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# **Straight-Through Processing: Where Are We Now?**



September 30, 2002 - Jerry O'Connell, a principal at Jeremiah Associates, a consultancy based in Ridgewood, N.J. and New York City, wrote the following exclusively for *Securities Industry News*.

**Straight-through processing (STP) is not a fad or the latest industry buzz, but rather a set of philosophy and workflow principles that are based on an efficient and uninterrupted processing cycle that delivers superior services to the client, service provider and industry as a whole. For most participants, STP will be realized through evolutionary, rather than revolutionary, changes. STP requires participants to examine their core processing for all order, trade and position reporting activities. They must identify manual workarounds, system interfaces and redundant processes, all with a view toward eliminating the inefficient practices and introducing a flatter, direct processing model to support their businesses' own models.**

For example, various industry studies show that the life of a trade, from its inception to its completion, includes many different "stress points" where data must be re-keyed or manual updates made. The elimination of these steps would clearly streamline trade flow-illustrating the true benefits of STP. Each participant must transform its business process model to integrate STP practices throughout processing approaches. The changes required will, in many cases, be pervasive and impact all areas of a participant's business, including everything from interaction with clients, through order and settlement processing, as well as position maintenance and reporting. Not to be neglected are non trade-related processing areas, such as corporate actions, and the cleanup required.

Is one-day settlement the end game? It is not. Is T+0 the end game? While it is certainly one goal, it is also not the end game. That said, there is certainly much interest in this revolutionary but rather straightforward idea of making an investment transaction as simple as an ATM withdrawal. The technology is there, but there is no plan to deploy it to achieve this clearly beneficial goal.

But should the securities industry's transformation be limited to simply realizing T+1 or even T+0? No. Rather, we should position our industry to accommodate future changes that may not be visible today. This requires planning, insight and consideration of future business models but most importantly, it requires applications and systems that can be "snapped" into the current infrastructure. Unfortunately, we do not have the luxury of gutting the existing infrastructure and starting from scratch. The model and plan for the transition to true STP must include the reality of what we have to work with today.

To be successful, true STP capabilities require the active participation of the business and technology areas from every group to determine their internal requirements. The processing of orders, settlement and position reporting do not contribute to making a participant more competitive. Thus, we believe that the experience of participants should be shared among every

market group. There must be a consensus on the STP vision that will enable the evolution of a widely, if not universally, accepted industry model and set of standards.

While much of this question has been born and pursued heavily in the United States, there are some tremendous concerns surrounding STP on a global basis. Differences in market transaction flow and system infrastructure present some unique difficulties and ones that need to be addressed in a flexible, nimble manner. Some key global challenges surely include the lack of a central matching entity and a central securities depository, identification of a cross-border regulator and solid applications to support the technology infrastructure.

The following lynchpin questions surrounding the issue of STP must be addressed:

#### **How does the SIA's delay affect STP?**

A leading question among industry players is how the Securities Industry Association's delay in recommending T+1 affects STP efforts. Is it, in fact, "torpedoing" the initiative as a whole?

We believe that the delay will not stymie the effort. Rather, firms that have considered T+1 realized that STP is the key to securities processing efficiencies. As such, T+1 was not the only driver of STP. Cutting costs and managing risk are still big and very visible motivators to move to STP even if the mandate for T+1 is not there.

#### **Who defines STP?**

Over the past few years, boardroom banter has frequently turned to who should define STP: the Securities and Exchange Commission, the SIA, self-regulatory organizations or more nebulous market forces?

Market forces, with oversight assistance and compliance from the SIA and SROs, seem to be the right answer. Plus, it's clear that there is no "one-size-fits-all" element to STP. The Bond Market Association seems to be the group trying to provide an STP model to the fixed-income market. A lot of the early STP work (back in 1997) was focused mainly on the equity markets and did not include the requirements of the fixed-income market. This is due to the impact on the four constituency groups, including investment managers, brokers, custodians and industry services organizations that include utilities, marketplaces, automation system providers and market data sources. The vast difference of the roles and responsibilities of these constituencies, as well as sheer number of participants within each, indicates that a single entity charged with oversight and compliance would face major obstacles. The buy side seems to be more fragmented in its industry focus, with groups such as the Asset Managers Association, Bond Market Association, Investment Company Institute and ISITC-IOA, among others.

Further, there is a larger question about defining STP on a global basis. It becomes much less clear as we open up the subject to the world financial markets. There are many markets in which a strong governing body is present, similar to the SEC. However, there are nearly as many markets-some rather important-that are lacking the infrastructure and regulation necessary to help weigh in on and then finalize a road map for implementation. With the lack of these central governing bodies and central counterparty (CCP) services, the ever-present market forces will surely be a driver, perhaps more so on the global front. For the answer to this part of the question, we may also look toward international organizations such as Swift, given their strong, far-reaching global expertise, to assist in implementation and a rollout that is inclusive and flexible

#### **Why not the SIA?**

The SIA is clearly central to this initiative and the debate surrounding it. Therefore, why should or shouldn't it be the SIA who controls this issue?

The SIA should indeed be involved in order to add their perspective spanning the industry roles and activities. The trade group can use its infrastructure to marshal the appropriate resources among its broker members. At issue is that the SIA traditionally has been identified with the sell side of the industry and only recently has made a major effort to be inclusive of buy-side representatives. Since it is the buy side that seems to be the slowest to adopt STP principles, there still needs to be more consensus-building among all segments of the business and thus, other entities must be involved in the definition of the "final" model STP will assume.

### **Enforcing the new business mode**

After arriving at a final and universally understood and agreed-upon model, the central question will be who or what enforces the milestones leading to STP and how can they truly be enforced—and, for that matter, why?

It is clear that enforcement within any of the constituencies will be difficult. A better strategy will be to implement STP in discrete pieces, rather than trying to do the whole ball of wax at one time.

Project management stands out as a big risk if it were to be of the scope recently laid out by industry organizations. A better tack is surely to undertake the project in a manageable, phased approach. Shorter "time to market" might also placate revenue-producing areas, which will ultimately foot the bill for much of the STP work. Impact on the bottom line in terms of significant cost reduction might well be the most compelling "enforcer." But, that gets us right back to the point of market forces likely being the best enforcers of STP plans and project implementation.

### **Regulation and the legalities**

An outstanding and unclear question is what of STP can be mandated from a legal and regulatory perspective—and moreover, by whom?

Participant constituencies can be mandated by their regulatory entities. Recent regulatory changes, such as execution reporting and anti-money laundering, indirectly drive the industry toward STP. Market forces, such as Depository Trust & Clearing Corp.'s recently announced intention to focus on activities and issues advancing STP such as dematerialization, will in the long run have an impact on guiding, leading or encouraging the industry toward adopting STP practices.

Many turn to the Securities and Exchange Commission and ask whether it should step in. For many of us, it seems that this is not an issue for the SEC's immediate attention. Their priority, of late, has been on the protecting investors through enforcement of current regulations or introducing new ones on investment banking, research and broker-dealer activities.

However, when one looks at the recent T+1 plans, besides mandating a new settlement date, there were opportunities where the SEC facilitated changes to Rule 10b-10, certain aspects of dematerialization and margins that impacted STP. This may change over time, but it is critical that the industry realizes the impact and importance of STP and progresses toward adopting sound operating practices.

### **The matching debate**

Many have said central matching, as is currently performed by Omgeo and the Global Straight-Through-Processing Association, should be mandated as part of the move to STP. Further, there is much discussion as to whether or not making this requirement is indeed what will be the motivating force behind firms joining a central matching service.

We believe that it could be mandated but again, "market forces" seem to have the potential to prevail and be the primary driving force behind this initiative. Certainly, it is clear that among institutional clients there seems to be a resounding lack of enthusiasm for the new systems. Many

institutions have concerns about matching system transaction flow weaknesses. Pricing is another concern of potential users, which believe that costs are too high.

In general, it seems that following a "free-market" mentality and not requiring the use of such a system is perhaps the best course. Perhaps we should all wait and see how Omgeo and GSTPA fare in the market. That will also allow us all the time to see how competitive offerings surface (perhaps SunGard and TradeWeb) and what their compelling advantages may be.

On the global stage, the issue of multiple and diverse VMUs will clearly present a challenge. For example, the Tokyo Stock Exchange recently announced plans to build a proprietary virtual matching utility (VMU); it is clear that other markets will follow suit, creating a potentially large interoperability issue and hurdle to clear.

### **A roadmap for success**

It is clear that in order to realize STP, there are many miles still left to go. So many issues must be identified and clarified-industry education to resolution of conflicting priorities to comprehensive training and a host of others.

We believe that if our industry places the greatest attention on a specific set of critical success factors, we will be well prepared, including:

- Executive sponsorship and commitment;
- An iron-clad program and project management;
- Prompt and effective issue resolution;
- Initiative-level involvement;
- Effective training and ongoing support;
- Perhaps most importantly, consistent and clear communication among all constituencies.

Further, we believe that the eventual benefits will serve as our most compelling "market forces" leading to the adoption and harmonious incorporation of these principles into our daily life in the financial services industry:

- Undeniable and dramatic increase in efficiency and reduction in operating costs;
- Increase in the capacity of businesses to grow and reach new heights;
- Increased facilitation of cross-border trading;
- Shortened settlement cycles;
- Significantly lessened risk exposure for all institutions across a variety of functional areas.

Therefore, as an industry we must dedicate the right resources to this issue. Further, we must be cognizant of quickly adopting industry wide standards, carefully review the field of vendor alternatives and fully understand their offerings. We must also all commit adequate resources in order to ensure timely and satisfying outcomes of STP-driven projects.

### **A means to an end?**

The final question may be whether or not STP is the end to the means or conversely the means to the end. At the end of the day, we believe that STP is indeed the means to an end by which our very competitive market realizes optimally efficient transaction processing and we see the most dramatic increase in efficiency, service to clients and perhaps most relevant-a dramatic enhancement to how we control operational risk and thus, increase profitability.