

Section 2: Executive Summary

Part 1 – Volumes, Customers and Staffing

Volumes

With intra-company deals excluded, survey participants report an average of 689 new OTC derivative trades per week (averaged over the twelve months to end-March 2001). Volumes varied considerably by size: large firms report an average weekly volume of 1,975 trades, medium firms 286 trades, and small firms 57 trades. The top five firms by deal volume account for 40% of the total average weekly volume for all respondents.

Most respondents expect volumes for most products to increase by up to 25% in the next year, though many expect no increase in FRAs and strong growth in credit derivatives.

Customers and Master Agreements

Respondents report, on average, over 2,000 (external) customers with whom they transact OTC derivatives business. They report overall that they consider around 40% of their customers to be professional counterparties and 60% end-users. At any given moment, they indicate a Master Agreement has either been signed (85%) or else is under negotiation.

Staffing

Given firms' sensitivities in providing staffing data for last year's survey, this year's asked for ratios rather than outright numbers. Respondents were asked to make adjustments to exclude staff requirements for processing internal deals. It may, however, be that not all response data is fully comparable. Nevertheless, respondents suggest that interest rate derivatives have, on average, just over 2 front office staff (dealers/marketers etc) to each member of operations/support staff compared with 4 front office staff per operations/support staff member for currency options.

Furthermore, the data indicates that for each operations/support staff member, respondents can average nearly 9 OTC interest rate derivative trades compared to over 38 currency option deals.

Large firms are able to process a greater volume of OTC interest rate derivatives per operations/support staff member than medium or small firms (large firms averaged 12.9 compared with 9.1 for medium firms and 4.1 for small).

The staff turnover figure of 21% is slightly higher than for last year. Most firms (86%) give up to 6 days training per year.

Part 2 – Organisational Structure

This part is intended to give a point-in-time ‘snapshot’ of whether firms centralise their operations departments or keep them decentralised (which generally means located geographically close to their front office). It should be remembered that, at some firms, centralisation may vary by product line and that, within a given firm, the various operations functions (eg, payments and confirmations) may be handled in different regions.

Part 3 – Operations Processing

Trade tickets (FRAs and vanilla swaps only)

All trade details are available for processing the same day and nearly nine-tenths of trades reach the back office by 5pm on trade date. Medium and small firms do slightly better than the large firms.

Medium-sized firms are the least likely to track error rates (48%, against 82% for small and 94% for large) and they have the highest estimated error rates (14%, against 8% for small and 11% for large).

The three types of data that firms most commonly have to add in the back office are: i) dates; ii) counterparty data; and iii) standard settlement instructions (SSI) details.

Confirmation production

Firms will typically set a frame time within which they ‘normally’ dispatch confirmations (though this can vary by product line). Within two days of trade date, firms report that they have sent out confirms for: all FRAs; 95% of vanilla swaps; and 73% of non-vanilla swaps.

The percentage of confirmations that do not meet a firm’s normal dispatch time grows with the size of the firm and with the sophistication of the product. For example, large firms report that 15.7% of their non-vanilla IR and currency swaps do not meet their target dispatch time, and small firms that only 0.6% of their FRAs do not. The reasons most often cited for the delays are:

- the requirement to process new or non-standard products;
- documentation awaiting approval from traders or marketers;
- (for large firms) awaiting approval from the legal and the compliance area.

On a volume-weighted basis (for the three product categories), around 40% of trades are confirmed by both parties sending out a confirmation that is reviewed and acknowledged by the other party, but not signed or returned.

Commercial auto-matching systems are used mainly for FRAs (34% of trades) and to some extent for vanilla IR and currency swaps (only 9% of trades). For FRAs, medium and large firms use auto-matching for similar volumes (37% for medium, 34% for large). Small firms only auto-match 9% (perhaps because the volume they trade does not warrant investment in automation).

Outstanding confirmations

The average number of confirmations that are outstanding (that is, they have been sent but are not finalised) increases with the sophistication of the product. For FRAs, the average number outstanding is 7.6 days worth of trade volumes; for non-vanilla swaps, it is 12.1 days. As regards the resolving of discrepancies, the more standardised the product, the quicker the process.

All large firms have a formal escalation procedure in place to deal with outstanding confirmations. Slightly fewer small firms do (89%, compared with 85% of medium firms), but they appear to activate their escalation procedures earlier.

Errors attributable to the confirmations area are less commonly tracked than those attributable to the front office. The error rate for FRAs in small firms is double that in medium or large firms. This may reflect higher levels of FRA automation among medium and large firms.

Payments and settlement

The 61 respondent firms make an average 7,633 settlements per month, with large variations across firm size (large firms report an average of 20,520 settlements per month compared with 3,488 for medium firms and 1,219 for small firms). Across all respondents around two-thirds send and receive payment advices (67% sent; 61% received), with large firms sending out considerably more than medium or small firms.

For small firms, phone confirmation tends to constitute an alternative to a payment advice. For other firms, phone confirmation is more often an additional check.

Prioritisation of nostro breaks is based primarily on the dollar amount involved, followed by age as a risk factor. While new nostro breaks per day run at an average of 4.0% of average daily settlements, small firms fare best (with 1.4% compared with 4.9% for medium and 5.4% for large).

Part 4 – Automation

This part focuses mainly on FRAs and vanilla and non-vanilla swaps. Other products are dealt with in more summary fashion.

Current automation

As expected, the more sophisticated the product, the less automation there is. Functions with a high degree of automation are:

- the transfer of trade data from the front office to the operations system;
- the transfer of data from the operations systems to the general ledger;
- the addition of data to the front office trade record, notably SSI and trade details.

Plans for further automation

For vanilla IR and currency swaps, the focus is on the transfer of trade data from the operations system to the general ledger. Nearly four-fifths of the respondents say that, for this aspect of processing, 90% or more of their deal volume is handled in an automated fashion. And of those with no automation, four-fifths plan to introduce at least some in the coming year.

Matching of details on confirmations is the function where the highest number of firms (52) have no automation. But nearly half of these 52 plan to introduce this in the coming year.

Part 5 – Trends in Market Practice

The majority of firms suggest they have a flexible approach to the signing of counterparty confirmations. Large firms are the least likely to agree to sign counterparty confirmations.

Part 5 also elicits firms' understanding of novations and assignments and the allocation of responsibilities for producing and signing of the relevant documentation. (Following the 2000 Survey, ISDA formed a group to work on a new universal template for these agreements.)

It also touches on:

- (criteria for) use of rate reset notices;
- policies with regards to swaption straddles;
- the use of termination agreements;
- actual/planned use of internet portals, and their benefits and applications.