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Title: **STP: Still the Prize**

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Any unanticipated exception handling diverts resources from growing the business. By *James Leman* and *Ravi Manchi*

The need for straight-through processing (STP) has only increased over the last seven years as electronic trading took hold, settlement cycles compressed, program trading expanded, trade size shrank, decimalization reduced spreads and the brokerage business contended with ever-shrinking commissions. Brokers also faced client demands to offer block trading, direct market access (DMA) and algorithmic trading tools – all at decreasing commission rates per share.

Now, brokers offering this array of strategies are experiencing an exploding number of orders and changes to orders with eventual execution reports increasing exponentially as algorithmic trading grows in popularity. Institutional clients concurrently are pursuing commission compression while embracing trading methods that generate higher transaction volumes. Brokers must contend with these volumes as part of their reality, while they must also perform more analysis on the costs resulting from these trends.

After the market downturn in 1999, most brokers continuously reduced their middle-office and operational personnel, as well as costs whenever possible. Often, automated trading initiatives sought to save headcount in one area, enabling personnel to be shifted to new products that required more manual intervention early in their development lifecycle.

Compounding this, front-office product development traditionally progresses much more aggressively than in the middle office or in operational processes. If trading volume estimates are not clearly established and processes are not completely mapped out or sized, an exceptionally well-received product can strain a firm's operations.

These realities have combined to create an environment where automated trading is expected to be processed from beginning to end in an STP fashion. Any unanticipated level of exception handling demands a diversion of resources, either business or technology, at the expense of growing the business or developing new products.

STP, ASAP

Given the realities and challenges of today's business environment, STP efficiency is an absolute necessity for brokers to manage their processing activities cost-effectively and to meet the most demanding clients' service level mandates. Brokers must analyze the transaction trail from inception to its

final settlement to determine STP's effectiveness and why costly exceptions occur. Brokers also need to eliminate exceptions and identify who and what generates internal exceptions and, therefore, expenses. Exceptions also divert resources from managing higher levels of clean STP volume that creates revenue.

After eliminating internal exceptions that block STP, brokers must then focus on clients. Some are very organized, demand prompt service and establish performance requirements of nearly 100 percent STP. Brokers failing to meet these criteria could lose these clients. Other clients' revenue potential must be weighed against their exception-generating profile and its impact on the firm's ability to generate a profit per client.

Brokers then have two choices: Either coach clients to eliminate exceptions or turn them away. Clients' inability to achieve substantially high STP levels makes serving them an unprofitable proposition. Some equities brokers are now making these decisions.

STP efficiency is not only a US equity product mandate, European and Asian markets have also been focusing on it, and they will see it intensify with higher DMA, program and algorithmic trading volumes. As any product matures in a competitive, high-volume, technologically assisted environment, STP is essential. This is especially true where a growing, hedge fund-populated client base trades multiple products electronically and expects consistent service levels across products. Spending on personnel and technology must be focused on high levels of cleanly processed volume. Spending on exception handling must be identified, isolated and eliminated to the greatest degree possible.

STP is an essential business process in today's environment where firms face demanding clients and increasing competitive pressures. Constant vigilance of exceptions and pursuit of a high STP level in global markets is imperative to run a successful high-service business.

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