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by email to CESR website

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From – Tony Freeman, Omgeo tony.freeman@omgeo.com

Ref - CESR/10-610, Standardisation and exchange trading of OTC derivatives

Dear Sirs

Please find below our response to question 7 of CESR consultation CESR/10-610. Omgeo wishes only to respond to question 7 and will not be responding to any of the other issues raised in the consultation.

Omgeo provides middle-office solutions to more than 500 firms in Europe – connecting the buy-side, broker/dealer and global custodian community. For more information on Omgeo, our products and our customers please go to www.omgeo.com where full details are provided.

Omgeo is a provider of trade confirmation systems to a large segment of the market. Omgeo is focussed strongly on the interaction between dealers and customers in the equity and fixed-income market. We do not provide trade confirmation services specifically for the OTC derivatives market - but we do believe there are many core principles in this segment that apply to all asset classes.

- Omgeo agrees that the issue of trade confirmation should be looked at as a discrete subject. Whilst the process can be closely linked to trading and clearing/settlement it deserves to be looked at from a policy perspective in its own right.
- Trade confirmation is the linkage between front-office (trading) and back-office (clearing/settlement) and the efficacy of all post-trade processing is heavily affected by the speed and accuracy of the trade-confirmation process: inaccurate trade processing can affect valuations, liquidity, risk profiles and many other critical post-trade functions
- Trade confirmation efficiency is becoming increasingly prominent because of the current debate in Europe about settlement cycles. A possible move to a T+2 settlement cycle will require a market-wide adoption of efficient trade confirmation processes.
- A large, but statistically undefined, proportion of the market has already adopted automated trade confirmation processes in all asset-classes. This has occurred gradually over the last 15 years as a result of efficiency initiatives, industry projects and regulatory pressure. An example of the latter is the successful project led by the New York Fed and ISDA, the so-called “Fed letter” process, to address post-trade issues in the OTC derivatives market. The threat of regulation very quickly led to a huge increase in the usage of trade confirmation systems. We believe that universal adoption would benefit the whole market but anecdotal evidence from our clients is that a minority client segment continues to process trades in manual and non-standardised way. This minority segment generates the majority of excess cost, risk and opaqueness in the market. A typical profile (in equity markets) is that 80% of clients are automated but the

remaining 20% of clients generate 80% of costs. (This subject was covered extensively in the Omgeo/Oxera report – “Building efficiencies in post-trade processing: the benefits of same-day affirmation” published in June 2008 and available at www.omgeo.com.)

- Our view is that the markets benefit from simple rules that can be universally applied: exemptions and segments create loopholes. An example of this is the differentiation between direct and indirect market participants referenced in paragraph 25 (CPSS-IOSCO recommendations). Omgeo does not agree with the delineation between direct (broker/dealer) and indirect (investment manager) participants. The assumption that buy-side firms are not able to achieve the same operational standards as banks/brokers is not supported by the evidence. Omgeo publishes data on Same Day Affirmation (“SDA”) which can be derived from our confirmation systems. In simple terms SDA is the completion of all trade confirmation processing on T (trade-date). Omgeo clients are currently achieving a global average SDA rate of 93%. Approximately 70% of all trades, in fact, are completed within 3 hours. These high SDA rates are dependant on both parties to the trade automating a near real-time process. We believe this proves that buy-side firms are just as capable of high operational standards as banks and broker/dealers. We suggest that a T+0 target is applicable to all market participants. This is especially relevant in cash markets if a T+2 settlement cycles is implemented.

- The Omgeo data above is derived from equity and fixed-income processing. OTC derivatives are clearly more complex instruments where the post-trade market infrastructure is also at an earlier stage of development. An SDA rate of 93% may not be possible in OTC derivatives but we believe a regulatory focus on SDA would benefit all asset-classes. SDA drives post-trade automation and standardisation which is good for market resilience and can aid post-trade transparency by acting as a feed to trade repositories.

- Whilst trade confirmation is a generic process across all asset classes it is also worth noting that cash products and derivatives should be treated somewhat differently: for a derivative (both exchange-traded and OTC) the initial confirmation of what is dealt is only the start of the process: “confirmation” should encompass ongoing daily collateral management processing and reconciliation for the lifetime of the contract. The economic terms of a derivative position over the life of the contract and the confirmation process therefore needs to be an iterative ongoing function.

Costs

The vast majority of costs in implementing universal trade confirmation have already been absorbed by the industry. A large group of vendors provide trade confirmation solutions which cover all asset classes globally. In general terms almost all “sell-side” firms (banks and broker/dealers) have systems in place to cover their interaction with both the street-side (interbank/interdealer) segment and buy-side clients. The gaps that do exist are predominantly within the buy-side segment - investment managers and hedge-funds. A substantial - but unquantified - group of buy-side firms continue to use manual processes. In fact many smaller buy-side firms do not actively participate in the trade confirmation process - they will receive a trade confirmation from their counterparty but not actively make a positive affirmation or rejection of the trade. A core part of the process is “allocation” - the breakdown of a block-trade into allocations which will later become a settlement. Allocation can be automated via trade confirmation systems - but many clients persist in using fax, email and telephone instructions. Plenty of evidence exists to suggest that manual processing increases both cost and risk - impacting the individual firms involved but also the wider market at a systemic level. Market convention is that clients are not penalised financially for manual post-trade processing. The result is a higher cost for all market participants. In effect the efficient automated clients are subsidising the costs of the less efficient firms. This results in a higher overall cost for the market - to the detriment of underlying clients. Regulatory incentive that results in universal usage of automated post-trade processing would solve this coordination issue and result in a more level playing field.

The implementation and usage costs of trade confirmation systems vary widely. Costs are driven by several factors:

- levels of integration range from usage of a web based GUI to a high-volume direct interface meaning that a small buy-side firm using a very simple integration model could implement a system for a few thousand

Euro's whilst an investment bank implementing a global highly integrated model could incur a cost above €1m

- transaction costs differ hugely due to volume differences in each asset class: typically high-volume segments such as equities would be well below €1 per trade whilst a specialist application for an idiosyncratic derivative could be a lot higher.

Our overall view is that the majority of market participants would endorse the widest possible implementation of automated trade confirmation. The industry issue that remains unresolved is how to incentivise the minority of participants who remain outliers. A regulatory incentive or mandate is a credible method of addressing this issue and also possibly the only way to achieve universal adoption.

Please do not hesitate to contact us for more information. We look forward to being of assistance to you.

Yours faithfully

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