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SWIFT SECURITIES STRATEGY

FUTURE-PROOFING THE POST-
TRADE ECOSYSTEM

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IMPACT BRIEF

INTRODUCTION

SWIFT has embarked upon a securities strategy to develop a comprehensive, multi-asset class shared service suite, combining a transaction manager for payments with smarter securities services, aligned with addressing the various challenges that the members currently face today. This Impact Brief provides details behind the new strategy and presents two global custody banks' assessments of how the SWIFT strategy (as well as possible future developments) benefits their operations and client-servicing functions.

SWIFT is a member-owned cooperative through which the financial world conducts its business operations with speed, certainty, and confidence. More than 11,000 banking organizations, securities institutions, market infrastructures, and corporate customers in more than 200 countries rely on SWIFT every day to exchange millions of standardized financial messages. The capital markets community is an important one that SWIFT serves:

- More than 50% of total message traffic over SWIFT is related to the securities and foreign exchange business lines of clients.
- A large community of more than 6,000 securities users includes all major central securities depositories (CSDs), asset managers, brokers, and custodians.

With this new strategic cycle, SWIFT is reinventing itself, moving well beyond its original mandate of developing a robust financial messaging platform to creating a comprehensive, multi-asset class shared service suite, combining a transaction manager for payments with smarter securities services addressing the various challenges that its members currently face.

This Impact Brief highlights SWIFT's new securities strategy, evaluating its strengths and potential pitfalls, and presents views of current members who are committed to supporting SWIFT's journey toward the next securities platform.

SECURITIES STRATEGY

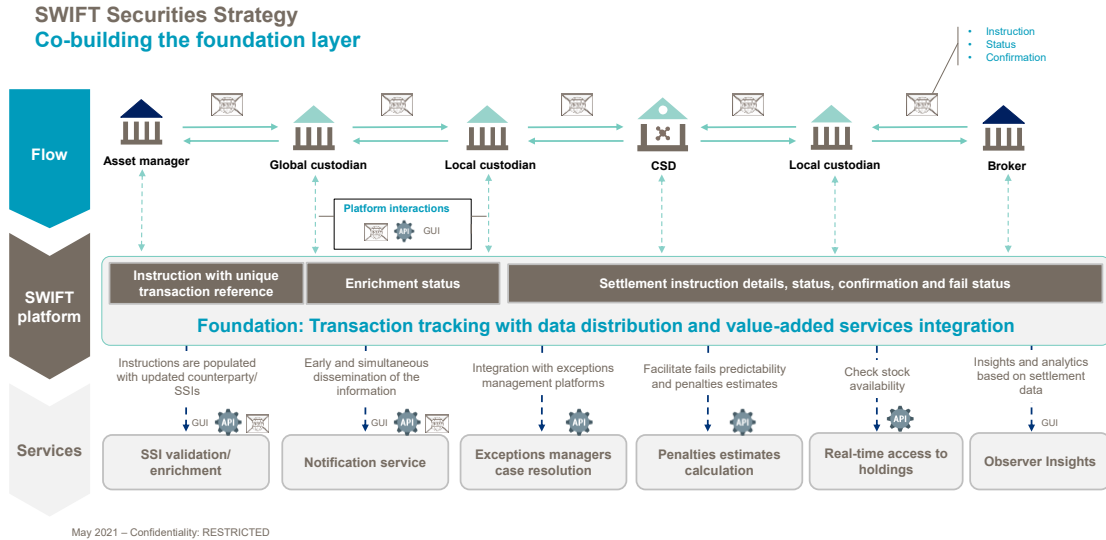
With this new securities strategy, SWIFT hopes to achieve three key objectives:

- Develop a frictionless, fast, transparent shared service suite for both securities and payments
- Implement an iterative development process, putting together concrete building blocks and not an “ivory tower” approach
- Focus on playing an important role in tokenized assets and distributed architecture in general, as there is a mutual effort SWIFT can take on in its shared cooperative role—whether for tokenized payments or securities instruments—so that the members and SWIFT can build the future together

These are the three building blocks toward developing a platform vision for SWIFT (Figure 1):

- **End-to-end (E2E) two-sided neutral transaction view:** This is the foundational layer of SWIFT’s strategic development. It allows users to track and provide visibility on the latest status in near real time of a settlement transaction to relevant parties in both legs of the settlement chain, and for a host of value-added services to be built upon it.
- **SSIs validation and ISIN screening:** Validate and enrich standard settlement instructions (SSI) information and screen instruments to reduce risk and settlement failure due to incorrect or incomplete SSI information and sanctioned instruments. The SSIs validation will leverage the securities foundation and is singled out here due to its importance as a cause of avoidable settlement fails.
- **Empower clients’ holdings forecast:** Provide notifications that allow firms to better forecast their client holdings.

FIGURE 1: BUILDING BLOCKS FOR SWIFT STRATEGY



E2E TWO-SIDED NEUTRAL TRANSACTION VIEW

This is the foundational layer of SWIFT’s securities strategy. It aims to leverage the Unique Transaction Identifier,¹ ISO standard 23897:2020, to a securities settlement transaction throughout both legs of the settlement chain to provide earlier visibility on transaction status. The message type (MT) messages for securities settlement are covered in the initial phase of the strategy and other business areas (such as securities financing flows and corporate actions), and syntaxes are covered later following a similar logic.

The potential benefits to industry participants include the following:

- Improving operational and risk controls through near real-time transaction tracking
- Reducing operational costs via fewer settlement fails, fines, and penalties, as well as mandatory buy-ins
- Fixing exceptions earlier due to advanced visibility of the status of instructions
- Providing clients with more accurate up-to-date settlement information

¹ This is also known as “UTI,” more commonly known as the USI (Universal Swap Identifier) in the United States, given that its implementation started in the derivatives space, post-2008.

- Tracking and acting on critical transactions in near real time

VALIDATION OF SSIS AND SCREENING OF ISINS

The key activities include the validation of SSIs and the notifications to users in case of incorrect data. The SSIs validation service may potentially evolve over time to also enrich securities settlement instructions with up-to-date verified SSIs and provides a guarantee to the integrity of SSI data during the instruction life cycle. For screening of International Securities Identification Numbers (ISINs), the service checks whether an ISIN stems from an issuer sanctioned by one of the main global regulatory authorities and alerts users so they can take remedial action, in particular, aborting an instruction message with a sanctioned ISIN before it is delivered to the next party in the chain.

The potential benefits to industry participants include the following:

- Obtain higher certainty on trade and settlement execution by detecting, correcting, or completing reference data
- Greatly reduce settlement failure and costs caused by incorrect counterparty SSIs
- Have greater certainty that SSIs have not been changed during the settlement cycle
- Have a one-stop-shop solution for ISIN (and other securities identifiers) to screen payments and securities transactions with flexible configuration
- For smaller users, mutualize cost and complexity of maintaining ISIN lists and screening engines

EMPOWERING CLIENTS' HOLDINGS FORECAST

The service will provide notifications (real-time transaction information such as confirmation, exceptions, matching etc.) that allow firms to better forecast their client holdings. This will also enable the service to integrate this information to highlight potential risks of shortage.

The potential benefits to industry participants include the following:

- Improving users' tools to provide underlying clients greater visibility on and control of short-term liquidity in securities and other traded instruments

- Reducing users' clients' use of expensive credit lines or last-minute buy-ins/repurchases of shares to cover fails
- Warning in case of potential shortage, one of the main reasons for settlement to fail

CUSTOMER TESTIMONIALS

This section presents views of two major global custodians, anonymized as A and B as per their request, on the suitability of the SWIFT strategy and possible future developments in their operations and client-servicing functions. Expectations expressed in these testimonials must not be read as SWIFT's commitment to deliver them. They only represent customers' aspirations and will be used as valuable input for future developments without any further commitment.

CUSTODY BANK A

Custody Bank A has been very supportive of SWIFT from the strategy's conceptualization phase in 2019. The SWIFT strategy complements Custody Bank A's strategy of providing transaction management service to its clients. According to Custody Bank A, SWIFT can leverage its more than 11,000 participants—specifically, the more than 6,000 using settlement and reconciliation messages—and use its data analytics, metrics, and transaction tracking and reporting capabilities to bring a transformational change in the current securities settlement process.

Views on SWIFT Strategy

Custody Bank A's views on its SWIFT strategy are highlighted below:

- **Pre-settlement validations:** Custody Bank A is very receptive to SWIFT's offering of SSI enrichment and validation services based on current industry sources of SSI. In its views, currently, many of the securities settlement fails occur due to incorrect SSI and other reasons such as lack of sufficient availability of securities in the account to meet the settlement obligations. SWIFT performing the SSI pre-validation on the settlement instructions ensures the completeness and accuracy of the settlement instructions. This results in a lower number of securities settlement fails and increases timely securities settlement.
- **E2E two-sided neutral transaction view:** Custody Bank A is very receptive to SWIFT's performing tracking of settlement instructions. The SWIFT-proposed service provides a unique reference identifier. This identifier remains the same across the settlement chain from initiation to completion of the settlement instruction, across both its delivery and receipt legs. This enables real-time transparency into the settlement process to every party authorized to view the

progress with a single identifier, in contrast with the multiple identifiers required in today's settlement chain.

Alignment With SWIFT Strategy

The SWIFT strategy aligns with Custody Bank A's internal strategy to increase the customer offerings and identify opportunities to mutualize the cost of servicing to clients:

- **Demand for real-time transparency:** Clients are requesting Custody Bank A to provide transparency in the securities settlement processing stages and real-time access to the data via APIs. This request from clients aligns with Custody Bank A's view of provisioning the data to its clients and with the SWIFT strategy of providing transactional data in real-time to help improve inventory management and customer reporting related to positions and holdings.
- **SSI validations:** The trade settlement process is currently dependent on the custody SSIs sent by investment managers. Custody Bank A has undertaken an initiative to integrate with Depository Trust and Clearing Corporation (DTCC) ALERT GC Direct for the maintenance and update of custody SSI data on behalf of the investment manager. The SWIFT strategy for SSI enrichment and validation, including integration with ALERT SSI data and securities tracking, complements the Custody Bank A initiative by ensuring accurate SSIs on all trade settlement instructions.
- **Mutualize the cost via utility model:** In response to clients' trading preferences for the new digital trading platforms, Custody Bank A has also launched several initiatives such as a digital tokenization initiative in the private equity market. Custody Bank A foresees cost mutualization opportunities for participants by building the solution once and having industry participants leverage the solution instead of every institution engaging in bespoke custom development to connect to new digital platforms. SWIFT can mutualize the cost of integrations with new marketplaces for service providers by providing seamless connectivity with new marketplaces and managing interoperability between current and new marketplaces.
- **Data standards:** Custody Bank A leverages its proprietary solution to transform the messages received from clients and counterparties in varied formats into a common message format. With the adoption of new message transformation capabilities within the SWIFT platform, Custody Bank A expects data exchange in a

standardized format and reducing the need to transform the data. The SWIFT proposition of transitioning from a message-based platform to a transaction-based service would provide more actionable and real-time insights for SWIFT users.

Implications of the SWIFT Strategy

Custody Bank A views the following challenges and opportunities in the SWIFT strategy during the rollout of the SWIFT strategy:

- **Need for strong community participation:** The success of the SWIFT strategy depends on strong community participation, at a cost point that everyone can afford and allocate budget and resources. A large multiyear program to roll out a transformation change needs sustainable momentum to achieve its objective and overcome the challenges from potentially competing priorities faced by member firms.
- **Buy-side participation:** The buy-side community members' engagement throughout the journey will be critical to update the offerings. SWIFT can also leverage its captive audience of 11,000 plus members to collect feedback and increase buy-side participation.
- **Opportunities for cost reduction:** Though Custody Bank A does not see a specific commercialization opportunity within the SWIFT strategy, it expects a reduction in its operations and technology cost and a platform to improve client interaction.
- **Opportunities for data analytics:** SWIFT can also further provide data analytics capabilities on real-time access to settlement and holdings—inventory-related transactional information. SWIFT can also leverage its access to collect information related to a settlement instruction to provide actionable insights via advanced data analytics, such as fails, for a specific reason across various counterparties, or if there is a common broker with an incorrect SSI impacting many counterparties.
- **New opportunity:** Custody Bank A foresees a potential opportunity for SWIFT to build a service to transform the messages from clients and counterparties into a single format that is easy for consumption by service providers. SWIFT should offer to enhance data transformation and backward data compatibility between existing MT security settlement processing messages and new API-based standards.

CUSTODY BANK B

Custody Bank B's custody services group had actively participated in SWIFT's effort to bring transparency in international payments via the SWIFTgpi payments initiative. Similarly, Custody Bank B has been very supportive of SWIFT's securities strategy to bring a transformation change in the current securities settlement process.

Views on SWIFT Strategy

Custody Bank B's views on SWIFT strategy are highlighted below:

- **Pre-settlement validations:** Custody Bank B is very receptive to SWIFT's offering of SSI enrichment and validation service based on current industry sources of SSI. While developing the solution for SSI validations, Custody Bank B believes SWIFT should consider the impact on internal practices and controls established in the financial industry today to process the settlement instructions. These established practices and controls should be supported in the SWIFT strategy, or it has the potential of generating more false breaks than today.
- **E2E two-sided neutral transaction view:** Custody Bank B is also very receptive to SWIFT's offering. It also supports the SWIFT proposed unique reference identifier that would remain the same from initiation to completion of the settlement instruction. The service also involves the frequent exchange of settlement status on messages between parties involved in the settlement chain. The new SWIFT strategy should aim to reduce the number of MT 548 messages exchanged between parties. Currently, most of the time, the same settlement status is exchanged between parties and the messaging specifications do not provide an ability to add details to the MT 548 messages for the receiver.

Alignment With SWIFT Strategy

The SWIFT offerings of pre-validation SSI enrichment and real-time E2E visibility on securities instructions are complementary to Custody Bank B's offering. Custody Bank B expects a lot of benefits from the SWIFT strategy for its clients and indirect benefits to itself:

- **Pre-settlement validations:** Over a period, Custody Bank B has developed internal practices and controls to process settlement instructions and service its clients. For example, Custody Bank B allows its clients to use legacy participant IDs while processing instructions in specific markets. Custody Bank B maintains an internal

mapping of participant ID to business identifier code to process these transactions and to meet the Target2-Securities (T2S) market requirements. Custody Bank B expects such custom services offered to clients should be supported in the SWIFT strategy. The SSI enrichment process should take care of such identifiers, else these settlements would be reflected as failed pre-settlement validations status.

- **E2E two-sided neutral transaction view:** The SWIFT MT 548 message is the most widely used real-time or near-real-time message to exchange details of the change in status and/or reason of the instruction. Currently, Custody Bank B processes the same MT 548 with the same settlement status multiple times through its internal system when it acts in multiple roles in the settlement chain. For example, sometimes Custody Bank B is a global custodian to the client and direct custodian of DTCC and CSD. It does not have control over the MT 548 message content to add details relevant to the message receiver. Though Custody Bank B's systems can handle the large volume of MT 548 messages, the SWIFT strategy could enhance the specifications so that firms can append the MT 548 messages with information relevant for receivers in the settlement chain. The missing additional details could be relevant under the ISO 20022 message format and have the potential to reduce the number of queries received by custody banks from clients inquiring about the settlement status.
- **Messaging standard for client's side communication:** As a custody bank, Custody Bank B has adopted ISO 20022 to interact with other custody banks. But the adoption of ISO 20022 messages by the client is lacking as the information carried by ISO 20022 is the same with little variation over existing ISO 15022 messages adopted by clients and a higher rate of straight-through processing. Custody Bank B is educating its clients that ISO 20022 can be used for other functions such as account opening. The SWIFT strategy can provide more options such as ISO 15022, ISO 20022, or SWIFT APIs to consume real-time status of the settlement on its side.

Implications of SWIFT Strategy

Custody Bank B views the following challenges and opportunities in the SWIFT strategy during the rollout of the SWIFT strategy:

- **Operational efficiency:** Custody Bank B expects indirect operational benefits due to the expected reduction in the number of settlement queries it would receive from its clients after SWIFT's real-time, end-to-end tracking is implemented. Custody Bank B

also expects indirect benefits by a reduction in the number of positive and negative acknowledgment status messages it currently exchanges when Custody Bank B is acting in multiple roles in the settlement chain, such as global custodian, direct custodian, and CSD.

- **Opportunities for reconciliation services:** SWIFT can offer a reconciliation service that may help to resolve some of the client queries and provide a view from the other party side for break analysis.
- **Opportunities to enhance MT 535 messages:** Many clients have informed Custody Bank B that they do not wish to receive MT 535 messages to confirm zero holdings in the account. There is an opportunity for SWIFT to address this concern with an alternate solution that can meet the requirements and does not require the generation of MT 535 for every account.

AI TE-NOVARICA GROUP'S TAKE

The SWIFT securities strategy is designed to future-proof the securities industry infrastructure by identifying functional areas in which a shared service platform could provide better solutions, offer transparency throughout the process, and mutualize the cost for the industry. When fully implemented, the SWIFT strategy will bring transformational changes to the securities processing arena.

Currently, industry participants connect with multiple service providers to perform SSI validations, sanctioned securities checks, failed settlement tracking, or even to receive required data to get a consolidated view of holdings. To support the full end-to-end transaction processing in securities operations, overlapping technology integrations and business relationships have been developed among internal teams and with external counterparties/industry utilities, leading to multiple operational processes across various service providers in different regions to get the job done. This reality has inevitably driven up the overall costs associated with trade processing, increased operational risk for all market participants, and weakened organizational resiliency.

The new SWIFT strategy will position SWIFT as the core shared service provider, relying on the flows stemming from market participants, activities performed on its network, and providers of reference data to perform validation checks. This would require leading partners that offer comprehensive and scalable coverage of services, and are acceptable by the majority of the industry participants. SWIFT is in the process of identifying these partners and integrating them into the overall solution offering.

The rollout strategy could face some resistance from market participants due to multiple reasons, such as viewing the SWIFT securities strategy as potentially competitive or duplicative to their current offerings to their clients. Others may have a preference to use internally developed systems or alternative market infrastructure platforms that may not support SWIFT. Other challenges will emerge as firms seek to clarify the commercial model to justify the business case.

To align its strategy with current business and operational practices, SWIFT should continue to refine and prioritize business use cases, segment by segment, as identified with industry participants via working groups. The global securities processing operations industry has a unique opportunity in adopting this SWIFT securities strategy to instigate the significantly needed operational and technology transformation journey necessary to future-proof the securities industry infrastructure.

CASE STUDY PARTICIPANTS

ABOUT SWIFT

SWIFT is a global member-owned cooperative and provides secure financial messaging services. SWIFT's messaging services support more than 11,000 financial institutions around the world. Through SWIFT, banks, custodians, investment institutions, central banks, market infrastructures, and corporate clients can connect with other firms to exchange structured electronic messages and perform common business processes, such as making payments or settling a trade. Visit SWIFT at www.swift.com.

ABOUT CUSTODY BANK A

Custody Bank A is a leading global custody bank providing securities settlement services to its clients.

ABOUT CUSTODY BANK B

Custody Bank B is a leading global custody bank providing securities settlement services to its clients.

ABOUT AITE-NOVARICA GROUP

Aite-Novarica Group is an advisory firm providing mission-critical insights on technology, regulations, strategy, and operations to hundreds of banks, insurers, payments providers, and investment firms as well as the technology and service providers that support them. Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base. The quality of our research, insights, and advice is driven by our core values: independence, objectivity, curiosity, and integrity.

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