



**globsyn infotech**

*(formerly Synergy Log-In Systems Ltd)*

# ***Nostro Reconciliation***

**White Paper**

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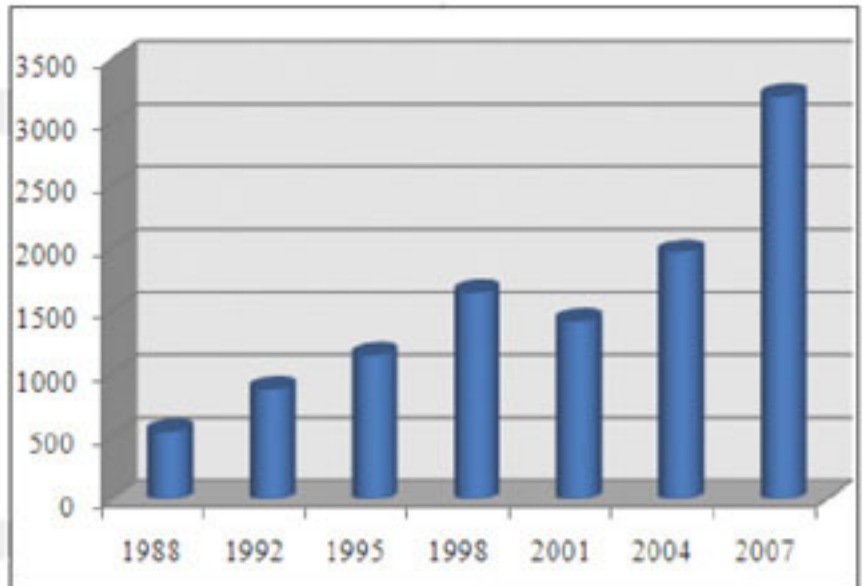
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# Introduction

The foreign exchange (FX) market is the largest and most liquid sector of the global economy. According to 2007 Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity conducted by the Bank for International Settlements (BIS) in April 2007. An excerpt from the BIS reads “The 2007 survey shows an unprecedented rise in activity in traditional foreign exchange markets compared to 2004. Average daily turnover rose to \$3.2 trillion in April 2007, an increase of 71% at current exchange rates and 65% at constant exchange rates...”



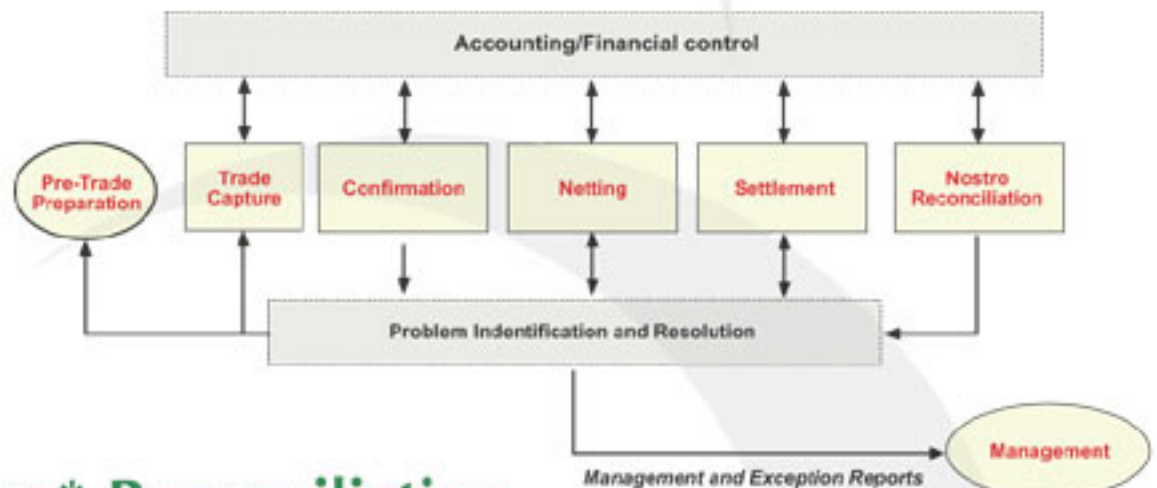
The FX market serves as the primary mechanism for making payments across borders, transferring funds, and determining exchange rates between different national currencies.

## The FX Marketplace

Over the last decade, the FX market has become more diverse as well as much larger. Although in the past, commercial banks dominated the market, today participants also include commercial as well as investment banks, FX dealers and brokerage companies, multinational corporations, money managers, commodity trading advisors, insurance companies, governments, central banks, pension and hedge funds, investment companies, brokers/dealers, and other participants in the inter-dealer market. In addition, the size of the FX market has grown as the economy has continued to globalize. The value of transactions that are settled globally each day has risen exponentially—from \$1 billion in 1974 to \$3.2 trillion in 2007.

The increased complexity of the market and higher trade volumes have necessitated constant changes in trading procedures, trade capture systems, operational procedures, and introduction of newer and newer risk management tools.

## The FX Process Flow



### Nostro\* Reconciliation

Nostro reconciliation occurs at the end of the trade settlement process to ensure that a trade has settled properly and that all expected cash flows have occurred. A bank should, typically, begin the reconciliation process as soon as it receives notification from its nostro bank that payments are received. If possible, reconciliation should be performed before the payment system associated with each currency closes. Early reconciliation enables a bank to detect any problems in cash settlement and resolve them on the settlement date. Typically, however, a bank does not receive notification from its nostro banks until one day after settlement, which does not allow them to correct payment errors on the settlement date.

The main objective of the nostro reconciliation function is to ensure that expected cash movements are in consonance with the actual cash movements of currency at the nostro bank. The process involves comparing expected cash movements with actual cash movements both paid out and received in by the nostro bank. If the reconciliation process indicates a difference from expected amounts, they can be due to any of the six possible reasons, where a Bank -

- ◆ expected to receive funds and did not,
- ◆ expected to receive funds and received the wrong amount,
- ◆ received funds and did not expect to receive them,
- ◆ expected to pay funds and did not,
- ◆ expected to pay funds and paid the wrong amount, or
- ◆ paid funds and did not expect them to be paid.

[\* our account in Latin, meaning an account kept by a bank or company in the currency of the country where the money is held, with the equivalent local currency amount noted in another column.]

# Best Practices for Nostro Reconciliation

With the growth in FX trading volumes, the associated Operational Risks have also multiplied manifold calling for technology based automation, defining and adhering to process models and ensure a system of checks and balances. Operational risk for foreign exchange in particular involves problems with processing, product pricing, and valuation. These problems can result from a variety of causes, including natural disasters, which can cause the loss of a primary trading site, or a change in the financial details of the trade or settlement instructions on a FX transaction. Operational risk may also emanate from poor planning and procedures, inadequate systems, human error etc. The following best practices have been recommended by The Foreign Exchange Committee, an industry group based out of New York that has been providing guidance and leadership to the global foreign exchange market since its founding in 1978.

## Best Practice 1: Perform Timely Nostro Account Reconciliation

Full reconciliation of nostro accounts should be completed as early as possible. A bank should attempt to establish capabilities that allow for intraday processing of nostro confirmations of receipts, thereby allowing the reconciliation process to begin before the end of the day. In no instance, however, should the reconciliation be done later than the day following settlement date. The sooner reconciliations are performed, the sooner a bank knows its true nostro balances so that it can take appropriate actions to ensure that its accounts are properly funded. In addition, nonreceipt of funds may indicate credit problems at a counterparty. The sooner this information is known, the sooner a bank can prevent further payments from being made to that counterparty.

## Best Practice 2: Automate Nostro Reconciliations

A bank should be capable of receiving automated feeds of nostro activity statements and implement automated nostro reconciliation systems.

A bank should establish facilities for automatically downloading the settlement information it receives from nostro banks as well as its own expected settlement data. A bank should establish an electronic reconciliation system to compare these two streams of data (confirmed payments and receipts from the nostro bank against the expected cash movements from the operations system) to allow for the timely identification of differences. Escalation procedures should be in place to deal with any unreconciled trades and/or unsettled trades. These procedures should be initiated when settlement and/or nostro reconciliations are not successful.

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## Best Practice 3: Identify Nonreceipt of Payments

Management should establish procedures for detecting non-receipt of payments and for notifying appropriate parties of these occurrences. Escalation procedures should be in place for dealing with counterparties who fail to make payments.

A bank should attempt to identify, as early in the process as possible, any expected payments that are not received. They should be prioritized by counterparty credit ratings, payment amount and currency, or by an internally generated counterparty watch list. All failed receipts should be subject to established follow-up procedures. A bank should also report nonreceipts to credit management and to sales and trading, particularly for any recurring failures with one particular counterparty. Management may wish to consider a limited dealing relationship with counterparties who have a history of settlement problems and continue to fail on their payments to the bank. Payment of interest and penalties should be prompt.

## Best practice 4: Establish Operational Standards for Nostro Account Users

A bank should require all other users of its nostro accounts to comply with the same operational standards as FX users.

The FX department of a bank may be the primary user of nostro accounts. However, other business groups (for example, fixed income, commodities, emerging markets, and derivatives) may also be users. Clear procedures should be established outlining how each account is funded (that is, individual or group funding). Consistent standards should be in place describing the necessary operating procedures that all users should follow. Without clear rules for sharing in place, the bank runs the risk of overdraft problems.

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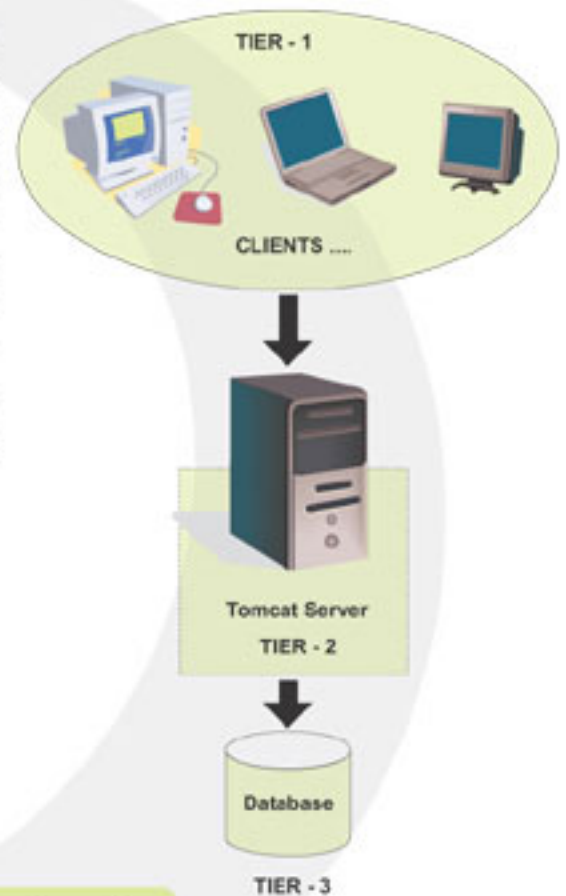
# SYNLOG™ MIRROR

## The New Age Reconciliation System

Developed as a modular application based on the classical 3 - tier Framework, MIRROR has been designed as a New Age Reconciliation System, tailor made to suit the critical reconciliation needs of Banks, Financial Institutions or users dealing with the FX market. The application supports a browser based front-end and uses server-side Java components for the middle or business layer. The future-proof Web based architecture of MIRROR ensures both flexibility and scalability where customers can centrally install the application and yet allow authorised users to securely access the application from dispersed geographical locations.

### Features that keeps you at the leading edge

- ◆ Browser based UI. MIRROR'S thin client architecture allows for reconciliation to be carried out from multiple workstations / dispersed geographical locations.
- ◆ Operating System (OS) Independent
- ◆ Supports Oracle
- ◆ Robust Matching Engine. Define your own matching rules
- ◆ Cutting-edge External Data Interface (EDIFICE)
- ◆ Chaser Generation
- ◆ Optional Exceptions Module
- ◆ Optional Communications Module



## EDIFICE – Cutting Edge External Data Interface

Designed and developed to be extremely flexible and versatile, you can convert SWIFT data to MIRROR readable data. Supports a strong complement of in-built data standards that enables virtually any type of data to be converted to MIRROR readable data

## Rugged and Customisable Matching Engine

MIRROR'S extremely rugged and customisable Matching Engine forms the core of the application. The Engine allows users to define:

- ◆ Transaction Types, Locations, Accounts, Currencies, Account Relations, Appn-Match Types, User Locations, User Privileges, Location Wise Balances, Account Wise Balances, Matching Modes
- ◆ Multiple Matching Types - Manual, Automatic and Intelligent
- ◆ Manual Match - One-to-One, One-to-Many, Many-to-One
- ◆ Automatic Match - Users can define custom matching roles
- ◆ Intelligent Matches - An extension of the Automatic Matching mode, matching is based on 12 pre-defined matching rules
- ◆ Define and Execute Matching Tasks
- ◆ Execute Forced matches and Internal Matches

## Extensive Querying and Reports Module

MIRROR'S extremely rugged and customisable Matching Engine forms the core of the application. The Engine allows users to define:

- ◆ Outstanding Deals Reports
- ◆ Matched Entries Report
- ◆ Reconciliation Report
- ◆ Ageing Analysis Reports
- ◆ Turnover Report
- ◆ Exceeding Credit Limit Report
- ◆ Average Balances Report
- ◆ Reconciliation Proof Report
- ◆ Large Differences Report
- ◆ Small Differences Report
- ◆ Suspended Matches Report

