Feeling Unsettled?

How asset managers and broker/dealers can significantly reduce trade breaks related to discrepancies in Standing Settlement Instructions

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The majority of trade breaks worldwide result from mismatches in Standing Settlement Instructions between asset managers and broker/dealers. Trade breaks are extremely disruptive to the post-trade process, resulting in unnecessary cost, manual intervention and a race to meet settlement deadlines. With Europe already at T+2 and the US not far behind, asset managers and broker/dealers can breathe a sigh of relief that FIX based post-trade offers a solution to this long-standing problem.

Talking to many of the world's largest asset managers about their post-trade strategy is how I spend most of each day. Increasingly, the conversation has turned to the use of the FIX protocol to achieve cost savings, near real-time post-trade processing and true STP.

With FIX, SSI are an integral part of the confirmation/affirmation process.

But there's yet another compelling reason for the use of FIX, namely, the ability to reduce settlement errors that result from mismatches in Standing Settlement Instructions (SSI).

In the prevalent post-trade process, the counterparties to the trade match the economic details on trade date, *but not the SSI*, through the confirmation/affirmation procedure. The SSI are not matched until T+1 or later, when a custodian bank (on behalf of the asset manager) and clearing agency (on the broker's behalf) compare SSI at the point of settlement. Because the asset manager and broker are not directly involved in this step, any discrepancies in the SSI between counterparties result in a trade break, with multiple parties (bank, clearing agency, asset manager and broker) scrambling to fix the problem before the settlement deadline.

This is a problem created by legacy technology. The good news is that FIX based post-trade technology can solve it.

Why do SSI mismatches occur?

There are two main reasons SSI discrepancies cause a trade break.

1 Timing of SSI information

The industry has traditionally relied on an outdated approach to managing SSI information — one that requires asset managers and brokers to update a third-party system with their respective SSI information. The updates to this third-party repository occur independently at the convenience of each party.

Consider a scenario where the broker, after confirming/affirming the trade, has retrieved the SSI from the repository and forwarded the information to the clearing agency. The asset manager then makes an update to the SSI in the repository and sends these updated instructions to their custodian bank. The two parties to the trade are now working with different versions of the SSI.

When the custodian bank and clearing agency compare the trade details at the point of settlement, the SSI differences cause a mismatch. Dealing with a mismatch this late in the post-trade process is a significant problem and increases the risk of missing the settlement deadline.

FIX can solve this problem by allowing *the matching of SSI on trade date* as an integral part of the confirmation/affirmation process. In addition to the economic details of a trade, both asset manager and broker can supply SSI information for matching. Any discrepancies can be resolved between the counterparties before additional participants, such as custodian bank and clearing agency, get involved in the process. (see Fig. 1)

FIGURE 1:
Utilizing FIX
for trade date
SSI matching
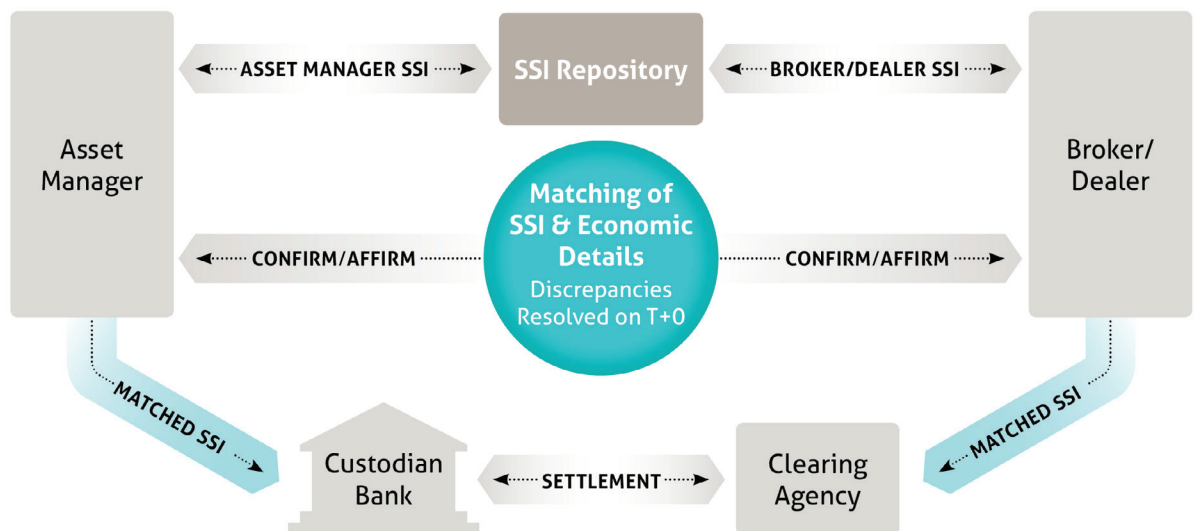
With FIX based post-trade, SSI are no different from other trade details and can be incorporated seamlessly into the confirm/affirm process.

2 Incomplete information

In the case of international transactions in which overseas brokers and settlement venues are involved, the asset manager typically does not have complete information regarding the SSI because there is no existing mechanism to transmit that information from broker to asset manager.

Consider the following example (see Fig. 2):

• A US based asset manager places an order with a US broker (BRKUS) to execute a trade in a stock that trades in South Africa.

• BRKUS routes the order to a local broker (BRKSA) in South Africa for execution.

  The trade is executed by BRKSA and will ultimately settle at a clearing agency in South Africa.

In this scenario, the asset manager has the information pertaining to BRKUS, but is not aware of BRKSA or the place of settlement. Consequently, the SSI information sent by the asset manager to the custodian bank is missing these valuable details and sets the stage for a possible mismatch in SSI at the point of settlement.

When FIX is utilized for post-trade, broker BRKUS can provide the asset manager *on trade date* with the full details of the execution, including BRKSA's SSI and the place of settlement. The asset manager can forward these details on to their custodian bank on trade date, preparing the bank with complete information to settle the trade in South Africa.

FIGURE 2:
Reducing errors
in international
settlement
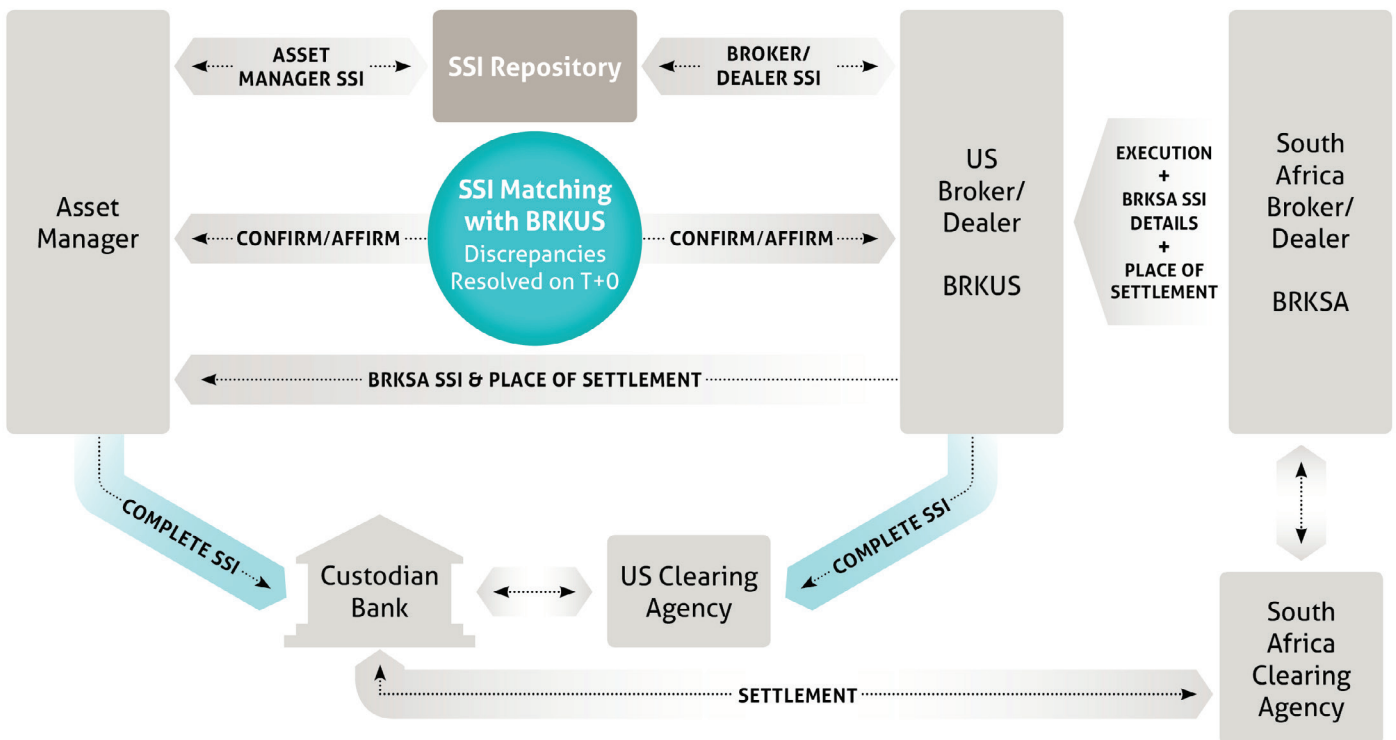
The settlement risk is inherently higher with international trades. FIX mitigates this risk by clarifying on trade date the details of overseas settlement.

FIX your post-trade

As an industry, we've successfully compressed trade execution to nanoseconds—not surprisingly, attention has now turned to the last frontier of inefficiency, post-trade. The moment a trade is broken, the dollars start adding up to correct the error. As trade volumes continue to increase and settlement cycles around the world compress, the ability to identify and resolve errors on trade date has become an imperative.

The matching of SSI information directly between asset manager and broker on trade date is a major milestone towards reducing error rates and achieving shorter settlement cycles, and FIX now makes it possible.

ABOUT THE AUTHOR

Ignatius John, considered by many to be an IT visionary, is recognized as a pioneer in the use of the FIX Protocol for post-trade. As Global Trading Strategist at asset manager AXA Rosenberg, Ignatius implemented a complete post-trade solution in 2008 using the FIX Protocol. This accomplishment was highlighted in a leading industry journal on trading, and was a precursor to the industry's adoption of FIX for post-trade. In various roles at AXA Rosenberg over two decades, Ignatius managed business strategy, product and technology development. He also worked for global custodian State Street Bank on real time trading technology. Ignatius has a proven track record of implementing functional improvements to the investment process, from pre- to post-trade in the US, Asia, and Europe, to increase workflow efficiency, mitigate risk and enhance portfolio returns.