



Response to Derivative Markets Institute Standards (“DMIST”) – Proposed Standard Regarding Timeliness of Trade Give-Up and Allocation

About Theorem

Theorem Technologies was founded in 2017 and launched in 2018 with the mission of simplifying post-trade processes for listed derivative market participants. The team has more than fifty years of experience in sell and buy side operations, trading, and technology, and has been developing and operating back and middle office technology for more than a decade. As one of its core workflow services, Theorem provides software tools for the generation, transmission, and absorption of allocation instructions for both buy and sell side firms. Clients include emerging and established commodity trading advisors, global hedge funds, commodity merchants, introducing brokers, and futures commission merchants.

We applaud FIA’s actions post Covid volatility and volume to lay the framework for the Derivative Markets Institute for Standards (DMIST), the leadership of the organization, and the industry for its participation in the exercise. We adamantly believe that understanding perspectives across the industry position participants to develop, stress test, and implement solutions. We’re appreciative of the opportunity to provide input regarding the “Standard Regarding Timeliness of Trade Give-Up and Allocation” and are excited to participate more formally in standard development and rollout moving forward.

Theorem agrees with the intent of the standard – to ideate, document, and implement best in class, but achievable practices for all market participants that will make derivatives markets operationally resilient and mitigate risk. We believe it’s a worthwhile exercise to understand unique perspectives and work towards a state that will enable our markets to operate efficiently in the highest volume scenarios.

Challenges to the Existing System (“Why are we here?”)

For quite some time, winning business from market participants by supporting unique, and what may have originally been small, non-impactful allocation, give up, and acceptance processes has been a part of our markets and is now used as a competitive differentiator. The differences across the space have grown larger and larger over time, and risks are highlighted during periods of high volume and volatility.

While Theorem agrees with the standard, we believe it’s important to work towards uniformity in the way that trades are allocated and given up as a first step before introducing time-based measures. Without such processing uniformity, more unique, risk-prone processes will be implemented to satisfy time requirements, which in turn will expand the gaps and generate more damage. We believe we must first address the root cause of the problem as a collective body.

As part of Theorem’s support of buy side clients generating allocation instructions, we interact with many Executing and Clearing Brokers that, we have come to understand, reflect very different internal processes. For example, many US-bank owned FCMs that we have connected to require rigidly defined data that includes as much detail as possible, average groupings, and a multitude of other referential data designed to be machine readable in a straight through process. Meanwhile, some other FCMs that we are connected to require allocation transmissions that are optimized for human readability. We don’t doubt that each broker has its own well documented process that meets its own internal needs, but the implementation of time-based measures without basic requirement and process standards may have unintended consequences such as making FCMs less competitive with each other.

With this in mind, and because Client actions are the first link in a chain of events that occur in the allocation and give up process, in our opinion, the most important question is, “why do Clients submit allocation instructions at different times?” In our experience:

- **Average Pricing:**

- The variance of average pricing support on global exchanges creates bifurcated allocation processes (i.e., separate instructions based on which Clearinghouse is in scope).
- Because some markets do not support average pricing, some Clients instruct give up at fill level, only to ask Clearing Brokers to support a books only process to average activity.
- Clients hold instruction transmission so that a full day’s activity in a product and maturity combination can be split at a single average price.

- **Resource Constraints:** Not all firms have the human capital capacity to generate allocation instruction immediately for all markets. For instance, a US-based small to midsize CTA may not have operational staff to initiate and monitor allocation processing for APAC based exchanges immediately, and instead, wait till the end of the trading day during early US hours to process. Others may synchronize their allocations based on regionality (e.g., allocate once per geographic zone).

- **Uncoupled Tools:** Many of our allocation clients have come to us only after learning that the trade allocation tool they use in their trading or risk application is not connected to the executing broker’s allocation systems. Lack of standards and a unifying technology for exchange traded derivatives results in non-ideal procedure making on the customer side.

Suggested Approach

We believe these answers help to identify the challenges that exist and should influence actions. We also believe that these answers allow us to identify pivotal actors, where actions can be targeted to have the most significant impact with the fewest touchpoints.

Taking these constraints into consideration, here are the actions we suggest this body explore in developing a suitable standard:

- **Adopt Referential Standards:** The lack of uniformly accepted and adopted security identifiers across all participants for exchange cleared derivatives continues to be a stress point in the system. By solving this problem first, 90 minute or less allocations will occur more organically, and any time limits can be implemented into the system that is less stressed and easier to use.
- **CCP Engagement:**
 - For CCPs that do not support average pricing, engagement to understand if the capability is on their roadmap, if it can be accelerated on their strategic plan, and to convey the importance of support for market participants.
 - Standardization of clearing windows post market closure (at least 90 minutes in length).
- **For Clients using a Post-Trade Vendor:** Such vendors need to engage their Clients to identify rationale for sending delayed instructions work to implement a timely process, including auto-triggers for overnight activity based on pre-determined splits.
- **For Clients using a proprietary tool for allocation instructions:** Executing Brokers need to engage and require such Clients to adjust process to deliver timely instructions, using standards and measures that are helpful to their Clients.
- **Clearing Brokers should review any allocation processes where Executing Brokers give up trades to a top account and further allocation is required before Clearinghouse closure.** Such processes should be discontinued with all trades being given up to end clearing accounts.
- **Executing Brokers should review supported Trading Screen Vendors to determine if any are currently sending allocation instructions that may not be utilized, prioritize work internally to absorb those instructions, or in the case of Trading Screen Vendors that do not transmit instructions, pressure such vendors to either develop the capability, or partner with Post-Trade vendors to implement functionality.**

We believe that these efforts will enable the responsible implementation of time-based measures and allow for measurement and enforcement. We also believe that this path will not over burden small to midsize buy-side participants in the form of staffing or technology costs, thus retaining equitable access to our markets. Theorem supports immediate standards for Executing and Clearing Brokers to process allocations and accept give in trades within 30 minutes, though we believe this to largely be in place today.

Again, we applaud the FIA, DMIST, and participants for bringing attention to often overlooked subjects and promoting dialogue to develop satisfactory solutions. We are excited to participate in this standard's fine tuning and implementation, and the opportunity to help develop future standards.

Sincerely,

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