

A Message to the Industry: Assessing SWIFT's Entry into Electronic Trade Confirmation



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TowerGroup Key Findings

- The SEC's new "no-relief" status for SWIFT's electronic trade confirmation message, MT515, lets investment managers use existing infrastructure to increase electronic processing of trade confirmations and data archival options, reducing paper handling.
- Many broker-dealers have the infrastructure to send SWIFT MT515 electronic confirmation messages and stand to save an estimated 50 cents per non-DTCC eligible trade by not having to mail trade confirmations.
- Investment managers and broker-dealers will need to maintain multiple confirmation systems and formats not addressed by MT515, and many vendors will need to retool applications to accept the new message.
- While targeting the non-DTCC eligible transaction space, use of SWIFT messages for electronic trade confirmation could impact some of Omgeo CTM's traffic in the future and force systems changes by order management and middleware vendors.

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Report Coverage

This TowerGroup ViewPoint examines the impact of SWIFT's recent receipt of "no-action" relief from the Securities and Exchange Commission for its electronic trade confirmation (ETC) message, the MT515. This event means that a properly formatted confirmation message now complies with SEC's rule 10b-10, which sets disclosure requirements for trade confirmations sent by broker-dealers to their customers. The designation establishes the SWIFT message as an option for delivering and storing compliant electronic trade notifications for non-DTCC eligible securities and cross-border trades. This ViewPoint discusses the consequences of the upgrade in designation for industry participants.

Introduction

Trade confirmations are a critical part of the transaction process. They serve as the legal contract between the two counterparties and contain vital information about the trade such as quantity and price, commission, and settlement instructions. The confirm also communicates certain information that the broker is obligated to disclose per SEC rule 10b-10. The communication of trade confirmations electronically is generally accepted as the first step in automating the posttrade process and achieving straight-through processing. Electronic trade confirmations are used to compare the transaction details taken from the investment manager's order management system with the details communicated by the executing broker. The automation of this process is known as "trade matching" and is facilitated by either an in-house matching engine or a solution provided by a third-party software application.

In the US market, most trade confirmations are processed using the Omgeo TradeSuite product and communicated electronically via the Depository Trust Company (the DTCC). They are recognized by the SEC as compliant with SEC recordkeeping requirements. However, for US

money managers trading non-DTCC eligible and cross-border equity and fixed-income securities, the process is not as standardized or automated. Broker-dealers use a variety of methods, including Omgeo Central Trade Matching (CTM) platform, proprietary systems, and fax, supplemented by mailed paper confirmations, to satisfy the SEC rule. Although the message itself has been around since the 1990s, SWIFT hopes to compete in this niche of the trade confirmation process with its newly SEC-compliant electronic trade confirmation, the MT515.

Impact on Investment Managers

In TowerGroup's opinion, the cost/benefit of the new ETC process is positive for investment managers. Some of advantages of the MT515 to the investment management community are:

- **Infrastructure in place.** Many US investment managers use SWIFT in some way already, usually to communicate trade settlement instructions for non-DTCC trades to their custodian banks or take in reconciliation messages.
- **Increased automation.** Having brokers send the MT515 enables investment managers to discontinue manual trade confirmation in favor of electronic processing and archival methodologies.
- **Decreased paper.** Investment managers no longer need to sort and store hard-copy confirmations to meet the SEC and other data retention requirements.
- **Flat messaging costs.** No cost will be associated with receiving messages because the sender of SWIFT messages — in this instance, the broker-dealer — pays for them.
- **Reuse of data.** The MT515 contains all of the data elements typically used by investment managers to craft trade settlement instructions to their custodians (e.g., MT540, 541, 542, 543).

Some disadvantages need to be considered, however:

- Investment managers still have multiple methods of electronically confirming trades and will need to maintain multiple platforms to facilitate the process.
- Adding the MT515 to their message library and matching protocols will require system changes to third-party and proprietary applications used by investment managers.
- To facilitate straight-through-processing, investment managers will need to add the MT517 trade confirmation affirmation message to their process to affirm a confirmation over the SWIFT network and an MT509 trade status message to communicate discrepancies in trade details.

Impact on Broker-Dealers

TowerGroup expects SWIFT's entry into the posttrade processing space will provide a net benefit to brokers in terms of ease of adoption and cost savings. Broker-dealers stand to benefit from using the MT515 to confirm trades for the following reasons:

- **Increased automation.** For brokers that have not yet moved onto the Omgeo CTM platform, the MT515 provides the means for sending electronic trade confirmations.
- **Infrastructure in place.** The MT515 is already in use in the international confirmation space and in the broker-to-broker confirmation cycle. SWIFT has a platform, Accord for Securities, that provides matching functionality at this level.
- **Cost savings.** Brokers stand to reduce their costs by limiting the number of paper confirmations they need to generate and deliver to their counterparties. Cost savings are estimated at 50 cents per confirmation sent electronically.

Some of the disadvantages to brokers are:

- Brokers still must maintain multiple confirmation formats and technologies for the non-DTCC eligible and cross-border trade process, depending on their customers' preferences.
- Brokers' international operating systems may be familiar with the MT515 today, but US domestic applications may lack the capability to create an MT515 and require development.
- Some of the savings realized from not having to print and send hard-copy confirmations will be offset by the anticipated increase in traffic, given that the sender of a SWIFT message has to pay for the message.

Impact on Technology Providers

Although the MT515 electronic trade confirmation contains many of the same data elements used by electronic trade confirmation providers, it is in a different format that must be adapted to both internal and external applications that consume confirmed trade data. Many software vendors support the matching of electronic trade confirmations for the investment management community and currently interface with the CTM and OASYS products. Systems such as Charles River Development's modular Investment Management Suite and Fidessa's Latent Zero Minerva order management system (OMS) provide connectivity with Omgeo's CTM platform for generating and matching confirmations. Many investment managers have implemented middleware solutions to serve as an integration layer to route trade information from the OMS to the posttrade communications service, whether that is Omgeo, SunGard Global Network (SGN), or SS&C Technologies' SSCNet, to name a few. Those interfaces will need to be modified to be able to take in MT515 data and then to transmit a "confirmed" trade status back to the OMS. TowerGroup anticipates that vendors must immediately evaluate and enhance their offerings to support the format as investment managers opt to receive the MT515 and brokers respond.

Summary

SWIFT's MT515 trade confirmation message and its recent win of SEC compliance is a significant development for the trading community. For those institutions that deal in cross-border securities or transactions that are not currently supported by Omgeo, the MT515 fills a gap in the electronic trade confirmation process. The investment management community will benefit from being able to automate these types of trades without a significant investment if they are SWIFT users already. They will still need to support their Omgeo connections as well, however. Brokers currently use the MT515 message internationally and with each other, so they already have the means to use the electronic confirmation message to confirm trades with investment managers. They will also benefit from the cost savings of being able to reduce the number of paper confirmations they send out. However, the increased messaging traffic will mean that their SWIFT costs could go up, depending on their arrangement. Vendors will also experience an impact. They will need to retool their applications to support the MT515 if they do not support the format currently. Although TowerGroup does not expect SWIFT to take away messaging traffic from Omgeo in a significant way, MT515 is beneficial to the industry because it supports competition in posttrade processing. Competition in the electronic trade confirmation marketplace will promote innovation and that can only be a good thing for the underlying consumers of the messages.