

Wall Street

Computer Review

INSTITUTIONAL PLAYER

Equinet, a worldwide messaging system, may help drain the swamp known as international trade clearing.

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INSTITUTIONAL INVESTING

SETTLEMENT SYSTEM EASES FOREIGN MARKET FEARS

THE TYPICALLY CHAOTIC settlement process found at most foreign stock exchanges has been forcing many U.S. money managers to fight shy of international securities markets.

Evidence of this back-turning trend was exemplified in 1986 when several money managers bailed out of the Italian stock market after its archaic settlement system broke down after being overwhelmed by an influx of foreign investors, huge trading volume, and tons of paperwork.

"Europe is terrible, Italy is appalling," says Steve Lane, manager of information services at GT Capital Management, San Francisco, which invests \$5.5 billion around the globe. GT once waited six

months for trade settlement reports from Italy, while other money managers reportedly waited over a year.

Pandemonium struck Italy just as the falling U.S. dollar made it cheap-

er to own foreign stocks. "A money manager could have lost money because those markets took off," Lane points out. "I don't think we'd go back to Italy for that reason."

At that time U.S. portfolio managers who had paid for Italian stocks could not take delivery of their shares. Moreover, they missed dividend payments and could not sell their stock because they did not know what they owned or where it was.

Obviously, better communications technology would combat this business barrier, which is just what Financial Technologies (FITEL) hopes to accomplish with Equinet—a global electronic messaging system. London-based FITEL designed this communications network for major U.S. brokerage firms executing international equity trades for money managers, mutual fund managers, and other institutional investors.

Equinet was created to help investors match and confirm the details of a trade seconds after the information is keyed into an IBM PC. It is not, however, a clearing system.

FITEL introduced the international messaging network December 17,

Equinet—a global electronic messaging system—is designed to take the frustrations out of trading and communicating with foreign markets.

1986 and by February 1987 had reported installations in London, Madrid, Boston, Chicago, San Francisco and New York.

Major U.S. brokerage houses testing Equinet include Bear Stearns, Salomon Brothers, and Merrill Lynch. First National Bank of Chicago,

which is a global custodian, is testing the system in Chicago and New York.

These firms execute several thousand trades a day. Prior to Equinet they had to report the details of a trade via telex message, await confirmation via telex, and repeat the

same steps for each party.

"FITEL represents an alternative to the traditional ways of communicating by tying everybody into the same electronic passage of information based on one input," says Joe Anastasio, director of international operations at Salomon Brothers, New York.

Salomon controls the quality of information as soon as it keys in an order. A money manager—or assistant trader or operations clerk—can go into the interactive system during the day and see what trades are coming in from his particular account from any brokerage firm on the system.

By a simple keystroke of 'y' for yes or 'n' for no, money managers agree or disagree with the details of a trade. "Then the onus is with the broker to come back and say why it is a no," explains Anastasio. "The problem that exists today is that 'yes's' between the client and the broker don't necessarily get communicated properly to the banks involved and wind up being no's at the end of the chain."

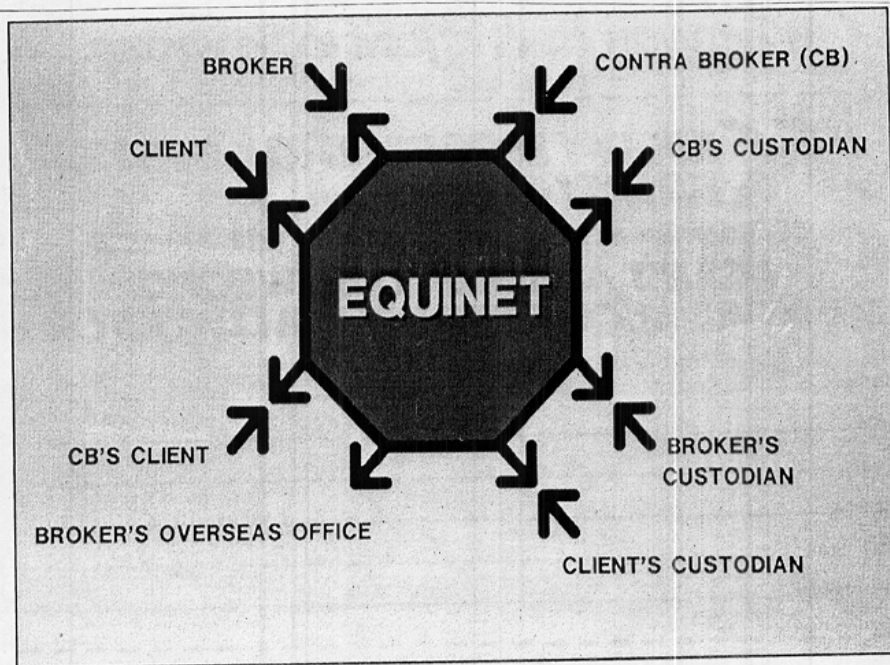
Equinet monitors transactions from the initial agreement to do a trade through to its settlement. It also updates the records as terms of a deal change.

Then, it automatically shoots details of an international trade to all participants and interested parties. There can be as many six or eight parties to a foreign trade, including a money manager and its custodian bank, a broker, contra-broker, its client, and a foreign custodian bank.

Built-in Smarts

Because intelligence is built into the software, Equinet processes the number of days it takes to settle trades in each foreign country. Salient features include:

- An automated screen for affirmation or confirmation of international trades.
- A standard format for entering and transmitting details of a trade with hard-copy records. Details of a trade can be entered, confirmed, transmitted, telexed and stored through settlement.
- Powerful database management software makes it possible for users to generate reports in a variety of formats. By sorting the historical database, users can produce reports by



unconfirmed transactions, transactions with overdue settlements, by country, by security, client, contra-broker and over any time period.

By mid-February Salomon Brothers had confirmed several thousand trades through the network. Though this is only a small segment of Salomon's total foreign business, it puts the broker in the driver's seat.

Salomon mostly trades international equities now, says Anastasio, adding that Equinet will someday be capable of confirming foreign bond trades, foreign exchange and securities lending as well. All Salomon's domestic offices are linked to Equinet's network; London is currently being hooked up and Tokyo is next.

One of Salomon's high volume clients, Wells Fargo Investment Advisors, San Francisco, is parallel testing Equinet as an advisor to the Wells Fargo Bank's \$400 million international equity index fund. The fund invests in a basket of securities representing the world's stock markets.

Though Wells Fargo already affirmed trades between its own in-house trading system and Salomon, FITEL went a step further by creating an interface between Wells Fargo's trading system, Salomon Brothers and Equinet, explains Susan Tomanek, vice president of Wells Fargo Bank.

DTC Global Twin

The purpose behind Equinet is to provide internationally what Depository Trust Company's (DTC) Institutional Delivery (ID) system achieves domestically. DTC's ID system provides a link whereby U.S. banks, brokers and clients trading domestic stocks can confirm trades and transmit settlement instructions electronically. Only Equinet upgrades its functionality and expands the concept internationally, its developers claim.

Messages are sent between all trading parties via General Electronic Financial Information Services (GEISCO). The telecommunications network provides sales, marketing and technical support to FITEL. Other than GEISCO, FITEL has no other business affiliates, emphasizes Michael de Mello, executive vice president.

FITEL's independence is important because the master database con-

tains a record of all trades made by U.S. brokerage houses on behalf of institutional investors. There are 10 levels of security built into the system. All participants are linked by telecommunications networks to FITEL's Tandem NonStop II computers in London. The central computer keeps a historical record of all transaction data entered by users.

There is no upfront subscription fee. Equinet is priced at \$25 to \$30 per trade depending on the geographic profile of the trade (European or Far East), as well as the number of parties that have to receive telexes. The largest fee is paid by the broker and typically the money manager pays zero, or perhaps \$10 to \$12 to send a telex to banks not on the network.

For a money manager, the primary advantage is the ability "to use the automatic delivery of instructions to their brokers and custodians about the details of a trade," says Graciela Chichilnisky, chief executive officer and director of FITEL Ltd., headquartered in London.

As much as 40 percent of international equity transactions fail to settle, according to Chichilnisky. The term 'fail' means that a transaction has not settled by a specific date as planned, explains Chichilnisky.

Trade Status Reports

By accessing FITEL's database, investors continuously monitor the status of foreign trades, whether they have settled, partially settled or failed. The cost-effectiveness of Equinet is paramount in the area of tracking trade status reports, explains Chichilnisky, who blames the 40 percent fail rate on a lack of communication. "Typically these fails take place because somebody did not get the message on time with instructions about the trade," she says.

The high fail rate includes even the largest brokerage houses like Salomon and Goldman Sachs, which operate the most efficient trading desks, says Jim Rogers, private money manager and finance professor at Columbia University. "Errors can happen anywhere along the chain," Rogers points out.

Can a money manager lose money? "Absolutely," he says. "especially if he tries to resolve an international trade a week or two months later, when traders have forgotten who did

what to whom, and when (foreign) currencies are moving all over the block. It's a nightmare."

After a fail occurs there's the additional expense of correcting it. Each party is sending multiple telexes and paying the operations staff overtime to troubleshoot the errors, adds Chilnisky.

The largest savings of the Equinet system is not in telecommunications, but the cost of brokers having to borrow shares when trades fail, she contends. Take the case of a trade failing in Tokyo because the client's American bank was too slow in transferring the money. Since the broker guarantees delivery—otherwise U.S. money mangers would not take the risk—he must borrow the Japanese stocks to deliver to the client until the original transaction is ironed out.

Future Success

The question of Equinet's success hinges on how many brokerage houses join the network, say users.

"We're concerned about the domestic brokers joining the system. That's who we do most of the trading with," says Lisa Togut, who operates Equinet at Bear Stearns. To be valuable, Equinet needs to have a majority of U.S. brokers with whom international money managers do business, says GT Capital's Steve Lane.

"If Equinet manages to capture 70 percent of the brokers you deal with, then you can gear up and start using it," says Lane.

FITEL is talking with the London Stock Exchange about future linkages with its clearance systems. Salomon Brothers' Anastasio—a prime user—is on the board of the International Securities Clearing Corp., the New York association establishing joint clearing agreements between U.S. and international exchanges.

Meanwhile, competition for Equinet's audience is heating up from vendors, mainly Reuters Holdings PLC. On February 9, 1987, Reuters acquired Securities Clearing Interna-

tional Corp. (SICC), a Toronto company. Its service called Instant Link is a real-time global communications system which enables all parties to a securities transfer—institutional investors, institutions and settlement agents—to simultaneously monitor securities instructions from the time an order is placed until settlement.

Reuters plans to adapt Instant Link to support clearing of all international trades over Instinet—the computer-based market access system used by institutions trading U.S. equities. Reuters plans to offer a complete package of services for international equities, that is to integrate real-time financial news and quotes with automatic execution via Instinet, and trade processing via Instant Link.

But Reuters programming experts may have to reconfigure the system if it is going to catch the fancy of Equinet users who have already made a substantial investment of time and money. ■ **Ivy Schmerken**