Nanyang Business School, NTU

BC3402: Financial Service Processes and Analytics

Tutorial 4: IT in the Trade Cycle (II)

Question 1:

Read the following excerpt from a whitepaper produced by Sungard and answer the questions below.

> The financial world has a dream. It is a dream of seamless transactions. Where trades are settled within 24 hours and exceptions are dealt with in real-time and broker/dealers, global custodians and investment managers all communicate across borders. It is a dream of reduced costs, reduced counterparty risk, and reduced operational risk. A dream of straight-through processing (STP).
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> Despite the dream, the reality is today's cross-border trade processing is characterized by repetitive manual procedures, incompatible data and minimal information standardization. The result: High error rates, settlement risks and significant operational costs. What's more, different messaging protocols and information standards confound straight through processing initiatives, particularly across borders. But EAI vendors such as SunGard Business Integration are working with others in the financial services industry to improve the situation.
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> If the STP carrot is reduced costs, the stick is initiative known as T+1 (next day settlement). Post-trade settlement is currently seen as the weakest link in the securities transaction chain, particularly in the cross-border environment. Currently T+3, or settlement within three days is the norm.
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> So it might seem daunting that these awkward and sometimes inaccurate procedures will now have to be done within the same day rather than the three-day period currently reserved for settling trades. The commercial advantage is clear – the longer you spend clearing, the longer time you don't have the money. But compliance will involve a lot of work from financial institutions and software vendors alike. For if post-trade settlement is currently seen as the weakest link in the securities transaction chain, the weakness can be traced to the challenge of integrating systems, applications, transactional and business processes.
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> This integration challenge can be intimidating. For example, TowerGroup, the research company, indicates that in the first quarter of 2001 "in only 13.5% of trades were the details agreed upon between investment managers and broker/dealers on the same day the trade was executed. Same-day affirmation rates should be around 90% to meet T+1 requirements. This represents a 667% improvement over current rates."
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> In short, TowerGroup believes T+1 will introduce new operational risk and transaction costs into U.S. capital markets unless drastic measures are taken to improve the process by which block trades are allocated and confirmed.

a) What are some factors that will make the "dream of T+1" attainable? Are there other factors that make the goal of achieving T+1 unattainable? After considering these factors, do you think the goal of T+1 is realistic?

b) Consider Singapore and the U.S. financial market. Which financial market do you think is likely to attain STP first? What are some characteristics that work for and against each market in achieving STP?

Question 2:

a) What are the benefits of implementing STP (Straight-Through-Processing) for the settlement of equity trades in a financial institution?
b) What are the technological and non-technological challenges financial institutions face in implementing STP? How do you think these challenges can be overcome?

Question 3:

The collapse of US brokerage MF Global in October 2011 highlighted the popularity and the dangers of a derivative product known as a contract for difference (CFD). MF Global's now-stricken Singapore arm was a big provider of this potentially lucrative product. In the wake of the scandal, which left many investors scrambling to get their money back, the Singapore Exchange (SGX) is looking at the possibility of clearing CFDs as part of its business. This would add another string to the SGX's bow, but it would also serve to safeguard the interests of investors who now buy and sell CFDs as part its business.

– Source: The Straits Times

a) Why do you think the current CFD market in Singapore does not have a central clearing system?

b) With the lifecycle of the trade in mind, explain how will SGX safeguard the interest of investors if it manages the clearing of CFDs?

c) Assuming SGX takes up the role of clearing CFDs. Describe some of the technological and non-technological challenges SGX will face in designing the clearing mechanism.

CFD
cost of stock is $10 now
You can buy and sell and contract.
If u bet on buying -> now the stocks $10.20 --> You earn 0.20
If u bet on selling -> Now the stocks $10.20 --> You have to pau 0.20 imeediately