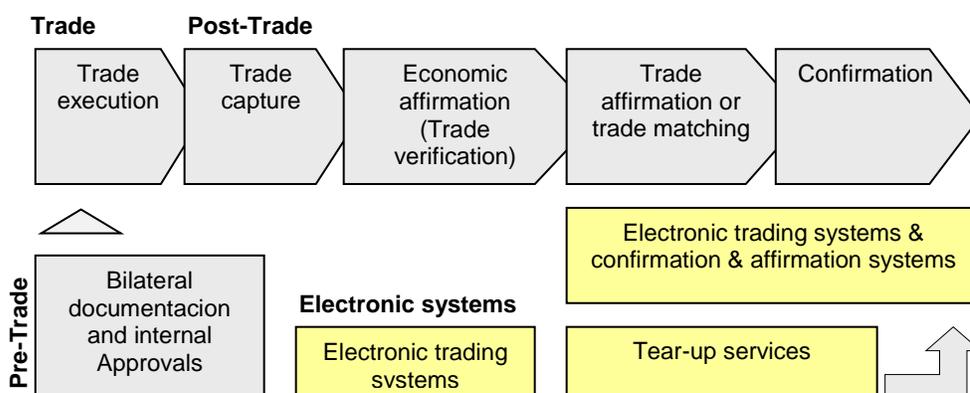


Annex C. Operational trading process in OTC markets

OTC derivatives start in the front-office with subsequent middle and back-office trading functions (Schinasi, Craig, Drees and Kramer, 2000, p. 20, 2000, p. 20). According to Schinasi, Craig, Drees and Kramer (2000, p. 20) while front-office functions are relatively easy to distinguish from other activities, this is not the case between middle and back-office trade functions where there is not a common terminology that precisely differentiate one from the other one. There is, however, a trend to denote trade processes that are directly related to risk management practices as middle-office functions whereas clearing and settlement operations are known as back-office functions (Schinasi, Craig, Drees and Kramer, 2000, p. 20).

Figure 19. OTC derivative transactions from trade to confirmation



Source: CPSS, 2007, p. 12

Trade execution takes place when the counterparties come to an agreement in terms of trade. After trade execution, *Post-trade processing* in the OTC market is closely attached to operational efficiency and automaticity. Post-trade stage is formed by a trade capture phase, the economic affirmation, trade affirmation or also known as trade matching and the confirmation phase (CPSS, 2007, p. 12).

During the *trade capture* stage the parties capture the trade details in their systems to use the information, among others, for risk management purposes which can be done manually or automated (CPSS, 2007, p. 12). Before the confirmation, parties could decide to go into a deeper review of key economical details stipulated on the contract and enter into a phase called *economic affirmation* also known as trade

verification (CPSS, 2007, p. 12). In order to create the final record of the transaction and support the trade verification, parties could opt for *trade affirmation*, whereby one party provide full details to the other, who undertakes the responsibility of verifying the content of the contract or known as *trade matching*, that is characterized by the delivery of the transactions records from both sides; in other words, both parties submit the records of the trade and send them to each other to match details (CPSS, 2007, p. 13). Once both parties agree the dealers issue the *confirmation* to the counterparties to be signed and returned (CPSS, 2007, p. 13).