THE INVESTMENT ASSOCIATION

ETD Trade Matching Best Practice

1. Executive summary

1.1 The nature of exchanged traded derivatives is such that trades will be given up immediately for clearing. A key challenge for investment managers is that typically they lose sight of a trade's progress post-execution until they receive a statement from the clearing broker on T+1, when it will be more difficult to fix any errors in the allocation or fee calculations.

1.2 The purpose of this paper is to promote the leverage of electronic platforms to (a) establish a single golden source of the relevant counterparty and fee data and; (b) provide real-time trade matching and visibility of the progress towards clearing.

1.3 Section 2 considers the current state processing for many firms, with each party maintaining their own trade, counterparty and fee data; and communicating bilaterally with the others.

1.4 Section 3 discusses challenges with this model, which is fragmented and high touch, and usually means that errors are not detected until T+1 when they interfere with the margining process.

1.5 Section 4 describes a more integrated approach that some firms have started to adopt, which allows greater automation and reduces errors. More importantly, those errors that do still occur become visible much earlier the process and can be fixed before they interfere with down-stream processes.

1.6 Section 5 recommends that firms engage with their counterparties with a view to migrating to this more integrated/automated approach.

2. Current state

2.1 The current post-execution process for most firms when trading exchange-traded derivatives includes providing allocation details separately to the executing and clearing brokers, who then engage regarding the give-up of the original trade for clearing in its post-allocated shapes. A single block trade might be allocated to individual clients/funds with different clearing brokers, with each of whom the firm will need to reconcile the respective cleared position.

2.2 The next the firm will often see after delivering the allocation data is on T+1, when they receive position statements from the clearing brokers. Figure 1 below aims to illustrate the broad relationships and high-level information flows.

2.3 In this model, each party maintains their own schedule of the fees and commissions that will be payable/receivable. These are then all collected by the clearing broker by way of the subsequent margin calls on the client/fund, with those relating to the execution being passed to the executing broker as necessary.

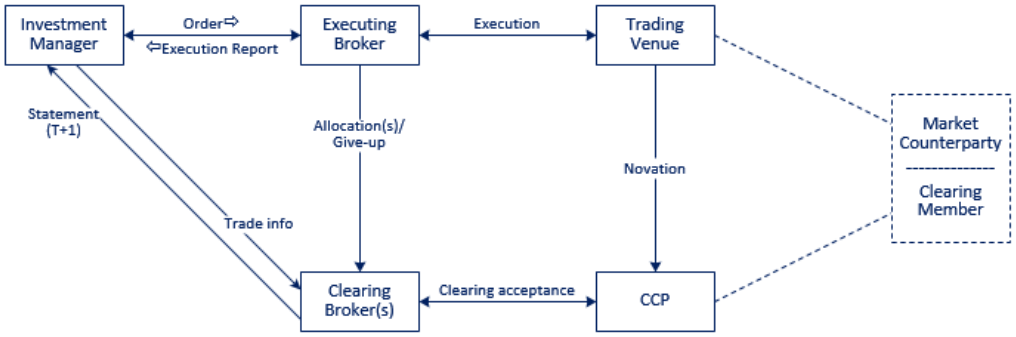

Figure 1

3. Challenges with the current state

3.1 As noted above, it is usually not until T+1 that the investment manager will receive client position statements from the clearing brokers. It is therefore not until then that the firm will have confirmation that the block trade has been allocated correctly between the clients/funds and their respective clearing brokers.

3.2 The format and delivery of such statements may differ across clearing brokers, which makes their ingestion by the firm more complex; while repairing errors that may already have occurred in the allocation of the cleared trade among the clearing brokers concerned can be labour-intensive.

3.3 A second, and sometimes bigger, issue concerns fees and commissions. Each party maintaining its own fee schedules independently leaves considerable risk that the individual data might not be fully aligned, and may therefore result in the amounts payable and receivable being accrued incorrectly.

3.4 Consequently, the maintenance and reconciliation process is high touch. Moreover, breaks that need to be repaired are not usually identified until T+1 and frequently impact the margining process.

4. Recommended future state

4.1 Some firms have started to adopt a more integrated approach, with a single golden source of counterparty and fee data being maintained by those involved, from which all parties' trade data can be enriched consistently. This enables greater STP and reduces considerably the reconciliation effort and need to repair potentially costly errors down-stream.

4.2 Figure 2 below aims to illustrate the broad relationships and high-level information flows under the recommended arrangement.

4.3 In this model, the three key actors - investment manager (for the client/fund), executing broker and clearing broker - submit their data once to counterparty management solution (depicted above as the FIA's "Docs" platform), with permissioning as necessary for the others to access it. This provides a single golden source reference for counterparty and fee data.

4.4 All three are also connected to a common post-trade confirmation and matching platform, which is also able to pull the relevant information (eg. on fees and charges) from the same golden source:

- The investment manager and executing broker submit their initial trade and allocation data to the platform for matching.

- Once a trade is matched, the platform delivers the data for each allocation to the relevant clearing broker, who confirms its acceptance for clearing to the CCP.
- Most importantly, the clearing broker maintains the status of the trade throughout the clearing process on the matching platform, which is then visible to the other parties in near real time.

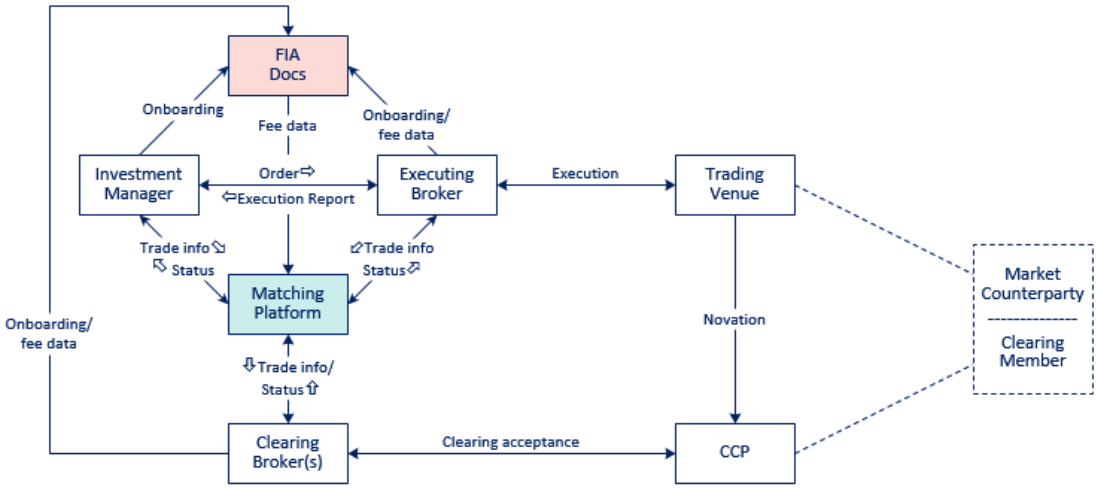

Figure 2

4.5 A more detailed illustration of the communication flows is provided in Annex 1.

5. Best practice recommendation

5.1 Those who have been able to migrate to this model so far have indicated that their processing of the trades concerned is considerably more streamlined and results in far fewer reconciliation breaks.

5.2 Perhaps most importantly, the investment manager is able to identify any issues, eg. in the allocation of a block trade or the fees agreed for the client/fund, in near real time. This allows them to be addressed on trade date, before they cause errors in margin calls that then need to be unwound, potentially back to the CCP.

5.3 It is therefore recommended that firms should engage with their executing brokers and the clearing brokers appointed by or for the client, as well as relevant vendors, with a view to adopting the model described in section 4.

ANNEX 1 - Future state communication flows