

Collateral Management Triparty

Setup between KVG, Depositary Bank and Triparty Agent

Gesa Benda; Global Head of Collateral Management Product

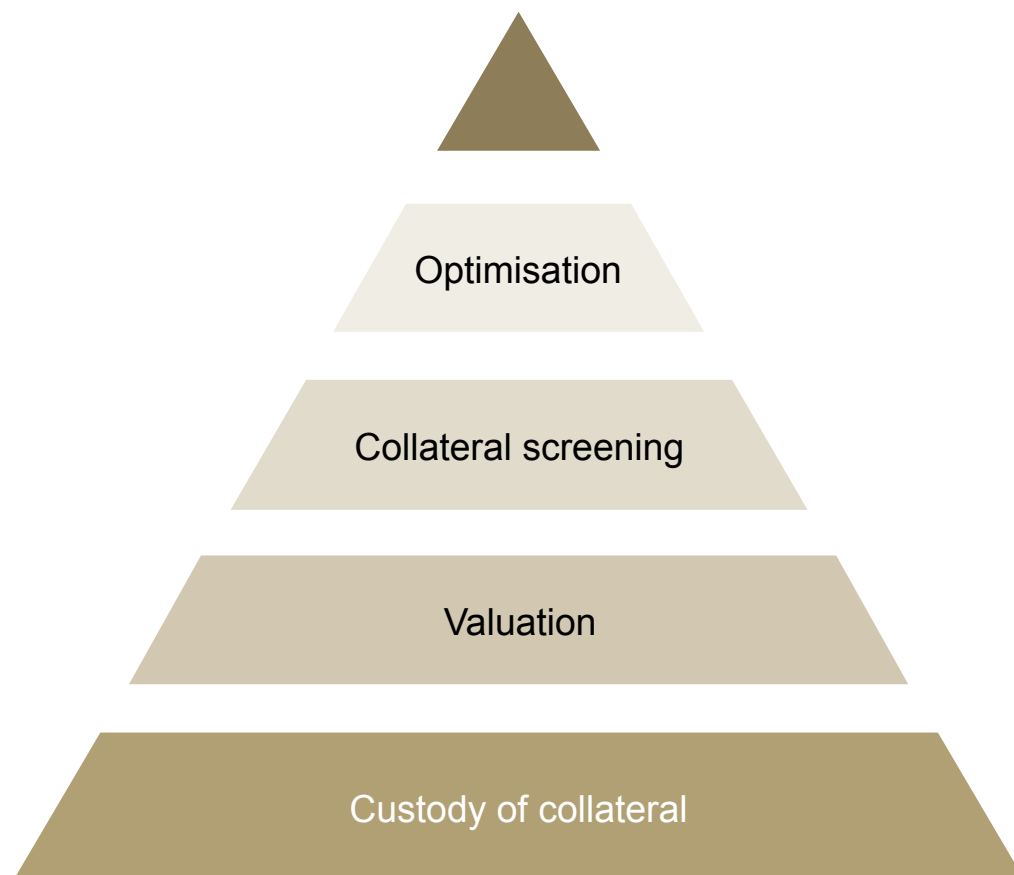
Markets

March 2018

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Collateral Management Services



Help clients to find effective collateral solutions.



Optimise the given collateral pool to allow the client to focus on trading opportunities.



Check to determine that collateral satisfies client-defined collateral criteria. Provide collateral projections.



Provide mark-to-market on all collateral, effecting valuation and margin calls.



Act as custodian for the collateral, settling and servicing the assets and effecting security substitutions.

Collateral Management and Segregation

Collateral management practices within a tri-party structure look to optimise the allocation of collateral for collateral providers and support the segregation of collateral held for collateral receivers.

COLLATERAL

Margin Calls

Eligibility Testing

Collateral Selection

Risk Mitigation

Valuation

Reporting

Collateral segregation practices look to address and help mitigate risks inclusive of:

- Credit/counterparty risk
- Operational risk (e.g., settlement, corporate event)
- Market/liquidity risk (e.g., eligibility, concentration)

Collateral Providers

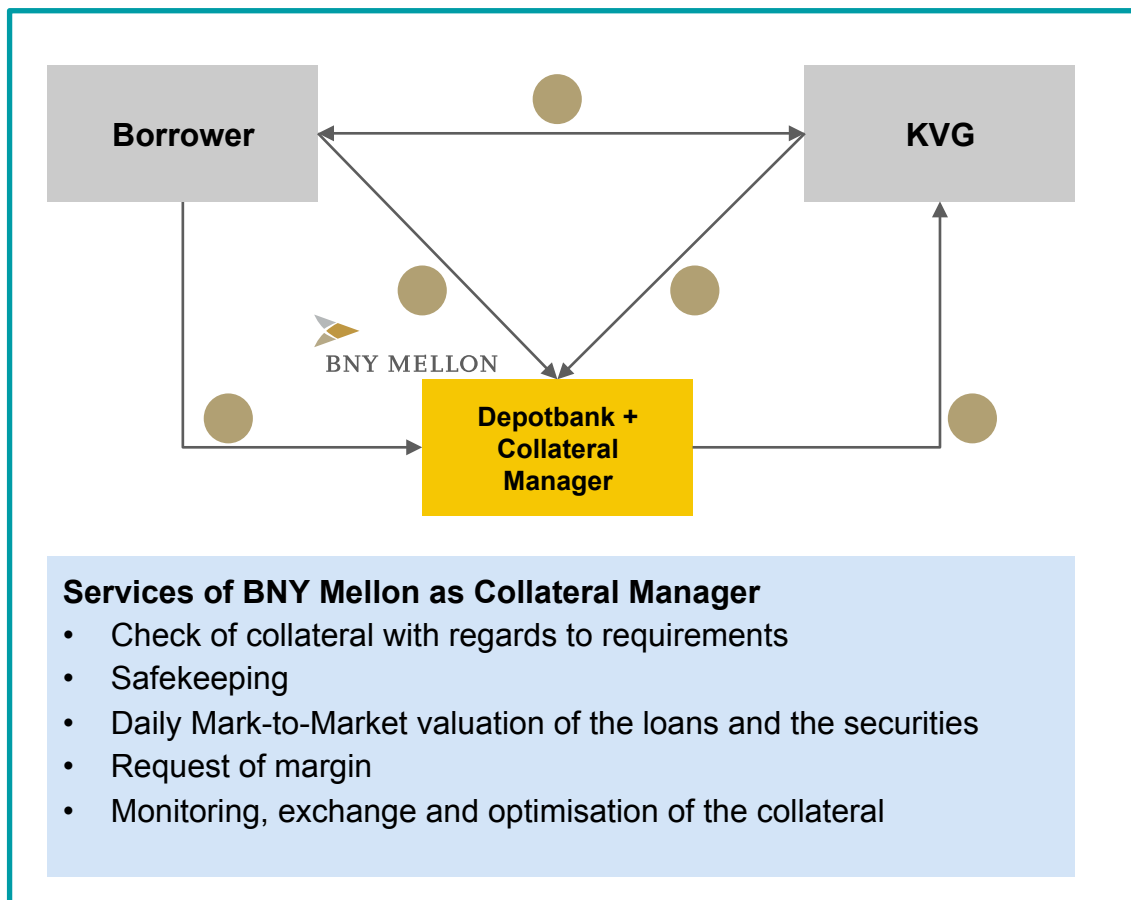
Collateral Management

Collateral Segregation

Collateral Receivers

High Level Tri-Party Collateral Transaction Flow with Collateral Administrator

Overview Involved Parties (Example Funds)

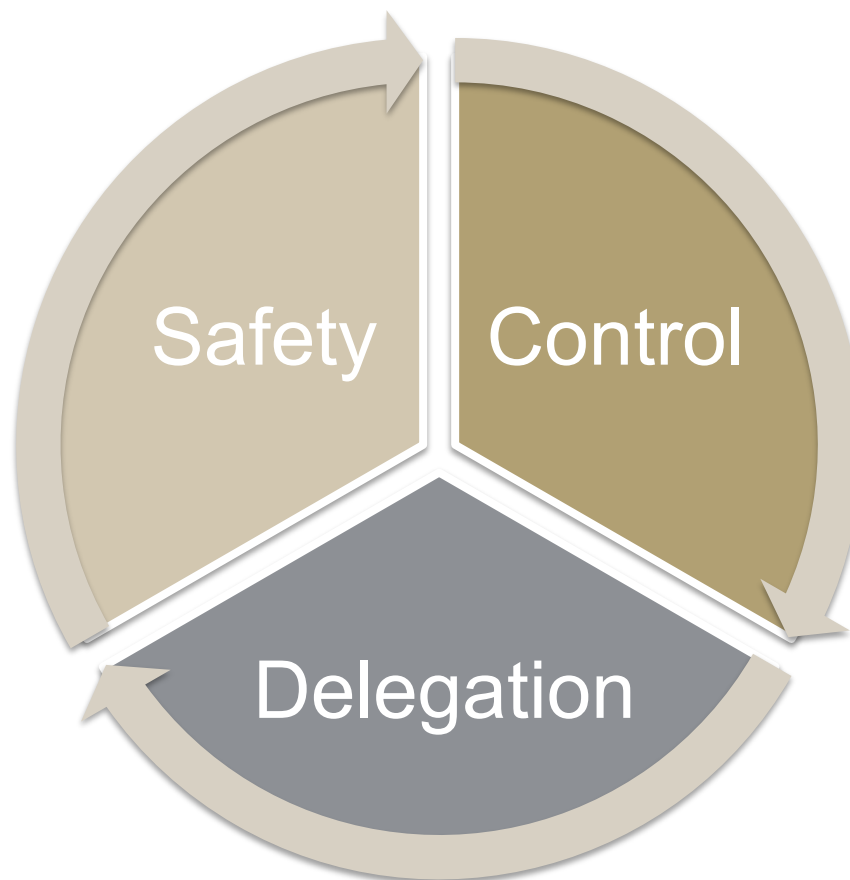


Process:

- **Agree trades**
- **Data delivery and matching**
 - Both parties deliver trade data to collateral manager
 - Collateral manager conducts matching
 - Collateral manager values position and requests margin from borrower
- **Delivery of collateral from borrower to the collateral manager**
 - Delivery of the collateral and check by the collateral manager
- **Confirmation by the KVG**
 - BNY Mellon as collateral manager confirms position (in a segregated account of the Depotbank)

Tri-Party Setup with KVG and Depository Bank: Key Areas of Focus

Sub-Custody &
Account Structure &
ESMA Opinion



Collateral Eligibility
Reporting
Online Access

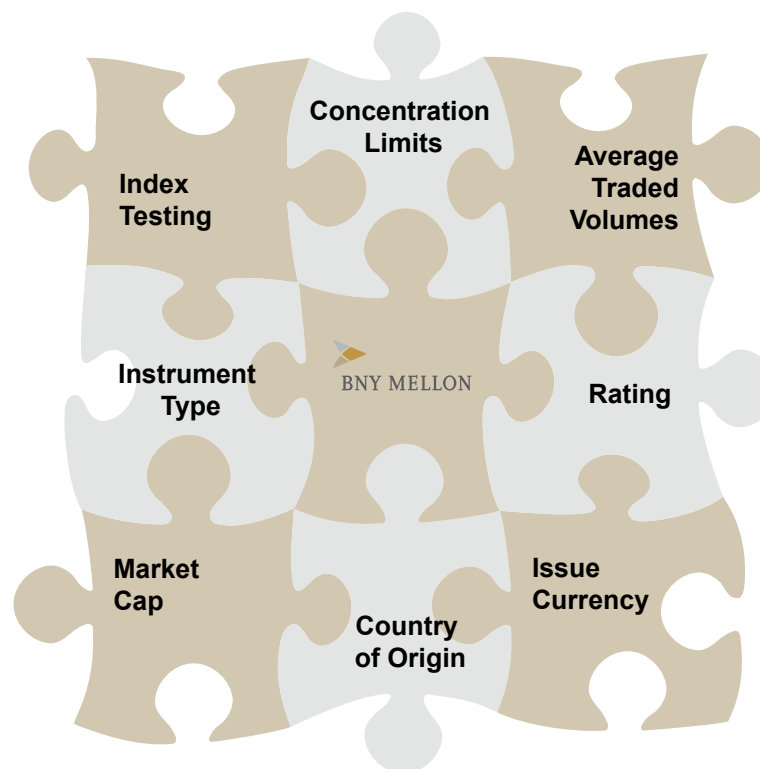
BaFin
Requirements &
Circulars

Collateral Selection: Create Diversified Pools

Benefits

- Central collateral manager - settlement efficient
- Advanced collateral selection
- Provision of full collateral reporting
- Reduces settlement and income risk
- Global operations on single system – Tokyo/Singapore/Brussels/NY
- Employ experienced collateral manager

Collateral Management



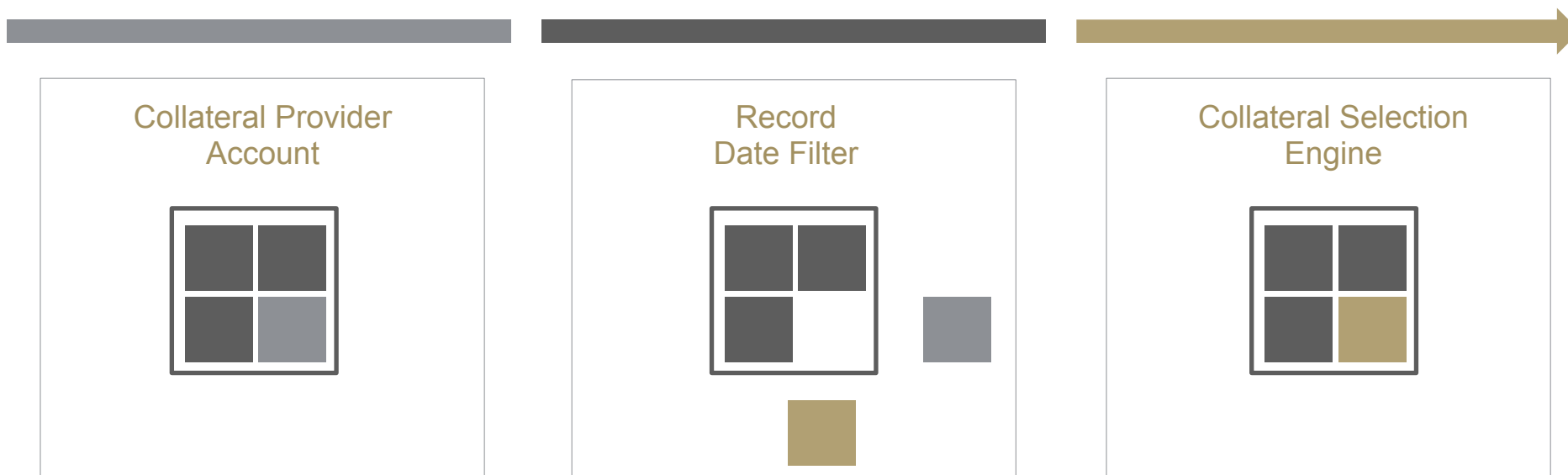
Collateral Solutions

Controlling Dividend Risk

BNY Mellon is responsible for asset servicing to both parties including assisting with corporate actions.

BNY Mellon substitutes or filters collateral so that income paying securities will reside in the collateral provider's account over record date unless separately agreed.

BNY Mellon allocates collateral based upon criteria mutually agreed between the collateral provider and collateral receiver.



Contractual Setup Under KAGB Regulation (1/2)

As Per Instruction of the KVG, the Collateral Administrator Becomes the Sub-Custodian of the Depositary

- KAGB-Principle: Assets of the AIF or OGAW have to be held at the Depositary Bank or a sub-custodian of the Depositary Bank.
- Based on Lending, Repo or Derivatives transactions the collateral administrator will hold custody of security collateral. Therefore it has to become a sub-custodian of the KVG's Depositary Bank (please see reasoning for § 200 KAGB).
- The collateral administrator does not perform any portfolio management functions:
 - During the collateral allocation process, the collateral administrator has to apply clear rules and limitations that have been defined by the KVG in the so-called “collateral matrix” that has been agreed between KVG, collateral provider and collateral administrator. The collateral matrix defines an eligible set of collateral under consideration of the legal and regulatory provisions.
 - In the Tri-Party Collateral Management Process, the collateral administrator performs the allocation of eligible collateral based on an integrated IT-allocation algorithms which optimises the collateral use for the collateral provider.
 - The collateral administrator does not have any leeway in decision-making for the selection and allocation of securities. The collateral administrator strictly applies the specifications given by the KVG under the collateral management agreement and collateral schedule. Therefore the nomination of the collateral administrator does not qualify as an outsourcing of the KVG's portfolio management functions according to § 36 Abs. 3 Nr. 1 KAGB.

Contractual Setup Under KAGB Regulation (2/2)

As Per Instruction of the KVG, the Collateral Administrator Becomes the Sub-Custodian of the Depositary

- The KVG has objective reasons to nominate the collateral administrator:
 - In accordance with § 73 Abs. 1 Nr. 2 resp. § 80 Abs. 1 Nr. 2 KAGB the nomination of the collateral administrator by the KVG can be considered as an objective reason angesehen werden. The decision to nominate a collateral administrator can be taken by the KVG as part of their portfolio management mandate.
 - Objective Reasons are for example the fact that the collateral administrator has a dedicated collateral management system which has been designed to provide additional efficiencies. In addition to that, the collateral administrator offers an improved access to the liquidity pools of several global dealers. The utilisation of a specialised collateral administrator allows for a reduction of operational risks and related costs in comparison to the bilateral collateralisation model.
- The Depositary Bank is therefore mandated by the KVG to nominate the Collateral Administrator as their sub-custodian:
 - If the depositary bank of the KVG does not offer the specialised tri-party collateral management product itself or if the KVG decided for other reasons to mandate an external collateral administrator, it will then be mandated by the KVG to contract with the collateral administrator. To be in alignment with KAGB regulation, the depositary bank therefore has to sign a sub-custody agreement with the collateral administrator.

Practical Implementation for Tri-Party Collateral Management

The Collateral Administrator performs relevant verifications as the sub-custodian of the Depositary Bank

- Only at the first collateralisation of a transaction, the Depositary Bank will perform an ex-ante check.
 - The collateral administrator will provide an intra-day report with the detailed collateral allocation.
 - Prior to the release of the loan securities, the depositary bank will check that the transaction is sufficiently collateralised.
- During the term of the trade, the depositary bank will only perform ex-post checks.
 - During the term of the trade there will be several intra-day substitution processes. Based on automated allocation processes, the collateral administrator performs ex-ante checks and ensures that the trade is collateralised according to the agreed collateral schedule.
 - If the depositary bank had to perform an ex-ante check for every substitution, this would slow down the process significantly. Compared to the bilateral collateralisation model it would thus not bring any additional efficiency gain for the KVG to mandate the specialised tri-party collateral administrator.
 - Therefore, a previous BaFin Circular (Paragraph VIII. No. 3 Circular 6/2010 (WA) from 2. July 2010) outlined the possibility for the depositary bank to only perform an ex-post check as long as an external collateral administrator is involved.

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