

TASK FORCE ON CONFIRMATIONS

PROGRESS REPORT

AGENDA

- Initial key questions
 - Scope in terms of products
 - Scope in terms of counterparties
 - Roles and objectives of the taskforce
- Recommendations (examples)
- Discussion topics
 - Phone confirmations
 - On line trading

AGENDA

- Discussion topics (continued)
 - How to improve exchange of confirmations with non banks ?
 - How to improve the STP level in confirmations processing ?
 - Move of confirmations to front office : impact of some market evolutions

INITIAL KEY QUESTIONS

SCOPE IN TERMS OF PRODUCTS

- Most existing recommendations focus on forex and money market (ACI, London FX Committee, ...)
- This is also the scope of the two parent groups of the OMG
- Nevertheless the taskforce proposes to cover the entire scope of transaction types

SCOPE IN TERMS OF PRODUCTS

- Forex – Money Market :
 - Spot, Forward, Swap
 - NDF
 - Loans/deposits
 - Call notice
- OTC Derivatives
 - Fx derivatives
 - IR derivatives

SCOPE IN TERMS OF PRODUCTS

- Equity derivatives
- Credit derivatives
- Commodity derivatives (including energy)

Need to differentiate between “plain vanilla”, exotic and structured

- Securities
 - Buy and sell trades
- Repo & securities lending

SCOPE IN TERMS OF PRODUCTS

- Depending on the product the issues are different
- Forex and money market : non banks
- Derivatives : STP level, need for standards
- Securities : confirmations are probably “less” important as focus is on pre-settlement matching and DVP settlement

SCOPE IN TERMS OF COUNTERPARTIES

- Financial transactions are dealt with a wide range of counterparties
- The taskforce proposes the following classification :
 - Banks
 - Non banks with
 - Large corporates
 - Small corporates
 - Funds and hedge funds
 - Other smaller clients (retail)

ROLES AND OBJECTIVES OF THE TASKFORCE

- Initial purpose was to issue a set of recommendations or best practices regarding confirmations
- The taskforce believes this kind of recommendations will add little value to already existing recommendations
- On top of issuing some fundamental recommendations the taskforce proposes some other initiatives :

ROLES AND OBJECTIVES OF THE TASKFORCE

- Lobbying on a number of associations, institutions
- Discussing at the OMG some topics relevant to the market industry, try to identify some best practices and encourage their adoption by market participants

RECOMMENDATIONS

RECOMMENDATIONS

- On next pages : some examples of recommendations (draft)
- Some references :
 - The confirmation or automatic matching of transactions (ACI Model Code)
 - Confirmation Processing – a good practice guide (London FX Committee)
 - Some extracts of the “Corigan report” – Counterparty Risk Management Policy Group

RECOMMENDATIONS

- Exchange of bilateral confirmations should be the rule
- Confirmations should be issued as soon as possible after trade execution
- Banks should favour the use of electronic formats (“standard messages”) in order to increase speed, allow full tracability and implementation of automatic matching

RECOMMENDATIONS

- Encourage participation in market initiatives like matching utilities (DTCC for credit derivatives, Swapswire for interest rate derivatives, ...)
- Banks should consider confirmations matching as a key risk mitigating factor and allocate enough resources to that function (skilled staff and adequate systems)

RECOMMENDATIONS

- Management reporting should be available and closely monitored (number of outstanding items, aging, ...)

DISCUSSION TOPICS

PHONE CONFIRMATIONS

- Phone confirmations should be avoided
- Confirmations should be as much as possible be issued :
 - In electronic structured format
 - Using standard messages
 - Through a secure way of communication
- Phone confirmations should only be used as a fall back solution (chasing)

ON LINE TRADING

- Automated trading systems have taken a major place in the marketplace
- Some examples :
 - EBS and Reuters Matching in the fx professional market
 - Multibank portals like FXALL in the corporate market
 - MTS and Brokertec in the bonds and repo market
 - Internal web based tools
- Regularly the question of the need to maintain the exchange of confirmations for this type of trades is raised

ON LINE TRADING

- The Taskforce is of the opinion that continuing to send confirmations reduces the overall level of operational risk
- Even if the presence of a trade in a deal blotter might be binding, the issuance of a confirmation has an added value :
 - Protection against fraud, hacker, ..
 - We do not know the STP level of our couterparties
 - Confirmations are often more complete

ON LINE TRADING

- Nevertheless the Task Force believes there will be forces to go away from confirmations exchange in some cases and banks will need some flexibility :
 - Need for confirmations for securities trades where there is DVP settlement (and sometimes “delegation” of settlement initiation to market like MTS) ?
 - Need for chasing “on line trades” which are already settled ?
- But going away from the bilateral exchange should always be agreed bilaterally

HOW TO IMPROVE EXCHANGE OF CONFIRMATIONS WITH NON BANKS

- The issue seems to be “cultural”. This best practice does not seem to be perceived as important by clients.
- Involve sales people in the “education” of the client
- Involve corporate audit firms ?
 - They could insist on the importance of checking confirmations and returning them to banks
 - This topic could be part of their audit reviews
 - Can the OMG play a role in this respect ?

HOW TO IMPROVE EXCHANGE OF CONFIRMATIONS WITH NON BANKS

- Should banks encourage clients to move to solutions like Misys or CLS ?
- Should regulators intervene and require provisions or “charge” capital for outstanding confirmations ? (in order to force banks to take actions)

HOW TO INCREASE STP IN CONFIRMATIONS PROCESSING ?

- Although standards exist for some products (MT305, 306), Swift is still “underused” by banks. Idem for NDF’s. Extension of usage should be encouraged.
- Initiatives like Swapswire or DTCC have clearly improved the STP level and contributed to the reduction of backlogs. So participation should be encouraged, but access for “smaller” counterparts remain difficult.

HOW TO INCREASE STP IN CONFIRMATIONS PROCESSING ?

- Lobbying on Swift (or others like Misys) to extend coverage ?
ex : fixing on NDF, ...
- Avoid ISDA long form confirmations ? i.e. Negotiate Master Agreement first and do not repeat ISDA Definitions or Master Agreements clauses in trade confirmations

CONFIRMATIONS CLOSER TO FRONT OFFICE ?

- Initiatives like Swapswire have moved the confirmations task from back to front office
- Similarly the process of “affirming” trades have moved us away from the bilateral exchange of confirmations
- These evolutions are in contradiction with some existing “best practices” or recommendations. Issue ?

CONFIRMATIONS CLOSER TO FRONT OFFICE ?

- The Task Force considers these initiative as positive. However banks should give attention to the overall level of operational risk. Some attention points :
 - STP level from FO systems to BO systems
 - Coherence of the data between both systems (need for reconciliation)
 - Potential need for periodic reconciliation with external data