

Derivatives

Enabling automation for OTC derivatives transactions



*ISDA and SWIFT
working together*

Benefits

- Enable exchange of FpML messages for OTC derivatives over SWIFTNet
- Encourage adoption of FpML-based messages by all parties
- Increase automation for buy-side, sell-side and asset servicing
- Reduce risk and cost
- Meet regulatory requirements

The recent explosive growth in the OTC industry has exposed, but also created, numerous areas of processing inefficiency that increase risk and raise the cost of back-office support.

To help the financial community respond to the challenge, SWIFT and the International Swaps and Derivatives Association (ISDA) entered into an agreement in June 2006 to support FpML messaging services over SWIFTNet.

FpML is the established syntax in the derivatives market space. The syntax is widely recognised and promoted within the ISDA community as the standard of choice for communicating electronic information related to OTC derivative transactions. Many institutions within the ISDA community have implemented FpML internally.

The two organisations agreed to set up a solution, called Derivatives over SWIFT, with the purpose of transporting FpML messages for OTC derivatives using the SWIFTNet infrastructure.

The agreement between SWIFT and ISDA is a key building block in SWIFT's alternative investments/derivatives strategy, which aims to help financial institutions respond to automation challenges in the OTC derivative post-trade area in a more efficient way.

The Derivatives solution

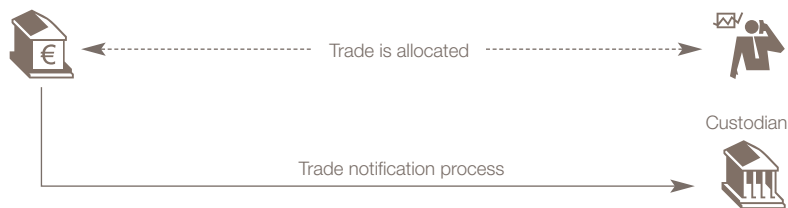
Derivatives facilitates the exchange of FpML messages related to OTC derivatives transactions over SWIFTNet. The intention is to leverage SWIFTNet services to provide a flexible, multi-lateral messaging solution for FpML messages.

FpML-compliant messages (XML syntax) are transported over SWIFTNet using SWIFT's InterAct store-and-forward messaging service.

Currently, the solution facilitates the exchange of information related to the contract notification process between buy-sides and custodians. It also covers the confirmation process between trading counterparties. It now also supports the exchange of ISO 20022 payment and cash statement messages, including specific usage rules for derivatives related payments.

Components of the solution

Derivatives enables investors, custodians, fund administrators, broker/dealers and prime brokers to communicate with each other in a fully standardised way, facilitating straight-through processing (STP) in an area that is still very paper-based.



- ContractCreated + ContractCancelled
- ContractNovated + ContractNovatedCancelled
- ContractIncreased + ContractIncreasedCancelled
- ContractPartialTermination + ContractPartialTerminationCancelled
- ContractFullTermination + ContractFullTerminationCancelled

Ⓐ Notification process

Standards

Derivatives supports FpML messages. These are XML messages developed by the International Swaps and Derivatives Association (ISDA).

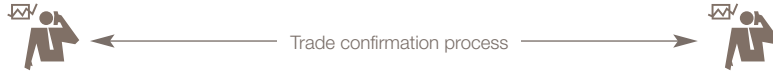
- Notification of a new Contract (ContractCreated)
After a contract is agreed and allocated between asset manager and dealer, the asset manager informs its custodian(s) of the details of the contract. This can be done either before or after the contract is confirmed between the trading counterparties.
- Notification of an Increase (ContractIncreased)
The asset manager notifies the custodian of an increase of the contract notional.
- Notification of a Novation (ContractNovated)
The asset manager notifies the custodian of a full or partial novation of an existing contract.
- Notification of a Partial Termination (ContractPartialTermination)
The asset manager notifies the custodian of a partial termination of an existing contract.

- Notification of a Full Termination (ContractFullTermination)
The asset manager notifies the custodian(s) of the full termination of an existing contract.
- Notification of a Cancellation (ContractCancelled)
The asset manager notifies the custodian(s) of the cancellation of the notification of a new contract.
- Notification of the cancellation of an Increase (ContractIncreasedCancelled)
The asset manager notifies the custodian of the cancellation of an increase of the contract notional.
- Notification of the cancellation of a Novation (ContractNovatedCancelled)
The asset manager notifies the custodian of the cancellation of a full or partial novation of an existing contract.
- Notification of the cancellation of a PartialTermination (ContractPartialTerminationCancelled)
The asset manager notifies the custodian of the cancellation of a partial termination of an existing contract.

- Notification of the cancellation of a Full Termination (ContractFullTerminationCancelled)
The asset manager notifies the custodian of the full termination of an existing contract.

The solution also supports three messages that belong to the confirmation process:

- Confirming a new trade (RequestTradeConfirmation)
After a trade has been agreed between buy-side and sell-side, both parties confirm the elements of the trades from their respective point of view.
- Modifying an already confirmed trade (ModifyTradeConfirmation)
One or both parties send a modification to update/correct elements of the trade.
- Cancelling a confirmed trade (CancelTradeConfirmation)
One or both parties cancel a confirmation that has already been sent.



- RequestTradeConfirmation
- ModifyTradeConfirmation
- CancelTradeConfirmation

Confirmation process

The SWIFTNet platform

Derivatives provides an industry communication protocol. Parties involved in derivatives trading will interact using a common communication platform, SWIFTNet, sharing the same security infrastructure and a common service for which the security features have been selected according to business needs.

The SWIFTNet messaging service used for Derivatives is InterAct. It uses the store-and-forward mode with the following mandatory features:

- central message validation
- end-to-end signature
- non-repudiation of origin, emission and reception.

The request for delivery notifications is optional.

Rules

Complementing the messages, a set of detailed business and operational rules has been formulated to create and maintain industry practice.

Benefits

FpML support on SWIFTNet will speed implementation of FpML-based messaging by a broad group of industry participants, including new counterparties.

It will reinforce automation within the buy-side, sell-side and asset servicing communities, helping to reduce operating costs, reduce risk and satisfy regulatory requirements.

Derivatives enables organisations to use their established SWIFTNet infrastructure to send and/or receive secure OTC derivative messages.

This is the logical next step for firms looking to build a consistent and reliable means of achieving STP in an OTC market that has witnessed unprecedented growth in recent years.

Future plans

ISDA and SWIFT continue to work together to enhance the service, adopting new FpML releases and messages as required by the customers of the Derivatives solution.

For more information, please contact your SWIFT account manager or visit www.swift.com



For more information about SWIFT
visit swift.com

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