaboration between HQLA^X, Clearstream, and Eurex Clearing, is designed to accelerate collateral mobility for clearing members and their clients.

At the heart of the offering is HQLA^X, a DLT-based ledger that records the ownership of securities without requiring the physical movement of the underlying assets. Instead of a security being physically transferred, a digital collateral record (DCR) is updated on the HQLA^X platform. This innovative approach allows the underlying security or securities basket to remain in its original custody location with its ownership represented by the DCR. This decoupling of cross-custodian settlement is the key to achieving true collateral mobility.

Using HQLA^X, clearing members can seamlessly mobilise securities from their local custodian to satisfy margin requirements at a CCP. Pension funds and asset managers looking to post margin towards clearing members can leverage this capability to enable just-in-time collateral management, allowing them to meet margin calls with the cheapest and most appropriate collateral available in their global inventory, even if it is held at a different custodian.

This newfound agility is particularly crucial in today's fast-paced markets, where the ability to access and move collateral quickly is paramount to managing liquidity and risk effectively.

Reducing settlement friction

The traditional processes for settling collateral transfers are a major source of friction and operational risk. They involve a complex chain of events, multiple intermediaries, and differing settlement windows, which can lead to costly errors and delays.

Mismatched instructions, manual data entry, and the need for labour-intensive reconciliation are all common challenges that introduce risk and drive-up costs. Settlement failures, in particular, can result in financial penalties and reputational damage.

The solution that HQLA^X, Clearstream, and Eurex Clearing have designed offers a powerful antidote to this dated model. By leveraging DLT, the platform creates a single, immutable source of truth for all collateral transfers. The ownership of any collateral that is delivered using HQLA^X is recorded in a DCR, which is able to be updated at precise moments in time. The near-instantaneous nature of the transfer also drastically reduces settlement risk and in future, HQLA^X anticipates introducing further programmability in its smart contracts to drive further efficiencies.

Automated workflows that are inherent in DLT-based systems such as HQLA^X create opportunities to significantly reduce operational risk. Manual intervention can be minimised, and the potential for human error can be drastically cut. This leads to a higher rate of straight-through processing (STP) and a more resilient, reliable operational workflow.

For clearing members of Eurex Clearing, this is particularly valuable, as it enhances their ability

Smart operational workflow

Enhance operations using automation and asset tagging

Decrease process latency

Satisfy margin calls with non-cash collateral within 30-60 mins

No structural changes

No change to the eligible collateral location or default management procedure

"This initiative marks a significant step forward in how collateral is mobilised across the cleared ecosystem. At Eurex Clearing, we are proud to lead the way in delivering solutions that empower our clients to unlock and mobilise their assets with unprecedented speed and flexibility across custody networks. It's a strategic step toward more agile liquidity management and a more efficient use of collateral — delivered through innovation, collaboration, and a deep understanding of our clients' needs."

Efthimia Kefalea, Director | Head of derivatives clearing development, Eurex Clearing

to mobilise non-cash collateral to secure margin obligations. It also enables them to manage risk across their cleared portfolios more effectively by ensuring they have immediate, unfettered access to the collateral they require to cover potential exposures.

This level of operational certainty is a game-changer for risk managers and back-office teams, and provides new collateral optimisation opportunities for resource management functions.

Mitigating the usage of cash as collateral

For a long period of time, cash has been a fallback for meeting margin requirements, despite its significant drawbacks. Holding large amounts of cash for margin collateral purposes is capital inefficient and in a low-interest-rate environment, the opportunity cost of holding cash for margin can be substantial. For many firms, a core treasury and liquidity management objective is to minimise unremunerated cash balances and put alternative assets to work.

The new product provides a compelling alternative by making it easier and faster to use securities as collateral. By making collateral mobilisation more efficient, clearing members and their clients can readily use non-cash assets, such as government bonds or other HQLA, to satisfy their margin calls.

This reduces their reliance on cash, freeing it up for other, more productive uses like investment or funding, as well as reduces the liquidity risk of being called automatically for margin in cash. This is a critical development for market participants, particularly those with vast portfolios of securities, as it allows them to optimise their balance sheets and enhance their return on capital.

The ability to seamlessly substitute one form of collateral for another — for example, a bond for a cash amount or a bond for a bond — in the future is also greatly improved. The HQLA^{X} platform's precision permits the instant substitution of collateral, further enhancing the efficiency of a firm's treasury operations and reducing the need to overcollateralise.

While clearing houses will still require some collateral in the form of cash for liquidity management reasons, a shift away from cash-based collateral is a move towards a more sophisticated, efficient, and capital-friendly ecosystem for securities finance. It also aligns with a broader industry trend toward maximising the utility of every asset on a firm's balance sheet.

Conclusion

In the intricate world of securities finance, innovation often seems to move at a glacial pace, constrained by legacy infrastructure and the need for meticulous governance and risk management processes. However, the cleared initial margin product launched by HQLA^{X}, Clearstream, and Eurex Clearing is a testament to the power of targeted, collaborative innovation. By harnessing the unique capabilities of DLT — to decouple ownership from physical location, and to facilitate precise, real-time transfers — they have addressed some of the most persistent inefficiencies in collateral management.

This is not just a story about a new product; it is a narrative of progress. It is about moving from a fragmented, friction-filled system to an interconnected, fluid one. The ability to mobilise collateral effortlessly, reduce operational burdens, and lessen the dependence on cash for margin requirements will have a ripple effect throughout the financial markets, enhancing liquidity, improving capital efficiency, and strengthening the overall stability of the ecosystem.

The partnership between HQLA^{X}, Clearstream, and Eurex Clearing demonstrates that the future of securities finance is not just about managing risk, but about unlocking the dormant value within our financial systems through intelligent, digital transformation. As collateral continues to be the bedrock of finance, solutions like this will ensure that it remains a source of strength, not a point of friction.

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Richard Glen
Solutions architect
HQLA^{X}