

Wiley Finance Series



Financial Markets Operations Management

KEITH DICKINSON

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Financial Markets Operations Management

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To Nicole

Preface

I have been involved in Operations for over forty years as a practitioner, an executive education trainer and university lecturer. In my practitioner days, there was very little by way of reference books that addressed Operations; in addition, the Internet had yet to enter our collective consciousness. As a consequence, it was difficult for those working in Operations to find any literature that dealt with their topic.

Today, we can research any topic we choose, including Operations, by accessing the Internet, clicking through websites managed by exchanges, depositories, custodians, regulators and various trade associations. In spite of this, and with one or two notable exceptions, there is a dearth of books that enable Operations professionals to navigate the settlement and post-settlement environment for securities and derivatives.

This book, *Financial Markets Operations Management*, fills that information gap.

The intended audience is fourfold. Firstly, the text may be used in a teaching context as a course reader for staff already working in an operational environment. Secondly, as a reference guide for students taking a financially focused first degree or Masters course. Thirdly, for staff working in non-operational areas that are interested in what happens “after the trade has been executed”. Finally, for those who are about to enter the financial world or who simply have a passing interest in the subject, this book is for those readers.

The text covers the trade lifecycle for securities and derivatives products from trade capture, pre-settlement and settlement through to the custody of assets and asset servicing. It is divided into four parts, as follows:

- Part One: An understanding of operations in the context of financial instruments, data management and the different types of organisation.
- Part Two: The post-trade processing of financial instruments; trade capture, clearing and settlement.
- Part Three: The post-settlement environment of safekeeping, asset servicing and asset optimisation.
- Part Four: A consideration of two key controls – accounting for securities and asset reconciliation.

Chapters are broken down as follows:

- Chapter 1 looks at the organisational structure of a typical investment company and at the Operations Department in particular. We consider the internal and external relationships that Operations manage.
- Chapter 2 defines the main financial instruments, explains the operational features and shows the transaction calculations including accrued interest for bonds.
- Chapter 3 considers the importance of data and its management.
- Chapter 4 explains how the various intermediaries and market infrastructures enable lenders and borrowers to operate.
- Chapter 5 starts the post-trade processing phase by looking at the clearing systems and distinguishing between clearing houses and central counterparties.
- Chapter 6 continues looking at the infrastructure and in particular the securities depositories.
- Chapter 7 follows the initial post-trade processes of clearing and the pre-settlement forecasting of cash and securities.
- Chapter 8 describes the different types of settlement including “delivery versus payment”, the reasons why trades fail to settle and what actions can be taken to manage the fails.
- Chapter 9 changes focus from securities to derivatives with a look at how exchange-traded and over-the-counter derivative products are cleared.
- Chapter 10 looks at the safekeeping of securities including the use of nominee names and the relationships between the beneficial owner and the securities issuer, together with the intermediaries such as custodians and securities depositories.
- Chapter 11 introduces the reader to what is considered to be the most risky area within Operations – corporate actions. This chapter looks at the complexities, processing requirements and information flows of this topic.
- Chapter 12 describes the different forms of securities financing and includes user motivations and the lifecycle. Securities financing is not risk-free; this chapter addresses the risks and the ways in which these risks are mitigated.
- Chapter 13 looks at the impact of securities transactions on the Profit & Loss Statement and Balance Sheet together with the transaction lifecycle from an accounting perspective.
- Chapter 14 explains the importance of efficient and timely asset reconciliation and how it might be used as a predictive tool to prevent problems from occurring.

To cover the entire operational spectrum would require a text containing many hundreds, if not thousands, of pages. In order to overcome this problem I have concentrated on what I consider to be the main operational processes for securities and derivatives. Whilst I do not cover every type of equity, bond and derivative, there is sufficient detail to enable the reader to understand what happens in the engine room of the financial markets, i.e. after the trade is executed.

Therefore, I have not included regulation other than by occasional reference. We are subjected to regulation for a variety of reasons – for example, to maintain confidence in the financial

system – and it is both complex and technical. Furthermore, in a global context, there are different and sometimes conflicting regulations from country to country.

I have also excluded commodities for two reasons. Firstly because in the physical world, types of commodities behave in different ways – think of the processes that enable you to pump petrol/gas into your car or electricity to light up your home. By contrast, commodities derivatives are cleared in similar ways to financial derivatives. Secondly, there is already an excellent book written by a friend and colleague, Neil Schofield.¹

Finally, this book does not cover funds administration. This relates to activities that support the running of a collective investment scheme (for example, a traditional mutual fund, hedge fund, pension fund, unit trust or similar variation).

In any event, there is more than enough material within the regulatory, commodities and funds administration world for an additional three books.

Students and instructors can find additional resources at www.wiley.com.

¹Schofield, N. C. (2007) *Commodity Derivatives: Markets and Applications*. Published by Wiley Finance (ISBN 978-0-470-01910-8).

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Contents

Preface	xix
Acknowledgements	xxiii

PART ONE

CHAPTER 1	
Introduction to Operations	3
1.1 Introduction	3
1.2 Organisational Structure of an Investment Company	5
1.2.1 Front Office	5
1.2.2 Middle Office	6
1.2.3 Back Office/Operations	9
1.3 Operations' Relationships	10
1.3.1 Clients – External	10
1.3.2 Clients – Internal	11
1.3.3 Counterparties	11
1.3.4 Suppliers	12
1.3.5 The Authorities	12
1.4 Other Business Functions	13
1.5 Summary	15
CHAPTER 2	
Financial Instruments	17
2.1 Introduction	17
2.2 Why Do We Issue Financial Instruments?	18
2.3 Money Market Instruments	19
2.3.1 Euro-Currency Deposits	19
2.3.2 Certificates of Deposit	23
2.3.3 Commercial Paper	23
2.3.4 Treasury Bills	25
2.4 Debt Instruments	26
2.4.1 A Bond Defined	26
2.4.2 Bond Issuance	27

2.4.3	Types and Features of Bonds	27
2.4.4	Other Key Characteristics of Bonds	28
2.4.5	Types of Bond	29
2.4.6	Form of Bonds and Interest Payment	30
2.4.7	Maturity and Redemption Provisions	31
2.4.8	Calculations	32
2.4.9	Accrued Interest	33
2.4.10	First Short Coupon	37
2.4.11	First Long Coupon	38
2.5	Equity Instruments	38
2.5.1	Equity Defined	38
2.5.2	Classes of Equity	41
2.5.3	Equity Issuance	43
2.5.4	Pricing and Calculations	44
2.5.5	Examples of Local Taxes	45
2.5.6	Disclosure	45
2.5.7	Summary of Cash Market Instruments	46
2.6	Derivative Instruments	47
2.6.1	Introduction	47
2.6.2	Definitions	48
2.6.3	Derivative Usage	49
2.7	Exchange-Traded Derivatives	52
2.7.1	Introduction	52
2.7.2	The Role of the Derivatives Exchanges	53
2.7.3	Major Derivatives Exchanges	53
2.7.4	Open Interest and Trading Volumes	56
2.7.5	Futures	58
2.7.6	Options	64
2.7.7	Summary of Exchange-Traded Derivatives	71
2.8	OTC Derivatives	71
2.8.1	Introduction	71
2.8.2	Forwards	72
2.8.3	Swaps	76
2.8.4	Summary of OTC Derivatives	80
2.9	Summary	81
2.9.1	Financial Products in General	81
2.9.2	Cash Markets	81
2.9.3	Derivatives Markets	81

CHAPTER 3

Data Management

83

3.1	Introduction	83
3.2	Importance of Reference Data and Standardisation	84
3.2.1	Introduction	84
3.2.2	Basic Securities Transactions	84
3.3	Types of Reference Data	86

3.3.1	Required Reference Data	86
3.3.2	Data Requirements – Securities	87
3.3.3	Data Requirements – Counterparties and Customers	91
3.3.4	Data Requirements – Settlement Information	92
3.3.5	Sources of Reference Data	93
3.4	Data Management	94
3.4.1	What is Data Management?	94
3.4.2	Approaches to Data Management	94
3.4.3	Data Processing	95
3.5	Legal Entity Identification	95
3.5.1	Background to Legal Entity Identification	95
3.5.2	The “Legal Entity”	96
3.5.3	The Global Legal Entity Identifier System (GLEIS)	96
3.5.4	LEI Structure	97
3.6	Summary	99

CHAPTER 4

Market Participation

101

4.1	Introduction	101
4.2	Market Players	102
4.2.1	Retail Clients	102
4.2.2	Institutional Clients	103
4.2.3	Banks	115
4.2.4	Sell-Side Intermediaries	126
4.2.5	Market Regulators and Market Associations	129
4.3	Market Structure	131
4.3.1	Introduction	131
4.3.2	Regulated Markets	131
4.3.3	Alternative Trading Venues	135
4.3.4	Over-the-Counter Market	136
4.4	Summary	137

PART TWO

CHAPTER 5

Clearing Houses and CCPs

141

5.1	Introduction	141
5.2	Overview of Clearing and Settlement	142
5.3	The Clearing House Model	143
5.4	The Central Counterparty Model	145
5.4.1	Risk Management	147
5.5	Features of CCPs and Clearing Houses	148
5.5.1	The Committee for Payment and Settlement Systems’ Statistics	148
5.6	Summary	150

CHAPTER 6**Securities Depositories (CSDs and ICSDs)****151**

6.1	Introduction	151
6.2	Historical Context	151
6.3	Definitions	154
6.3.1	Domestic (Local/National) CSDs	154
6.3.2	International CSDs	154
6.4	Central Securities Depositories	154
6.4.1	Features of CSDs and ICSDs	154
6.4.2	Functions of CSDs	155
6.4.3	The Changing World of CSDs	158
6.4.4	CSD Links and Interoperability	161
6.5	International Central Securities Depositories	163
6.5.1	Background	163
6.5.2	Features of the ICSDs	164
6.5.3	Clearstream Banking Luxembourg (CBL)	164
6.5.4	Euroclear Bank (EB)	165
6.6	Linkages – Exchanges, Clearing Systems and CSDs	167
6.6.1	United States of America	168
6.6.2	Europe	169
6.6.3	Rest of the World	170
6.7	CSD Associations	171
6.7.1	Introduction	171
6.7.2	Americas' Central Securities Depositories Association (ACSDA)	171
6.7.3	Asia-Pacific CSD Group (ACG)	171
6.7.4	Association of Eurasian Central Securities Depositories (AECSD)	172
6.7.5	European Central Securities Depositories Association (ECSDA)	172
6.7.6	Africa and Middle East Depositories Association (AMEDA)	172
6.8	Summary	173

CHAPTER 7**Securities Clearing****175**

7.1	Introduction	175
7.2	Generic Clearing Cycle	176
7.2.1	Trade Capture	176
7.2.2	Trade Enrichment and Validation	177
7.2.3	Trade Reporting	177
7.2.4	Confirmation and Affirmation	178
7.2.5	Clearing Instructions	178
7.2.6	Forecasting – Cash	179
7.2.7	Forecasting – Securities	180
7.3	Trade Capture	182
7.3.1	Dealer's Blotter	182
7.3.2	Trade Input	182
7.3.3	Trade Output	183
7.4	Trade Enrichment and Validation	184

7.5	Regulatory Reporting	186
7.5.1	Background	186
7.5.2	Transaction Reporting	186
7.5.3	Transaction-Reporting Mechanism	187
7.5.4	Trade Repositories	188
7.6	Confirmation and Affirmation	188
7.6.1	Confirmations	189
7.6.2	Affirmation	190
7.7	Clearing Instructions	194
7.7.1	Types of Instruction	194
7.7.2	Instruction Validation	196
7.7.3	Instruction Matching	196
7.8	Forecasting – Cash	199
7.8.1	Introduction	199
7.8.2	Timing Issues	199
7.8.3	Cash Forecasting Methodology	200
7.8.4	Funding Uncertainties	201
7.8.5	Benefits of Predictive Forecasting	202
7.9	Forecasting – Securities	203
7.9.1	Introduction	203
7.9.2	Securities that are Available for Delivery	204
7.9.3	Securities that are Not Available for Delivery	204
7.10	Summary	205

CHAPTER 8

Settlement and Fails Management	207
8.1 Introduction	207
8.2 The Different Types of Settlement	208
8.2.1 Gross Settlement	209
8.2.2 Net Settlement	210
8.3 Delivery versus Payment	211
8.3.1 Definition of DVP	212
8.3.2 DVP Models	213
8.3.3 Settlement Instructions for DVP	214
8.4 Free of Payment Settlement	215
8.4.1 Settlement Instructions for Free of Payment	215
8.4.2 Where Settlement Takes Place	216
8.4.3 Settlement Conventions	216
8.5 Settlement Fails	217
8.5.1 Overview of Settlement Failure	217
8.5.2 Why Transactions Fail to Settle	218
8.6 The Move to Shorter Settlement Cycles	228
8.6.1 Background	228
8.6.2 Project Status	228
8.7 Summary	229

CHAPTER 9**Derivatives Clearing and Settlement****231**

9.1	Introduction	231
9.2	Regulatory Changes	232
9.2.1	Background	232
9.2.2	Financial Stability Board (FSB)	232
9.2.3	Reform Requirements	233
9.3	Exchange-Traded Derivatives Contracts	234
9.3.1	Introduction	234
9.3.2	Derivatives Exchange and Clearing System	235
9.3.3	Give-Up Agreements	235
9.3.4	Clearing Process	236
9.3.5	Margin Calculations	237
9.3.6	Initial Margin – Eligible Assets	239
9.4	Cleared OTC Derivatives Contracts	240
9.4.1	Types of OTC Derivative that are Cleared Centrally	241
9.4.2	Trading Platforms	242
9.4.3	Trade Repositories	244
9.4.4	Central Counterparties	244
9.5	Non-Cleared OTC Derivatives Contracts	245
9.5.1	Documentation	245
9.5.2	Non-Cleared OTCD Processing	248
9.5.3	Trade Capture	248
9.5.4	Confirmation	249
9.5.5	Settlement	250
9.5.6	Collateral	251
9.5.7	Event Monitoring	254
9.5.8	Reconciliation	254
9.6	Summary	255

PART THREE**CHAPTER 10****Custody and the Custodians****259**

10.1	Introduction	259
10.2	Custody	260
10.2.1	What is Custody?	260
10.2.2	Forms of Securities	260
10.2.3	Ownership Transfer – Bearer Securities	261
10.2.4	Ownership Transfer – Registered Securities	262
10.3	Holding Securities	263
10.3.1	Register in the Custodian's Name	263
10.3.2	Nominee Account	264
10.3.3	CSD Nominee	266
10.3.4	Safekeeping Methods – Summary	267

10.4	The Custodians	267
10.4.1	Custody in a Local Market	267
10.4.2	Custody in Global Markets	271
10.4.3	Custody in the EuroMarkets	277
10.5	Target2Securities (T2S)	279
10.5.1	Introduction	279
10.5.2	Eurosystem	280
10.5.3	How T2S Will Work	281
10.5.4	Migration Plan	282
10.5.5	Further Information	282
10.6	Summary	283

CHAPTER 11

Corporate Actions

285

11.1	Introduction	285
11.2	Types of Corporate Action Event	286
11.2.1	Voluntary or Mandatory Events	286
11.2.2	Predictable or Announced Events	287
11.3	Participation in Corporate Actions	287
11.3.1	Fund Manager	287
11.3.2	Global Custodian	287
11.3.3	Local/Sub-Custodian	288
11.3.4	Local Central Securities Depository	288
11.3.5	International Central Securities Depository	288
11.3.6	Data Vendors	288
11.3.7	Receiving/Paying Agent	288
11.4	Entitlements, Key Dates and Claims	289
11.4.1	Entitlement	289
11.4.2	Record Date	290
11.4.3	Ex-Dividend Date	290
11.4.4	Payment Date	292
11.4.5	Claims	292
11.4.6	Key Dates for Bonds	294
11.5	Corporate Action Event Processing	294
11.5.1	Introduction	294
11.5.2	Cash Dividend	296
11.5.3	Optional Stock Dividend	298
11.5.4	Fixed-Income Bond Coupon	300
11.5.5	Floating-Rate Note (FRN) Coupon and Rate Reset	302
11.5.6	Bond Redemption	305
11.5.7	Bond Conversion	307
11.5.8	Capitalisation (Bonus) Issue	309
11.5.9	Rights Issue	310
11.5.10	Other Examples of Event Types	314