collateral token managed in a distributed ledger environment is used to record ownership of individual securities or even baskets of securities. The underlying securities remain in an account of a trusted third party (TTP) and are not moved further.

At first glance, as a third party acts as a collateral manager this model may seem similar to conventional triparty services, but de facto goes beyond it. While collateral used for triparty services always has to be mobilized into the custodial account environment of a specific triparty agent (TPA), the TTP model at hand no longer requires collateral movements across different custodians. In addition, once a token has been created it can be directly exchanged between the collateral giver and the collateral taker according to applicable rules.

This DLT-based set-up will allow collateral givers and collateral takers to take advantage of higher collateral mobility. It will remove complex reconciliation efforts necessary between various actors using traditional services for securities settlement and collateral management, which would open the door to substantial cost savings.

The analyzed model is characterized by four different layers. The Exposure Layer describes the exposure that usually arises between counterparties of financial transactions that have to be collateralized. On the Collateral Token Layer, tokens representing securities or baskets of securities will be exchanged. The Trusted Third Party Layer introduces a neutral and reliable trustee which blocks securities held in the Custody Layer and creates representative tokens. The Custody Layer will work as today but provide its services in this model to the TTP.