

# How regional banks are transforming collateral management functions

July 2024



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# Introduction

Recent market events and increased regulatory focus on liquidity have led regional banks across the United States to review their collateral management capabilities under stress and normal markets. Regional banks are proactively upgrading their collateral management capabilities to address both self- and regulatory-identified challenges, continuously learning from the recent market experiences.

Financial collateral can be defined as any financial asset, including cash, that has been or is available to be pledged or received as a means of obtaining liquidity value or as a credit risk mitigant in connection with transactions. Collateral management is an integral component of regional banks' treasury and liquidity functions, and implementing robust collateral capabilities can yield significant commercial benefits, along with enabling compliance with collateral-related regulations (e.g., Regulation YY, 2052a).

Regional banks are investing in front-to-back collateral management infrastructure, data management and broader governance enhancements across:

- 1 Asset monetization
- 2 Collateral operations and controls
- 3 Collateral reporting and analytics
- 4 Policy and governance

Enhancements across these capabilities can help regional banks to facilitate sustained growth, operational efficiency, regulatory compliance and resiliency. As regional banks look to implement enhancements, they should consider their scale and projected growth to best future-proof these capabilities and implement solutions that are tailored to their clients, products and strategy.

## In brief

- ▶ Market events and regulatory pressure have altered the collateral management landscape for regional banks.
- ▶ Regional banks are enhancing their collateral management capabilities for better regulatory compliance and stress response.
- ▶ Regional banks are diversifying their funding strategies, investing in analytical capabilities, and uplifting technology, business and operating models.



### Asset monetization

During times of market stress, banks must maintain access to funding effectively mobilize and monetize their high-quality liquid assets (HQLA) and other liquidity-generating assets such as the lending portfolio to meet commercial and liquidity objectives. Common pain points include outdated operational capabilities to mobilize collateral (e.g., dependencies on spreadsheets) and lack of capacity in the interbank lending markets during market stress.

Leading firms have implemented strategies and mechanisms to help unlock further value from collateral and their investment portfolios. The recent adoption of the U.S. Treasury and Repo Clearing rule will make it increasingly important for regional banks to assess their market access approach to enable asset monetization strategies and potential hurdles caused by the rule. Focusing on the following capabilities can allow regional banks to withstand significant market pressures and improve their overall funding capacity:

- ▶ **Review the comprehensive asset monetization strategy** for the enterprise to source liquidity in market stress scenarios, prioritize monetization based on asset types, and optimize assets held to achieve both regulatory and commercial objectives.
- ▶ **Broaden monetization channels** and diversify the methods and counterparties used in monetization so capacity to finance investment portfolio, such as bilateral repos, tri-party repos, cleared/sponsored repos, cash sales, securities lending, discount window pledging and other loan pledging are optimized.
- ▶ **Enable capabilities** to monetize lending portfolio via home loan banks and the discount window to further increase borrowing capacity
- ▶ **Implement comprehensive testing strategies** and develop programs to test market access and capacity monetize various assets.

- ▶ **Review the operating model and governance structure** leveraged for collateral capabilities, inclusive of trading and operational infrastructure, timely and accurate data, and associated policies and procedures.
- ▶ **Perform financial impact analyses** to determine impact of monetization and ensure that planning/scheduling is in line with current financial framework of the firm.

These capabilities must be enabled by a robust data infrastructure and enterprise system that allows for the rapid mobilization of collateral and operational connectivity to source funding. Additionally, enhanced capabilities can enable regional banks to effectively utilize eligible collateral to reduce capital requirements, enhance capital efficiency, manage contingent funding and effectively control liquidity buffer reserves.

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# Capabilities

Collateral operations and controls  
Collateral reporting and analytics

## Collateral operations and controls

Operational constraints and capabilities are major factor in regional banks' abilities to manage, mobilize and track collateral and margin. Regional banks are widely using manual spreadsheet-based processes and fragmented workflows, which can lead to significant operational errors and inefficiencies. Moreover, such operational risks from legacy infrastructure or manual processes are especially prevalent during times of significant volatility or stress, where spikes in volumes can trigger missed calls and fails, without transparency into the status of settled collateral and margin calls.

Regional banks must have robust collateral operations capabilities and control measures to enable operational and governance processes, risk management, loan and regulatory reporting and compliance measures at scale. 'Leading firms have prioritized enhancing their collateral operations and controls processes' by taking the following actions:

- 1 Consolidate treasury, margin and funding operations teams** into a single unit enabled by a consolidated enterprise platform to manage margin calls and securities financing capabilities.
- 2 Automate collateral management workflows** and reduce manual processes, including settlement, reconciliations, disputes and post-trade actions.
- 3 Implement risk-based collateral control frameworks** to continually assess risks, triggers and thresholds.
- 4 Develop an enterprise-wide collateral management system** with connectivity into downstream businesses and respective settlement infrastructure.
- 5 Enabling end-to-end operational connectivity**, including connecting order management systems (OMS) and execution management systems (EMS) across treasury, central investment office, derivatives and funding functions.

By removing operational constraints and establishing reliable and efficient platforms for mobilizing and tracking collateral, regional banks can facilitate significant return on investment and yield funding benefits, while increasing their confidence to mobilize their contingent funding plans at scale in times of stress.

As regional banks consolidate and streamline their collateral management infrastructure, they can utilize collateral capabilities and effectively plan, manage and optimize the use of the firm's financial resources to meet collateral and liquidity obligations, while also feeding the data needed into broader treasury and liquidity risk management tools.

## Collateral reporting and analytics

To address regulatory expectations (e.g., the ability to effectively monitor encumbered and unencumbered assets) and inform commercial decision-making, regional banks are increasingly focused on modernizing data and technology infrastructure. They continue to rely on outdated tools and manual processes to support their collateral reporting and analytics needs. Investments are being focused on uplifting capabilities to enable centralized enterprise-wide data and analytical capabilities across collateral.

Timely and complete collateral insights are especially critical in times of market stress and volatility, when the increased demand for collateral can force firms to allocate assets that are reported as available, as opposed to optimal, assets to meet obligations. Intensifying the issue, firms may have siloed collateral management functions, resulting in a fragmented infrastructure with little visibility into available collateral inventory, requirements, eligibility and under/overcollateralization at the enterprise level.

The data and analytical capabilities also form a critical capability to meet the evolving regulatory expectations across Regulation YY, and for those that are subject to it that includes recovery and resolution planning and qualified financial

# Capabilities

## Collateral reporting and analytics

contract (QFC) requirements such as the ability to monitor collateral associated with QFCs and the ability to understand details on pledged collateral.

Regional banks are assessing implementation of these capabilities with build vs. buy analysis to determine the most appropriate approach based on their respective size, portfolio composition and future growth expectations.

While specific requirements may vary depending on a bank's balance sheet size, The data and analytical capabilities also form a critical capability to meet the evolving regulatory expectations across Regulation YY, resolution and broader regulations for collateral. There is an added benefit that these reporting and analytical capabilities can be used for commercial (e.g., optimized funding) objectives when appropriately implemented.

### Key collateral analytics capabilities

| Use cases            | Purpose   |
|----------------------|---|
| Inventory            | <ul style="list-style-type: none"><li>▶ Provides an enterprise-wide view of the collateral positions at the end of each business day, including security and transaction details for each position</li><li>▶ Provide end users with the capability to view available assets and open transactions to inform funding and collateral optimization decisions in business as usual, including on unencumbered assets</li><li>▶ Leading firms have implemented capabilities that allow for intraday tracking of collateral inventory and positions</li></ul> |
| Pledge               | <ul style="list-style-type: none"><li>▶ Provides ability to monitor the firm's assets that have been pledged out as collateral to various locations, including bilateral counterparties, tri-parties, financial market utilities, central banks, etc.</li></ul>   |
| Obligations          | <ul style="list-style-type: none"><li>▶ Summary of all collateral obligations at the beginning of each business day, specifying the value of pledged assets relative to the amount of security required under the relevant contracts with the intention of highlighting under/overcollateralization</li></ul>   |
| Eligibility          | <ul style="list-style-type: none"><li>▶ Indicates which assets within the firm's inventory can be used to satisfy collateral obligations against given locations and counterparties</li><li>▶ Provides ability to search and query to view and manage eligibility across products, obligations, relationships, asset classes, etc. to enable decisions regarding optimization</li></ul>   |
| Contingent liability | <ul style="list-style-type: none"><li>▶ Enables ability to calculate changes in collateral requirements due to credit rating downgrades</li><li>▶ Changes in collateral obligations will be based on factors such as need to post additional initial amount, changes in minimum transfer amount or thresholds that could result in additional variation margin</li></ul>  |
| Maturity profile     | <ul style="list-style-type: none"><li>▶ Provides a view into the roll-off/maturity periods of collateral and their underlying transactions to provide information on liquidity stress</li></ul>   |
| Sources and uses     | <ul style="list-style-type: none"><li>▶ Consolidates asset types and their collateral sources and uses across businesses to facilitate asset traceability</li><li>▶ Provides a summary of the existing and potential sources of collateral, while also identifying the collateral obligations the sources can meet</li></ul>  |

# Capabilities

## Policy and governance

### Policy and governance

Regional banks are subject to increasing regulatory expectations with governance as a core pillar across collateral and many other critical areas. A centralized collateral management policy and governance framework enables standards for how collateral will be managed across both credit and liquidity risk at the enterprise level. Striking the right balance between effective governance and oversight over multiple business lines and functions has proved to be a challenge for many regional banks.

Firms are finding it increasingly important to invest time and resources into clearly defining responsibilities and implementing governance committees to increase collateral oversight and enable regulatory compliance. Ineffective

governance can significantly hinder the objectives of the firm and the ability to meet regulatory expectations, even for those with leading capabilities and infrastructure.

A lack of enterprise policies and effective governance can lead to siloed functions and decision-making and typically correlates with fragmented infrastructure and inability to meet wider regulatory expectations. Failing to fully establish requirements at the top of the house can also impede a regional bank's ability to meet regulatory obligations, effectively optimize collateral and drive investments for continuous improvement. Firms are typically appointing a head of collateral management to spearhead the governance needs and have accountability across the regulatory and commercial agenda.



# Benchmarking

Based on our experience with regional banks, the table on the following page outlines the lagging and leading maturity of regional banks' collateral capabilities. The capabilities that are flagged as "leading" are differentiating for regional banks with complex multi-asset-class portfolios.

Our experience has revealed that only a few regional banks are implementing leading-edge capabilities. This necessitates that many regional banks perform an analysis to determine where they fall compared to the industry and need to invest in their capabilities as the bar continues to rise among peers and regulatory expectations increase.

Our experience has revealed that only a few regional banks are implementing leading-edge capabilities.



# Benchmarking

## Collateral capabilities benchmarking

|                                    | Lagging   | Leading   |
|------------------------------------|---|---|
| Asset monetization                 | <ul style="list-style-type: none"> <li>▶ Inability to monitor collateral quality and eligibility for monetization</li> <li>▶ Limited investment options to enable balancing of risk and return</li> <li>▶ Difficulties in accessing interbank lending markets during liquidity shortages</li> <li>▶ Limited monetization channel diversity</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Comprehensive asset monetization strategy to provide liquidity in stress scenarios, including defined monetization channels</li> <li>▶ Rapid mobilization and monetization of collateral enabled by enterprise systems</li> <li>▶ Broad monetization channel diversity (e.g., tri-party, securities lending) and ability to pledge loans</li> <li>▶ Robust enterprise governance to align on objectives and enforce strategies</li> </ul>                |
| Collateral operations and controls | <ul style="list-style-type: none"> <li>▶ Manual operational infrastructure for reporting and trade processing</li> <li>▶ Daily margin processes</li> <li>▶ Lack of utilization of industry utilities in margin call processing and dispute resolution</li> <li>▶ Limited scale; challenged ability to diversify funding sources and creates inefficiency in trade processing and reporting</li> </ul> | <ul style="list-style-type: none"> <li>▶ Infrastructure connectivity into settlement systems/ledgers, allowing for trade lifecycle management automation, controls and real-time transparency into position management</li> <li>▶ Implementation of a centralized treasury operations operating model with supporting infrastructure to future-proof the design</li> <li>▶ Operational capabilities to facilitate funding diversification strategy such as tri-party/securities margin</li> </ul> |
| Collateral reporting and analytics | <ul style="list-style-type: none"> <li>▶ Collateral agreements not available in a digitized format; limited understanding of financing and collateral agreements</li> <li>▶ Siloed view of collateral pledged, including counterparties, governing law and contracts</li> <li>▶ Fragmented collateral data across businesses, entities and products</li> </ul>  | <ul style="list-style-type: none"> <li>▶ Enhanced data architecture and standards to enable comprehensive analytics to be generated on an intraday basis</li> <li>▶ Consistent data incorporated across business and regulatory horizons.</li> <li>▶ Customizable analytics and dashboards that provide drill-down capabilities into transaction-level details for decision making</li> <li>▶ Analytics platform leveraged either in-house or vendor platforms</li> </ul>                         |
| Policy and governance              | <ul style="list-style-type: none"> <li>▶ Lack of an enterprise-wide collateral management policy</li> <li>▶ Ambiguous roles and responsibilities</li> <li>▶ Fragmented governance based on credit or liquidity risk</li> <li>▶ Shortfalls in collateral associated controls, standards, procedures and related documentation</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Enterprise-wide collateral policy to mandate oversight, requirements, and roles and responsibilities</li> <li>▶ Robust business procedures to outline collateral management processes and controls within businesses and functions</li> <li>▶ Centralized governance structure inclusive of both credit risk and liquidity</li> <li>▶ Formalization of roles and responsibilities between treasury, business and associated operations</li> </ul>        |



# Strategic action plan and next steps

The pace of growth and regulation has left many firms lagging on core functionality. After the recent issues impacting regional banks, regulators are further scrutinizing collateral management on a day-to-day basis. With these additional pressures on collateral functions, firms must look to enhance their capabilities and streamline their operations.

While it may require up-front investment, modernization efforts offer increased access to liquidity, improved capabilities and contingent funding forecasting, yielding significant benefits and enabling strategic growth.

Regional banks should assess their collateral capabilities to meet both their commercial and regulatory needs. As part of this transformation review, regional banks should consider their needs across desks, businesses and products to identify commonalities in features, function and capability. Additionally, a bank's efforts on uplifting capabilities must be fit-to-size based on the organization and its expected growth. Outlined below are four critical steps that regional banks should consider in their transformation journey and begin to build a strong foundation for collateral management.



## 1 Asset monetization

Assess and uplift existing monetization strategies and enhance capabilities to enable the rapid mobilization of optimal collateral.

## 2 Collateral operations and controls

Transform operating models and implement centralized collateral management systems and automated workflows and controls.

## 3 Collateral reporting and analytics

Uplift data and technology capabilities to enable holistic collateral reporting in line with regulatory and commercial objectives.

## 4 Policy and governance

Develop comprehensive enterprise collateral policy and associated governance to mandate objectives and clearly delineate collateral roles and responsibilities.

# Conclusion

Due to market turmoil and volatility in recent years, it is becoming increasingly important for regional banks to review their current collateral management practices and identify opportunities for improvement.

Although regulators are expecting higher standards for collateral management, regional banks also stand to gain significant benefits by prioritizing their collateral, including enhanced risk mitigation and strengthened financial resiliency.

Firms must also remain agile and future-proof their capabilities to keep pace with evolving industry trends and increasing regulatory burdens. With the adoption of proper collateral management capabilities, firms will position themselves to optimize their collateral allocations, streamline their operational processes and withstand changing market conditions.

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US SCORE no. 23687-241US\_2

2402-4423272

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