

outlook



Post-Trade Processing: Roadmap to a Global Standard

By Mary Ann Burns

The listed derivatives exchanges in the U.S. and Europe have been working together for the past two years to determine the feasibility of adopting a global standard communication protocol for post-trade processing. The adoption of such a standard could lead to significant improvement in the efficiency of clearing trades and a real reduction in costs for connecting to exchanges worldwide. The project is being coordinated by the Futures Industry Association and the Futures and Options Association.

Standards are already in place for other parts of the trade cycle. FIX has become the dominant standard for pre-trade and trade execution; Swift dominates the banking and settlement area. The post-trade space, on the other hand, has been left to proprietary interfaces developed by each exchange or clearing organization. Many firms and service providers are managing more than two dozen interfaces with exchanges around the world. Post-trade processing includes areas such as trade reporting, allocation reporting, confirmations, trade and position transfers, give-ups, average pricing, position adjustments, exercise and assignments, collateral reporting and maintenance, end-of-day price reporting, security reporting, corporate events, reference data, and registration instructions.

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The search for a post-trade communications protocol has two drivers. The first is the widespread recognition within the industry that transaction processing across exchanges all over the world needs to be more efficient. The second is a 2003 directive by The Giovannini Group, a quasi-governmental body established by the European Union to identify the principal barriers to cross-border clearing and settlement. One result of this effort is that European equities and fixed income markets are now poised to adopt ISO 20022, a communication protocol developed by Swift. This has raised the issue of whether the listed derivatives industry should also adopt this standard, or instead a version of the FIX protocol called FIXML that is already in use at most U.S. listed derivatives exchanges.

A working group of European and U.S. exchanges, clearing organizations and firms has been meeting to determine an appropriate standard for the global listed derivatives industry that will meet the requirements outlined in Giovannini Barrier One. The group recently decided to move forward with determining the feasibility of using FIXML as the standard communication protocol for post-trade processing and, at the same time, achieve interoperability with the Giovannini protocol.

The Giovannini Protocol

In 2003, The Giovannini Group, composed of representatives from the European financial services sector, identified 15 barriers to efficient cross-border clearing and settlement of securities transactions. Barrier One is the lack of a common communication protocol for clearing and settlement providers. Swift, through its Securities Market Practice Group, was tasked with

defining a protocol. The SMPG formed an Independent Advisory Group which published a consultation paper in 2004 and a final recommendation in March 2006 outlining a plan to achieve a standard. The recommendation makes it mandatory for all participants in EU cross-border clearing and settlement, and asset servicing of equities, fixed income, and exchange-traded funds to use ISO 15022 and ISO 20022 standards and syntaxes. Syntax is the manner in which data elements combine to form a message. Affected organizations have a five-year window, which began in March 2006, to implement the standard.

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The final IAG recommendation does not mandate the extension of the Giovannini protocol to listed derivatives, but it does ask “relevant” organizations such as FIA, FOA, FpML, Eurex, LCH.Clearnet and FIX Protocol Limited, “to consult on the feasibility and, if appropriate, recommend a plan to achieve compliance with the IAG recommendation for exchange-traded derivatives.” The response is due in March 2008.

Of key interest to the listed derivatives industry is the way the IAG recommendation is implemented. The IAG has determined that standardization can be achieved by establishing a common data dictionary

based on ISO 20022 and allowing individual standards bodies to continue to use pre-existing syntaxes. A data dictionary spells out what each element in the standard represents. One solution is to have two entries for every field: one representing FIX elements and one representing ISO.

FIX Protocol Ltd is working with Swift, FpML and other organizations to develop a roadmap that would define how standards organizations could work together and avoid duplication of efforts. The roadmap is due to be completed in December.

The FIA/FOA Initiative

When FIA commented on the original IAG proposal in 2004, it recommended that the IAG consult with other standards-setting bodies and associations with the idea of extending current standards rather than creating new solutions or government-mandated standards. FIA emphasized that any standard adopted in Europe that includes listed derivatives should be globally recognized.

FIA spearheaded a similar movement in the U.S. that began in 2000 in which the U.S. exchanges selected FIXML for post-trade processing. Today five U.S.

derivatives clearing organizations are using FIXML: CME Group, Options Clearing Corporation, New York Mercantile Exchange, ICE Clear U.S., and The Clearing Corporation. Over 100 million FIXML messages are distributed on a daily basis.

In order to determine the most appropriate standard for listed derivatives on a global basis, FIA first surveyed exchanges in December 2005 to determine what standards were being used and what standards would be implemented in the next one to three years. Twenty-nine organizations responded from the U.S., U.K., Japan, Australia, Germany, China and India. The majority of interfaces were proprietary, however, respondents said that 75% of their proprietary interfaces would be replaced by a standard protocol in the next two years. FIX was the preferred standard for order routing; Swift dominated in settlement instructions

and banking. FIXML was the most frequently mentioned for planned implementation in the post-trade area.

FIA held meetings in January 2006 with firms, exchanges, and back office service providers in Europe to discuss the best solution for the listed derivatives industry as well as an appropriate response to the recommendation by the IAG. It was generally agreed that any standard for the listed derivatives industry should be global in scope, should provide a front-to-back end solution, and should be voluntary rather than mandatory. Global brokers emphasized that they operate across multiple regions and would find limited benefit to a Europe-only standard for post-trade processing.

Recognizing that a standard would be driven largely by the exchanges and clearing organizations, representatives from Eurex, Liffe, FpML, LCH.Clearnet, OMX,

and CME began in August 2006 to discuss possible standards. Although the Giovannini initiative provides a concrete reason to evaluate standardization of interfaces, the group determined that this was an opportunity to improve efficiencies for central counterparties and their customers across a broader set of post-trade processes. The group agreed to draft a project charter that would define the scope, benefit, objectives, and assumptions of the effort. The charter was completed in May 2007.

One of the deliverables of the charter was a business process analysis of the full spectrum of post-trade and pre-settlement functions. It does not include trade execution and banking and settlement. Once the business process analysis was complete, the working group detailed the specific interactions required by each business process in a workflow document. The workflow document was finalized in September 2007.

The working group has drafted a roadmap for the remainder of the project. The roadmap recommends using FIX as the basis for the standard for listed derivatives and taking advantage of the significant body of work completed by the U.S. listed derivatives exchanges on FIXML.

The working group will begin compiling a data dictionary, defining messages, and conducting a gap analysis in December. The post-trade data dictionary is scheduled to be completed in March 2008, message definitions and the gap analysis submitted to FIX in June, and a completed interface specification in September. The working group also plans to complete an implementation timeline and cost analysis by June. Best practices guidelines are due in October and implementation is scheduled to begin in January 2009. In addition, the listed derivatives industry intends to comply with the Giovannini goal to eliminate Barrier One. The roadmap calls for the working group to meet with FIX and Swift to encourage cooperation. That meeting is tentatively scheduled for December of this year. ■

Mary Ann Burns is executive vice president, industry relations, of the Futures Industry Association, and editor-in-chief of *Futures Industry*.

FIA/FOA Post-Trade Roadmap

December 2007

- Work with FIX Protocol Limited and Swift to establish relationship and encourage cooperation
- Continue work on specifications: data dictionary, message definition, gap analysis

March 2008

- Deliver post-trade data dictionary
- Submit Giovannini response

June 2008

- Deliver post-trade message definitions
- Deliver gap analysis and submit to FIX
- Form Post-Trade Implementation Committee
- Estimate member implementation costs and timeline

September 2008

- Deliver completed interface specification
- Begin educating user community

October 2008

- Deliver Best Practices Guidelines
- Assess Giovannini compliance

January 2009

- Execute Post-Trade Implementation Plan