

Global Straight-through Processing – The Evolution Continues

a report by

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Approximately US\$1.8 trillion worth of trades remain outstanding and unsettled globally every business day, contributing significant credit and operational risk exposure to the trading participants. Compressing the settlement cycle can reduce the risks as well as create liquidity for other uses. If the industry is to continue delivering the high level of cost-effective and risk-managed services that the trading participants and investors demand, it is critical to streamline the trading-to-settlement process by moving to global straight-through processing (GSTP) and compressing the settlement to near realtime trade date plus one day (T+1). Shorter settlement cycles will reduce current daily settlement risk¹ exposure for trade date plus three days (T+3) settling products by at least US\$250 billion in the US alone – this value is expected to exceed US\$760 billion by 2004 (see *Figure 1*).

Multiple hurdles challenge international trading activities. Many of the processes required to conduct cross-border trades involve the following:²

- manual handling;
- multiple service providers with proprietary technologies;
- incompatible files and databases;
- divergent cross-border rules and regulations;
- non-standard processes;
- high failure rates;
- high costs; and
- high exposure to different operations and credit risk profiles.

Further, the global securities industry faces several challenges in the near future that have a significant affect on cross-border trading:

- increase in the domestic and cross border trading volumes, which are stretching the capacity limits of the trading infrastructures;
- need for consolidation and realtime linkages of exchanges and other industry utilities, such as global custodians and central securities depositories,

in domestic, regional and global markets, and establishment of central counterparties;

- need for clearing and settlement cost reduction, both domestic and cross border;
- advent of electronic communications networks and alternative trading systems, and the resulting challenge of 'commoditisation' and 'extension' of trading to 24 hours a day;
- forthcoming regulations to decrease settlement cycles (e.g., move to T+1 and T+0 in the US);
- requirements for realtime information for managing portfolios, and controlling credit and operational risk, and netting on a near realtime basis;
- diversity of information technology (IT) standards and protocols used in communicating data;
- need for good metrics and advanced techniques for decision-making and performance measurement in an operations environment; and
- back-office legacy systems, suffering from lack of investments for upgrades.

To respond to these challenges, the securities industry must prepare for major changes, the key among them being straight-through processing (STP) and GSTP. With increasing cross-border volumes and shorter settlement periods, securities firms cannot afford the risk and cost of manual processing and failed trades. Participants in cross-border trading, including broker-dealers, fund managers, custodians, exchanges and depositories, need to re-engineer technical, business process and operational architectures to realise the ultimate goal of GSTP. Several competing solutions are being sponsored, including the Global Straight Through Processing Association's (GSTPA's), Thomson Financial/Depository Trust & Clearing Corporation (DTCC) global joint venture and other Internet-based solutions and tools.

1. Securities Industry Association, http://www.sia.com/t_plus_one_issue/

2. <http://www.gstpa.com>

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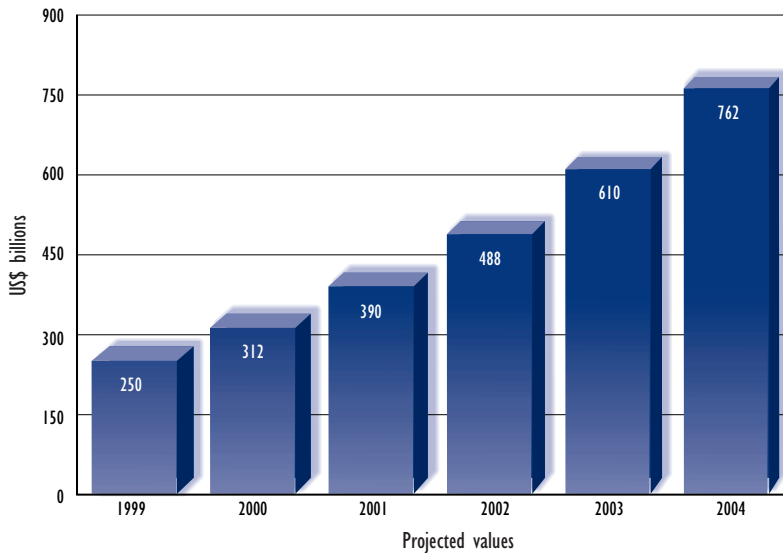
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Figure 1: Projected Reduction in Settlement Exposure from T+1 Settlement

Source: Depository Trust & Clearing Corporation (DTCC)

Some of the key drivers for GSTP emphasise its importance:

- The continued trend towards globalisation of assets has increased the complexities of trading and settling investments across borders. Lack of standards and automation increases costs and risks to the industry, hence the need for GSTP.
- A move to T+1/T+0 settlement environment within the next three to five years is likely. As soon as trade is executed, it must be confirmed quickly in the near realtime environment demanded by T+1/T+0, e.g., in the custodian's order management and clearing system for settlement. There will be little time for end-of-day batches, manual exception handling, faxes or duplicate keystrokes.
- Firms are under continuous pressure to grow business without increasing costs or assuming undue risk. Consolidation in all markets continues. This trend has changed the nature of the business and has introduced and expanded product base to firms previously operating in a far narrower niche. It is increasingly difficult to support myriad disparate processes, many manual, in a fast-moving and complex environment.
- Good staff are hard to find, expensive to train and generally have different workplace expectations than employees who entered the workplace in previous years. Staff are unwilling to work unlimited overtime on routine processing. Operations professionals need to create an environment in which staff can become problem-solvers rather than paper-shufflers. The only way to accomplish these goals is via STP. In the evolving digital economy, staff shortages are expected to last well into the next decade.

Consolidation and STP are essential building blocks in the construction of the new capital markets in which processing of trade information from front office to confirmation, payment and delivery is accomplished without exceptions, and without re-entering the same information into another system, to complete the process.

The future industry model envisions a full STP and GSTP, Internet-enabled and scalable trading, and a clearing and settlement environment whereby trading will be supported by a limited number of globally competing trading platforms and utilities. This model will involve regional/geographic consolidation (that is, North America, Europe, Asia or Australia/New Zealand and eventually Central and South America) of clearing and settlement within the framework of commercial user-owned utilities.

The infrastructure components of this new model will be linked in realtime and with the various participants in the transaction cycle. Professional and retail investors will have direct access to trading. The larger funds and institutions (if transaction flows can justify the related investments and operating expenses) will have direct access to the post-trade services. Small and medium-sized investors (with insufficient flows) will continue to use clearing members and custodians.

Finally, the advent of and move towards GSTP imposes certain disciplines and creates the potential for new revenue opportunities for institutions with effective IT and business operations infra-structures in the areas of liquidity provisioning and collateral management services. As a result, GSTP will require major organisational changes in the structure of the market participants. Executives and shareholders need to take a hard look at the return on capital for each component of the digital supply chain of the trading process, starting with client acquisition and retention to clearing and settlement.

The true return on investment will ultimately determine whether the shareholders are best served by investing in back-office processing or in areas where investment is focused on client/market share acquisition and retention.

These changes will precede the development of new value-added services with the ultimate goal of centralised shared utilities. These utilities will provide market participants with a cost-effective standardised approach, unified support and benefits of a single investment, without affecting the core competency front office to help achieve differentiation. This new vision will revolutionise the industry. ■

More information on this subject may be found at <http://www.eds.com>



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