
Emily: Hello and welcome to a DerivSource podcast. I'm Emily Fraser Voigt, Acting Editor of DerivSource.com.

Securities settlement failures are rife among global financial institutions, thanks to a variety of factors including regional nuances and data discrepancies, according to a recent Aite Group report entitled "[Settlement Market Practices: A Legacy of Failures.](#)"

In today's podcast, I'm speaking with Virginie O'Shea, research director for Aite Group, about the steps firms are taking to address this challenge, and the roles market structure reform and technology will play in improving efficiency in the global settlements process.

Welcome to the podcast Virginie.

Virginie: **Thanks it's great to be here.**

Emily: In your report, you mention that settlement failures are a fact of life for global financial institutions. Why is this?

Virginie: I think there are a whole host of reasons why failures happen. In my report I look at some of the underlying causes, but if you look at it from an asset class perspective some of the OTC asset classes have particularly high settlement failure rates, largely because there are a lot of manual processes involved in receiving of data which can cause data quality problems later down the line.

So a lot of those settlement pieces of information are incorrectly typed, and you can see at a firm level some of the failure rates as high as around 20% for certain asset classes, which is quite extreme. Obviously, when you look at the more traditional equity-based instruments they tend to be a lot less, round about 1% or less than 1%. If you look at the industry level, it's hard to see because everything is aggregated, but if you look at the CSE level the failures aren't that high, but it certainly is a big problem if you look at it from a certain perspective.

Emily: What are some of the challenges for financial institutions when it comes to settlements, and how can they mitigate them?

Virginie: I think a lot of the problems come in when firms are trying to understand what's causing their settlement failures. They certainly, unless they have a very automated process in place, which many do not, it's very hard to see where bottlenecks are going to occur if you're having a high settlement failure rate on a particular day. So you can have to throw a lot of manual effort at such a process to reconcile the data to be able to deal with any exceptions

and issues that may be caused by externalities or internalities, depending on the underlying root cause of the failure.

So it certainly is quite tough for firms on a day-to-day basis in figuring out where their failures are, what's causing those failures, and how best to deal with them.

Emily: Let's talk a little bit about Market structure reforms, such as MiFID II, EMIR and Dodd-Frank. These regulations are shaking up the way the financial institutions operate. What impact do you think will they have on the settlement space and will they solve any of these challenges?

Virginie: Well certainly we've already seen some of the changes that have happened as a result of the OTC derivatives reforms across the globe, particularly in the US and in Europe. We've seen a lot more electronification of process, a lot more standardisation of process.

Obviously in the interim it threw up a lot of data quality issues, and through those there's a light for the industry. So certainly I guess that's improved matters because people are now able to deal with the visibility of their data and understand where some of the problems are coming in with regards to instruments and counterparty identification and the like.

If I look at MiFID on the other hand, that's coming in next year and it's huge in terms of its potential impact, because when you look at best execution it's relating it to the whole lifecycle of the trade, so it's not just about trans-office costs, it's also about clearing and settlement costs.

So when you think about assessing the best execution for your trade, you have to think about whether settlement failure rates are very high or not. Particularly, there's going to be a lot of reporting, there's going to be a lot more standardisation of data also, so that I imagine will throw light on some of the data quality issues again.

If I look at another piece of regulation, the CSDR regulation / CST regulation in Europe, that's also bringing some settlement penalties and a regime to highlight some of the issues there at a European level.

So there are whole alphabet soup of different regulations that are going to compel firms to re-evaluate settlement failure rates and their settlement efficiency.

Emily: It's almost like improving settlements accuracy is a happy byproduct of these regulations that are coming in...

Virginie: Hopefully. Of course, unfortunately you can't stop a certain level of failure obviously. If you're short of stock on either side, or short to deliver, or failure to deliver... that's always going to happen, just by nature of the markets and different market practices, and cross-border is particularly high in that regard.

I think there's going to be some degree of focus on the data side of things and trying to improve the failures that you can improve, but I imagine you can't eradicate it entirely, unfortunately, due to different market practices at a national level.

But certainly, yes, regulation could be used as a help, certainly to get budgets for some of the operations teams that are really struggling with a lot of this stuff.

Emily: You mention budgets – and firms are obviously very focused on dealing with all these regulations - How big a priority is improving settlements accuracy for the firms you have spoken with?

Virginie: If you ask a settlements person it's obviously going to be a priority for them. Unfortunately, I think at the C-Level there's still not enough transparency of process or understanding of some of the long-term impacts of settlement fails. So it's not quite at the critical level it needs to be, but I certainly think with MiFID coming in that's going to make a big difference, and certainly with CSDR at the same time you could see firms getting fined or being penalised by the market and by regulators for lack of settlement efficiency. So I think it will certainly be increased in priority at that point.

Emily: What role will technology play as firms look to improve efficiency in back office operations?

Virginie: Technology solves a lot of things - it doesn't solve bad data - it can help you identify bad data, it can help you alleviate some of the burden when it comes to manual processes, but you really need to figure out what the underlying causes of problems are, and that really requires re-evaluation of the entire lifecycle of the trade. I think that's where firms need to take stock first before they implement technology.

When it comes to actual technology that you could implement, you could certainly have workflow tools to help with resolution of settlement fails, you could have tools that help you dashboard or understand where the fails are coming in, and if it's particular geography (because there's certainly a geographical dimension to this), and you can't change market practices obviously if you're dealing with more esoteric instruments in foreign currencies and things like that, but you can certainly be forewarned and forearmed about any of those issues that may arise.

Emily: Thank you very much Virginie for your time and for your insights. They're much appreciated.

Virginie: Thank you very much.

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