Towards an electronic confirmation for Commodity Swaps/ Swaptions

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Background - Why a Commodity Swaps Project ?

Automating Commodity Swap transactions
Project Background - *Market*

- Growing swap volumes → paper confirmations imply increased **costs** and **risks** of human error.
- mandatory **reporting** of derivative transactions. → paper confirmations cannot be used to generate reporting flow.

→ **Standardised Electronic confirmation:** solution for both problems:

  – Can be automatically generated
  – Reduce ambiguity
  – Can be automatically transformed into syntax for reporting
  – Easier to match, possibly automatically
  – *Can* be sent via SWIFT

Automating Commodity Swap transactions
Project Background - *SWIFT*

- Approached by **Arcelor Mittal**, with proposal to create a message
- New context regarding Standards Development: towards more flexible approach
- Ambitious project to **renew** central confirmation Matching service **Accord:**
  - build best possible solution; **highly flexible**
  - Complement with **solution for non-connected parties**

Automating Commodity Swap transactions
SWIFT's *current coverage* of Commodities

- **Standards**: set of messages (cat 6) for trade confirmation and later steps in the value chain.
  = mostly **interbank, for precious metals.** usage grows; is currently concentrated on precious metals / base metals
- **Confirmation Matching**: Accord matches MT 600 and MT 601 (pilot).

➔ Banks are increasing investments in automated processing of Commodity trades

Our working group: structure, ambitions and current results

Designing a Commodity Swap Confirmation
Group Dynamics

- **Informal** working group of **mostly corporates + a few banks**; delegates have **hands-on experience w/** the products
- SWIFT-moderated **open discussion**, all opinions and questions allowed. Minutes circulated.
- Unanimity where possible, voting where necessary
- French in origin, European expansion.
- 90 minutes Webex meeting every +/- 6 weeks
- Started spring 2013 with fundamental discussions re structure of the trades; all delegates learning from each other.
- Newcomers welcome !
- **Current Members**: Arcelor-Mittal, BNP Paribas, Coca-Cola Hellenic, Lafarge, Morgan Stanley, Nexans, PSA, Schneider electric, SocGen

Designing a Commodity Swap Confirmation
Scope

- Confirmation of a **swap trade**
- Confirmation of a **swap reset**
- Confirmation of an **Option** trade (Swaption)
- Initially limited to **Metals**
  - Future **extension** to commodities with similar structure (e.g. gas, oil)
  - NO extension into electricity
  - NO extension into structured deals

Designing a Commodity Swap Confirmation
Design principles - Objectives

- **Cost control** to maximise adoption
- **Maximise STP** for majority of trades
- Allow for **human processing**
- **Flexibility**: allow for changes

Designing a Commodity Swap Confirmation
Design principles - Consequences

- **Cost control**
- **Maximise STP** for majority
- **human processing**
- **Flexibility**

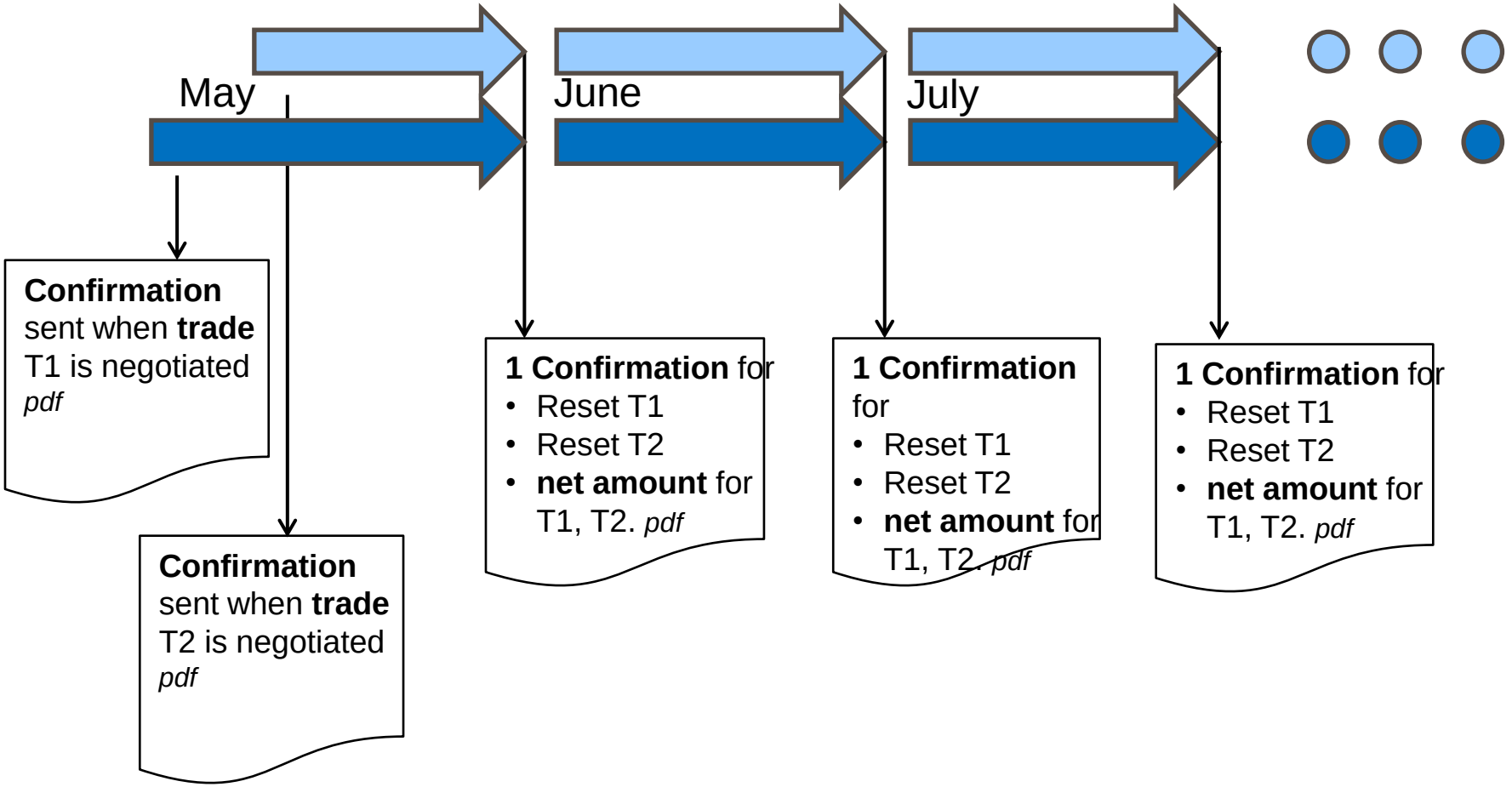
- Separate confirmation for TRADE & RESET; as similar as possible
- Trade and Reset messages similar to Interest Rate Swap
- *All* fields pre-exist, with similar meaning
- Working group meets via Webex
- Avoid “optional fields” where possible
- Strict separation between different logical steps (trade, reset, net settlement)
- XML schema for IT staff/vendors generating messages + very traditional FIN ISO 7775 syntax for messages (iso FpML)
- Sub-message (SMT in MT 698 envelope) instead of MT → message can be changed/enriched by the group; bilateral variants possible. No link to annual standards release.

➔!! Attention: *no* central validation; adherence ensured through peer pressure

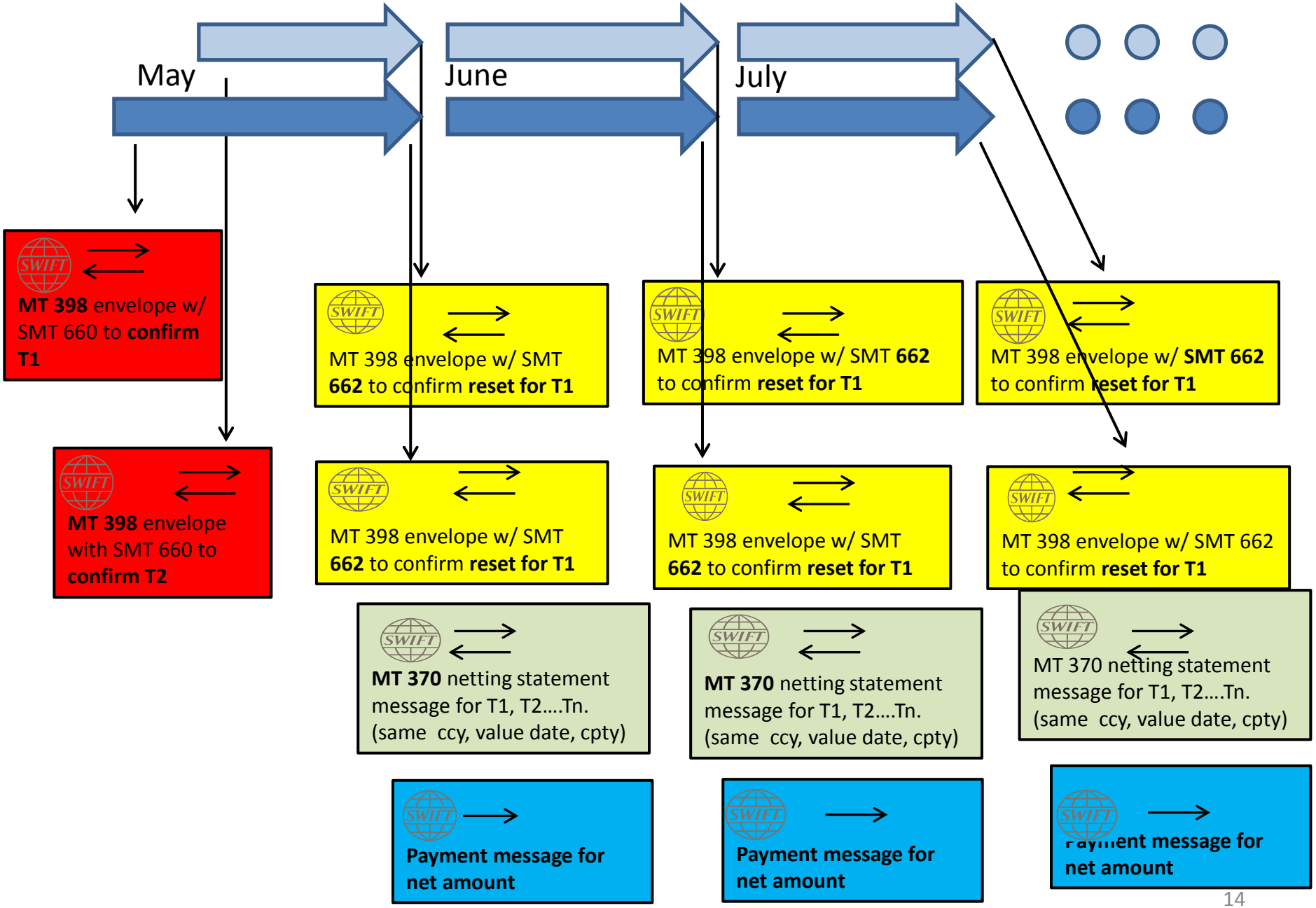
Current (paper-based) confirmations
Trades and resets mixed up

- **Medium:** Long form confirmations via **fax** or **e-mail**; manual signature. No real exchange, but "s*ign and send-back*"
- **Value chain**: single multi-month trade is booked (depending on player and/or software):
  - Either as single swap with x resets, or
  - As x swaps if the deal was for x months
  - (this choice stays possible, on bilateral agreement)
- **Resets/Netting**: 2 steps often merged in single message. For all swaps with coinciding reset dates & same counterparty: a single long form confirmation is sent, combining **all resets** + the resulting **net amount** (nearly all trades are in USD).

Current (paper-based) confirmations
Trades and resets mixed up: Graphical representation



Working Group Proposal: 1 msg/trade + 1 for each reset; netting separate



Progress report + next steps/timing

Commodity swaps working group
Progress report

- All fundamental issues discussed/agreed, for fixed/floating swaps.
- Fully worked out example available, for complex case
- Additional “option” sequence to be created by mid May
- XML schema + human readable “SWIFT UHB” pages can be produced automatically after each change

➔ Consolidation moment very near. Time to:

  – **Enlarge** the group with additional corporates/countries
  – Time to involve more **banks**
  – Time to inform software vendors

- Q3-Q4 2014: corporates to pilot with banks, exchanging SMT 660/662, reporting feedback to all members
- 2017: SWIFT to add matching, on new platform + Affirmation model for non-automated parties.

Questions?

Thank you !