



The Asset Managers Forum Same Day Affirmation (SDA) Working Group

Concept Paper
Match-to-Settle and Same Day Affirmation
Presentation to the ISITC Membership

Scottsdale, AZ

June 7, 2010

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Initial question: Is there value in mandating “same day affirmation”?

Issues with the Current Model for Trade Processing in the US

- ❑ Approximately 11% of all DTC-eligible trades are not affirmed
 - Trades not affirmed at DTC are processed via “delivery orders” (DOs) whereby each delivering party submits their side of the trade “blindly” to the DTC in the hope that it will have a corresponding match
 - The delivery order process diverts broker/dealer and custodian resources away from addressing and resolving true exceptions
 - At current interest rate levels, it’s easier to settle the un-affirmed trades and address the few resulting problems than to spend the resources on investigating all un-affirmed trades
- ❑ Approximately 5% of all trades that are not affirmed are “reclaimed” *
 - Approximately 0.5% of all affirmed trades are reclaimed
- ❑ Some parties “affirm” trades without undergoing a proper matching / exception resolution process
 - Shifts the burden for ensuring accurate settlement to the custodian (see “delivery orders” above)
 - Reduces the effectiveness and meaningfulness of the affirmation process
- ❑ The US model is viewed as mature and efficient (especially for US equities). What is the incentive to spend time and money on further enhancements to this process relative to other strategic priorities?
 - * *Reclaims: broker/dealer (buys) and custodian (sells) attempt to delivery the securities versus payment, but the counterparty does not accept the DVP (versus a “fail” where the DVP transaction is submitted and accepted, but the actual delivery or payment does not occur)*

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Is there value in mandating “same day affirmation”?

Statistics – Monthly Affirmation Rates for both equity and fixed income in TradeSuite for Q1 2010 (source: Omgeo)

	Confirm / Affirm Model	Matching Model	Blended Rate
January 2010			
Trade Date	27 %	57 %	37 %
Trade Date + 1	83 %	93 %	87 %
Trade Date + 2 (AM)	86 %	94 %	89 %
February 2010			
Trade Date	27 %	59 %	39 %
Trade Date + 1	84 %	93 %	87 %
Trade Date + 2 (AM)	86 %	94 %	89 %
March 2010			
Trade Date	29 %	60 %	40 %
Trade Date + 1	85 %	92 %	87 %
Trade Date + 2 (AM)	88 %	93 %	90 %

Affirmation rates in the US have not changed substantially since the introduction of T+3 (see Appendix)

Trades not affirmed by noon on T+2 are subject to the deliver order process

Statistics – Sample Affirmation and Fail Rates for One Custodian

	US – Buys	US – Sells	US – Total
January 2010	1.94 %	1.06 %	
February 2010	1.68 %	0.95 %	1.32 %

	Affirmation Rate	Total Fail Rate	Fail Rate – Affirmed Trades	Fail Rate – Un-affirmed Trades
March 8 – 12, 2010	88.10 %	2.12 %	0.93 %	8.81 %



Canada – National Instrument 24-101

- ❑ NI 24-101 provides a framework in securities legislation for ensuring more efficient and timely processing and settlement of institutional trades.
- ❑ Participants in the institutional trading process are required to have in place processes and procedures that allow trade matching within prescribed limits which were originally scheduled to be phased out over a period of time
 - Current target is for 90% of trades to be matched by noon on T+1 by June 30, 2010 *
- ❑ Confirmation statistics for February 2010: **

	% of Total Number of Trades Entered in CDSX by Brokers – Equity	% of Total Number of Trades Confirmed in CDSX by Custodians – Equity	% of Total Number of Trades Entered in CDSX by Brokers – Fixed Income	% of Total Number of Trades Confirmed in CDSX by Custodians – Fixed Income	% of Total Number of Trades Entered in CDSX by Brokers – Combined	% of Total Number of Trades Confirmed in CDSX by Custodians – Combined
Trade Date	73.60%	48.54%	77.97%	56.57%	74.32%	49.82%
T+1 (AM)	90.90%	86.05%	90.73%	84.58%	90.88%	85.81%
T+1 (PM)	93.91%	90.75%	93.76%	89.86%	93.90%	90.60%
T+2 (AM)	96.16%	94.51%	95.44%	92.75%	96.05%	94.22%
T+2 (PM)	97.19%	96.11%	96.29%	94.53%	97.04%	95.85%
T+3	98.94%	98.65%	98.36%	98.15%	98.84%	98.56%
> T+3	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

* Deferred from original target date of June 30, 2008

** Source: Canadian Capital Markets Association

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Potential benefits of same day affirmation

Timely, Accurate Data Facilitates Downstream Processes, Reduces Operating Risk and Lowers Overall Processing Costs

- ❑ Facilitates T+1 NAV accounting processes
- ❑ Accommodates time zone differences for overseas clients
 - Trend towards demanding communication of “confirmed” deals and providing status on “unconfirmed” trades
- ❑ More accurate positions for trading and cash management
- ❑ Reduces manual efforts required to support delivery order processing and follow-up on un-affirmed trades
- ❑ Accurate intraday client reporting
- ❑ Reduces the opportunity for securities lending recall fails
- ❑ Fewer trade fails

Same Day Affirmation Facilitates Shorter Settlement Cycles

- ❑ Europe considering the harmonization of settlement cycles as a possible solution to Giovannini Barrier 6 *
 - Trade date matching and same day affirmation are included within the scope of these discussions
 - The Working Group is also charged with engaging with other global markets on possible global harmonization of settlement cycles
 - Group will start with the US and Japan

* See: “Work on Giovannini Barrier 6 – Conclusions and Next Steps; CESAME2 Group Meeting, Brussels, March 2, 2010”



Challenges that must be addressed

- ❑ Overnight / batch processing for sending allocations to broker/dealers
- ❑ Overnight / batch processing for sending confirms to investment managers
- ❑ Majority of trades are executed on the close
 - Creates potential staffing issues after market close
 - Need to clearly define what is meant by “same day affirmation”
- ❑ Investment manager perception that this is not a significant priority
 - Highly automated, efficient processes for US equities, with low fail rates
- ❑ Lack of readily available / recognized market statistics that effectively quantify the problem
 - DTC and FED cannot readily produce fail metrics
 - Can the custodians quantify the cost of the current inefficiencies; does this imply that they will then pass any realized savings on to clients?
 - Do the metrics support our conclusions?

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Is same day affirmation the right answer?

Overarching Goal: Settlement Certainty

Issue #1: Not all DTC-eligible trades are being affirmed

- Issues with role clarity?
 - Who is the affirming party?
 - How much has the uptake of SWIFT messaging contributed?
- Does accelerating the time frame to complete the affirmation process sufficient address this issue, or will it make it worse?
- Is mandating matching as a condition to settlement more effective for solving this issue?

Issue #2: Trades are being affirmed but are still failing (“bad affirms”)

- Are high settlement rates contributing to bad practices?
 - Lack of understanding of the processes and resources needed at the broker/dealer and custodian to ensure timely settlement
- Would “faster matching” or even “mandated matching” cure bad practices?
- Is central matching the needed solution to ensure more accurate matching?

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Recommendations

1. **Require matching as a condition to settlement**
 - ❑ Scope: all DTC-eligible trades that naturally settle on a T+3 basis
 - Deadline = T+2 at noon
 - Consider extension to instruments that naturally settle less than T+3 as a later phase
 - ❑ Unmatched trades should not be allowed to settle
 - Introduce a planned phase-out of deliver orders for unmatched trades
 - Incrementally increase delivery order charges during the phase-out period as a disincentive
 - Consider implementing “penalties” at the depository for failed trades
 - ❑ US appears to be an outlier as compared to other markets
 - ❑ Block-level matching as a condition to releasing allocation details is preferred over allocation-only
 - ❑ Central matching is preferred over local matching in order to reduce the number of instances of “bad matches”
 - ❑ The matched trade becomes the 10b-10 confirm



Recommendations

2. Recommend same-day matching as an industry best practice

- ❑ Same day matching in isolation is not sufficient to solve all issues associated with the current process
- ❑ The Committee was unable to reach consensus on the effectiveness of the Canadian model
 - Processes are more efficient
 - Settlement rates are higher
 - There is some push back on a T mandate v T+1
 - There is no defined “penalty” for not meeting prescribed targets
 - Canada also requires a “match-to-settle”
- ❑ Same day matching reduces operational risk, increases end-to-end process efficiency and supports the needs of downstream systems, processes and consumers for timely, accurate data



Other Alternatives Considered

Agreed Code of Practice Backed by Economic Incentives / Disincentives

- Design to discourage inefficient behavior; provide incentive for adherence to code of practice



Initial Discussion with the DTCC

- ❑ Representatives from the Working Group met with the DTCC on May 27
- ❑ DTCC was generally supportive of the proposal
 - Suggested that the Working Group gather sufficient data to support our problem definition
 - Ensure that there is sufficient industry support for “match-to-settle”
 - Ensure no unintended consequences (e.g., higher fail rates)
- ❑ Noted that significant systems changes would not be required to implement
 - Can manage through use of DO reason codes
- ❑ And that there may be some flexibility in the T+2 noon deadline
 - Approximately half of all unaffirmed trades as of noon T+2 are affirmed by noon T+3



Timeline

Develop initial recommendations



Present to AMF Steering Committee
(May 10)



Initial discussion
with DTCC
(May 27)



- Presentation to ISITC (Jun 7)
- Presentation to AMF membership (Jun 17)
- Discussion with SIFMA Broker/Dealer Ops Group (Jun 22/23)
- Discussion with AMF Custodian Committee (TBD)



Follow-up discussion with DTCC to agree next steps
(TBD)



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Appendix – Historic Affirmation Rates

		Confirm / Affirm Model	Matching Model	Blended Rate
December 2004	Trade Date	21 %	49 %	27 %
	Trade Date + 1	82 %	87 %	83 %
	Trade Date + 2 (AM)	88 %	91 %	89 %
December 2005	Trade Date	17 %	53 %	25 %
	Trade Date + 1	83 %	90 %	84 %
	Trade Date + 2 (AM)	88 %	92 %	89 %
December 2006	Trade Date	14 %	56 %	23 %
	Trade Date + 1	86 %	89 %	87 %
	Trade Date + 2 (AM)	90 %	91 %	90 %
December 2007	Trade Date	16 %	60 %	26 %
	Trade Date + 1	86 %	90 %	87 %
	Trade Date + 2 (AM)	90 %	92 %	91 %
December 2008	Trade Date	21 %	56 %	33 %
	Trade Date + 1	81 %	92 %	84 %
	Trade Date + 2 (AM)	84 %	93 %	87 %
December 2009	Trade Date	26 %	59 %	37 %
	Trade Date + 1	84 %	92 %	87 %
	Trade Date + 2 (AM)	87 %	93 %	89 %
March 2010	Trade Date	29 %	60 %	40 %
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Source: Omgeo

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