

The cost of failure

Failed securities trades cost the industry dearly. But at last the problem of communication is being tackled. Garry Booth reports on the work being done by two bureaux to ease the flow of information between brokers and custodians as well as the efforts made by the DTC to internationalise its own institutional delivery system



"The explosion in global securities trading should have happened three years ago," says Bob Hayim, associate director of Financial Telecommunications. "It didn't because of the problems banks encountered in settling trades." Few operations managers need to be reminded of how different settlement periods in different countries with different regulations and diverse communication standards can make the processing of transactions both costly and prone to failure.

Even the most straightforward trade can cost a disproportionate amount in processing, often without success. Today, operations managers running a back office operation in London can think themselves lucky if each back office worker settles eight trades daily, internationally. That number might be as high as a dozen for domestic business. It is reckoned that the average cost of processing a single trade for a UK broker is around £70 at least.

The problem is one of communication of information - information which is easily available, timely and in a format which can be understood by broker, bank and investor. Now two "third party vendors" - I P Sharp and FITEL - are providing network facilities which bring these participants together. Standing between these two is SWIFT, which has recently admitted the securities business to its network, not to mention the Depository Trust Company (DTC), which is soon to extend its International Delivery service to international trades executed outside the US.

Information is finally beginning to flow. FITEL made it possible in January this year, when its Equinet network went live. The service links trading brokers with their

clients and custodian banks around the world with information on trade status via its Tandem NonStop computers in London.

FITEL was founded in 1985 and is privately held. It is capitalised at £13.5m, and has offices in New York and Tokyo as well as its HQ in London.

"One key to effective settlement is effective communication and in communicating trade information we want to eliminate manual intervention," says David Mann, vp and group manager operations at Merrill Lynch in New York, which subscribes to FITEL's Equinet.

By its own definition Equinet:

- provides an automated, screen based international affirmation/confirmation system;
- provides a standardised format for entering and transmitting details of an international trade, with hardcopy records;
- automatically sends messages to custodians, banks and interested parties to a transaction;
- monitors transactions from the initial agreement of a trade through to its settlement and continuously updates the records as a deal's status changes;
- maintains transaction records and provides brokers and their clients with prompt access to their records in any desired format.

Acting upon instructions from his client investor, the broker executes a trade and enters it on the Equinet screen. The trade details are then sent back to the investor's screen whereupon the trade is confirmed (or disagreed) instantly with the broker and the record updated in the system database. The banks of the two brokers

and investors are then advised via Equinet (or by telex if they are not on the system) and both investors and brokers obtain confirmation of message receipt. The banks then indicate settlement of the transaction and a record is stored in the central database.

The I P Sharp Instant Link works in a similar manner. Investment managers, brokers, sub-custodians and global custodians can transmit orders, report, affirm and settle transactions. A shared database is at the heart of Instant Link. It is, as Sharp puts it, a "one write system where each person's view of the data is determined by his or her role and relationship to other participants." Instant Link has been on-line since 1985 having been pioneered by the Canadian Imperial Bank of Commerce. Other users include Banque Indosuez, Royal Bank of Canada, National Australia Bank and the Royal Bank of Scotland.

"It's a good concept," says Colin Gage, senior manager for stock developments at the Royal Bank of Scotland, "especially when you need to pass on instructions to reciprocal partners." (Like the majority of global custodians, Royal Bank is soon to unveil its proprietary network and will also integrate its own with the bureau service subscribed to: agents on Instantlink and clients on the inhouse network.)

Clearly, the benefits to be gained from use of the bureau services will depend on the number of users each signs up. Both FITELE and I P Sharp claim a similar number of users - about 25 - and it will be interesting to see which comes out on top as the securities industry begins to wake up to the advantages offered by each. As Merrill's Mann points out: "It is a question of critical mass and whoever reaches it first will inevitably dominate in the longterm."

Fidelity Securities of Boston has been using Equinet on a pilot basis since the middle of the summer. "We were pleasantly surprised at how much data there is in there," says senior vice president, George J Sullivan, whose outfit manages some £75bn.

Likewise, Charlie Fisher a director at Shearson Lehman Brothers in New York says that his clients in the US like it, it can be slow but it replaces the 'phone and the telex. "We're ready to sign a contract but since Black Monday we've been kind of busy..."

More help is at hand in the US for the likes of Charlie Fisher. The Depository Trust Company, New York's securities clearing house for domestic stock, is planning to go international next year. In a memo sent to its members this summer, the DTC "considered" the expansion of its institutional delivery (ID) system to allow trades executed outside the US and

Canada to be reported into ID "to make a more efficient settlement possible".

COD-DK problems, which the DTC calls "don't knows", are said to run at between 40% and 70% for international trades and one broker/dealer reports that financing costs for related fails amount to multi-millions annually. This means that clearance and settlement costs for foreign institutional trades can reach several hundred dollars per trade, the memo reads.

Thus the ID system will accept trade confirmations from broker-dealers, distribute confirmations to institutional investors and transmit affirmations to those concerned - including foreign sub-custodians. Such a comprehensive plan does not however leave FITELE and I P Sharp in the cold (in theory) since the DTC is prepared to link international ID with these service bureaux to allow them to customise ID-related information "in a way that DTC cannot".

DTC director Ira Rubenstein says that the expanded ID service should commence on a pilot basis during the first half of 1988 using the London market (and perhaps one other) as guinea pigs.

That only leaves SWIFT - or SWIFT Service Partners to be more accurate. Where does it fit in? SSP has been involved in discussions with both FITELE and I P Sharp but it is not yet clear towards what end. SWIFT has the network, the bureaux have the software, as Mann points out, and mutual customers can be interconnected. SWIFT cannot reach the investor, and that no doubt pleases all parties.

And pleasing all parties will be the major problem faced by the bureaux, the DTC and SWIFT. ■

How the DTC international ID will work

An investment manager buys a DTC ineligible foreign security on behalf of a US pension fund, placing this order with a US broker-dealer or its affiliate abroad. This pension fund uses a master custodian bank. The master custodian in turn appoints a foreign sub-custodian to settle the trade. On trade date the ID broker inputs trade data to DTC. On trade date plus one (T+1), ID confirmations will be produced and made available to the ID institution, agent bank, broker and others designated as interested parties or their designated service bureaux and service organisations. The ID institution, after reviewing the ID confirm, should be able to confirm to DTC on T+1 or T+2. The following day an ID DTC-Ineligible Trade report (a compared report) will be produced and made available to all five parties. The ID DTC-Ineligible Trade report can then be used as the basis for settlement outside DTC between the delivering foreign sub-custodian and the receiving foreign sub custodian.

