

# U.S. E-Settlement Update and Here's What's Next!

**PAT LORET DE MOLA** – Founder, President & CEO, Trade Settlement Inc.

The LSTA and its E-Settlement subcommittee galvanized the loan market in 1999 with their early initiatives to create unique loan identifiers and an electronic settlement process. Since then, the basic pillars that support these initiatives have been constructed, resulting in greater transparency and increased liquidity.

## **E-SETTLEMENT FIRMS ARE A LOAN MARKET REALITY**

E-settlement firms were established in 2000 and have gained significant traction in the past few years. Trade Settlement Inc. (“TSI”) experienced a 953% increase in number of credit facilities settled from 2004 – 2005 and similarly; TSI’s client base has exploded nearly ten-fold in the past twelve months alone. In tandem, the percentage growth in dollars settled on TSI’s e-settlement platform has increased 747% in those two years.

## **CUSIPs & OTHER MILESTONES**

CUSIPs (unique identifiers) were launched in early 2004 and have been adopted by virtually all the major Agent banks. In addition, the various LSTA committees have produced standardized transfer documents, including trade confirmations and purchase and sale agreements, as well as set standard settlement times for secondary trades: T + 7 for Par trades and T + 20 for Distressed trades. In conjunction with these standard settlement times, delayed compensation for overdue settlements was also introduced. These milestone achievements have helped to foster growing

confidence in the syndicated loan market and have encouraged substantial financial investment in the electronic settlement systems that service this huge and burgeoning asset class.

### **TRADE SETTLEMENT: THE OLD WAY vs. E-SETTLEMENT**

The old-fashioned way of completing a loan trade (which some firms still use) is a labor intensive multi-step process that is prone to errors and delays. These steps include: the manual retrieval and scanning/copying of lengthy Word or PDF transfer documents<sup>1</sup>; faxing or emailing the same to the parties that need them; and collecting physical signatures from sellers, buyers, administrative agents and borrowers. By taking advantage of several important loan market innovations, the modern e-settlement platform has automated many of these time consuming processes. A few of these innovations are highlighted below:

- Loan settlement documents are now created automatically allowing institutional accounts to sub-allocate online. The loan settlement documents then digitally pro-rate and multiply accordingly, providing instantaneous sub-allocated trade confirmations, assignment agreements and funding memorandums.
- Data and calculations, such as delay compensation and purchase price calculations, are incorporated into these documents through electronic means and feeds. This method dramatically reduces redundant data input and manual errors.
- Physical signatures can be replaced with electronic signatures on secure web-sites, eliminating the need for them to be faxed or scanned. This online process allows the signer to review basic trade terms then batch execute all or selected trade documents at once. In the U.S. the overwhelming percentage of loan industry participants have been empowered to execute electronic trade confirmations and assignment agreements using

---

<sup>1</sup> Transfer documents include: trade confirmations, credit agreement-specific assignment agreements, purchase and sale agreements, funding memos, affiliate letters and tax forms.

electronic signatures. There are ever fewer holdouts lagging behind and still preferring the old standbys of physical signatures, faxes and unencrypted emails. Their numbers appear to be diminishing rapidly.

- These executed documents are warehoused online for many years, allowing business managers to produce historic records on the fly and to meet the constantly increasing regulatory and internal compliance requirements.

### **E-SETTLEMENT: THERE'S MORE TO BE ACCOMPLISHED**

Notwithstanding these accomplishments, much remains to be done in order for this market to attain the level of operating and settlement efficiency required to further reduce settlement times, minimize operating and credit risk, and ensure compliance. Some of these tasks include:

- The establishment of greater overall document standardization to overcome the “old” institutional habit of customizing standard market transfer documents;
- The creation of common market nomenclatures and cataloguing loan-specific reference data such as credit facilities and institutional account names;
- Adoption of best market practices for Agent banks and their counterparties, to encourage more disciplined and timely primary and secondary loan trade settlements;
- Definition, publication and implementation of industry-wide standard data formats using open standard communication protocols<sup>2</sup> for real-time seamless transfer of data and documents between the various loan system providers in the syndicated loan life-cycle, and;

---

<sup>2</sup> Open standards protocols are best practice rules governing communication procedures between vendors. These protocols facilitate multivendor systems' interoperability despite differences in underlying architectures. For example, Internet Protocol (IP) is the common protocol for communication and routing. Protocols include relevant standard, syntax and technology. Some syntaxes are also considered standards such as ISO 15022/20022, (structured message and file formats), XML and ISO 6166 (ISIN).

- More change in old work habits. For example, although logging in to execute a signature is a simple, one minute process, in many cases today, signatories are physically signing offline, then requiring their closing assistants to log in to the web-site and execute (i.e., sign) on their behalf. This creates unnecessary inefficiencies and delays.

### **THE HOLY GRAIL: END TO END STRAIGHT THROUGH PROCESSING**

It is clear that as loan trading continues to skyrocket and becomes even more intense, the market cannot continue to evolve and grow effectively while standalone systems remain closed to interfacing with other external systems. Standalone, closed loan systems that store data in closed formats, lock in and expose customers to single software providers. These providers are free to raise prices, change their software, or change licensing terms to something less favorable, sacrificing efficiency and client needs for their own agenda.

With some systems connectivity already in place, and others coming, today there is greater promise than ever in reaching the Holy Grail: the possibility of end-to-end straight-through-processing (“STP”) for this still highly complex asset class. In the past, STP has traditionally been viewed as a purely operational issue, with the sole aim of ensuring the trade process is automated. But loan participants’ views are changing. In today’s climate, all financial institutions are focused on improving their bottom line productivity, differentiating themselves with higher-quality customer service and reducing operational risk. Achieving high levels of STP is critical to addressing all of these business aims.

### **WHAT’S NEXT? WILL IT COME?**

Industry-wide connectivity across legacy systems and common standards are major steps in the right direction in this journey. With the increased market adoption of automated trade

confirmations and assignment agreements, the next step could be centralized e-processing using a loan clearinghouse partially owned by the banks and users. Another step towards this goal is improving the loan CUSIP protocol. One such improvement was implemented last fall when the LSTA and Standard & Poor's introduced a new online CUSIP application process.

### **Automated Central Loan Clearinghouse**

Nearly six years ago when the LSTA disseminated its CUSIPs questionnaire, nearly 100% of the institutions surveyed stated that there were great benefits in establishing an automated central clearinghouse. This envisioned the incorporation of the funds transfer/clearing process, including a mechanism for establishing the assignee of the loan as a Lender under the credit agreement.

Four and a half years later several broker dealers and their e-settlement provider have tried to initiate linkages between e-settlement and e-clearing, simulating simplified bond-like clearing mechanisms where an external, non-interested party assumes the task of Lender recordation under the various credit agreements. In addition to creating the foundation for e-clearing, e-netting and enhancing operational efficiency, establishing loan trading anonymity was a major objective. These initiatives are still under consideration but they have been slow to catch on for various reasons (e.g., some loan legacy systems can not currently accommodate bond-like settlement such as settlement with accrued interest, increased credit risk concerns, administrative agents' desire to maintain the Lenders' records, etc).

The pace is quickening – let's all get ahead of the curve!