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## **Step Forward, Back Office**

By: Malcolm Clark

Consider successful, modern-day restaurants as an analogy for today's securities services world. I'm not talking about fast food joints or the super deluxe four star places with a sommelier on tap, rather the middle-of-the-road, pleasant sorts of places where you feel comfortable taking your children and your mother on a regular basis. Think about the STP that such places offer. Yes, really, STP in a restaurant can be likened to STP in financial services!

First, consider what used to be the rule in restaurants (and still is in many) in terms of information flow between you and the various restaurant staff.

In some, you place your order with a waiter or waitress. He/she jots it down on a pad.

Special requests are scribbled in underneath in a scrawl meaningful only to the writer. Your waiter has to physically take the order to the kitchen and may be distracted en route by another diner – inserting an unwelcome delay. The chef has to interpret the scribbles to prepare your meal.

If he has run out of one ingredient, he tells the waiting staff, who have to communicate it back to you. You may then be disappointed, and may change your order. (Tell my daughter the restaurant has run out of guacamole and she will no longer want the Mexican chicken!)

Once cooked, your meal is placed under a hot lamp, awaiting the waiter's return to the kitchen to take it to your table.

Lots of room for error, delay, and disappointment.

### **Not-so-STP**

Now consider how technology has changed that not-so-STP process in some establishments to make the whole process more efficient.

In our more advanced restaurants, your waiter takes your order on an electronic keypad. The order is communicated to the kitchen as soon as you've finished placing it with the waiter – before he moves on to the next task and without him having to go back to the kitchen. Special orders can be tapped in as well, using short codes or in some cases with free-form text. The chef gets a clear order. Missing ingredients can be communicated back to the waiting staff instantaneously – but are also less likely. A central supply chain system will recognize what dishes are being ordered in what volumes and can ensure sufficient ingredients are delivered to the kitchen on time. The waiter is alerted when your meal is ready, meaning you're more likely to receive it hot.

The benefits to all participants are clear. You get faster service, and you're more likely to get what you want and the restaurant gets more efficient waiters, and more efficient supplies.

### **Point Of Demand**

Now, how on earth does this relate to financial services? What restauranteurs have done is to consider STP not just from the food production point of view (their 'back office,' the kitchen), but rather straight from the point of demand – you, the diner. For financial firms to get the best out of their kitchens, they also need to embrace STP from their diners (the traders, or front office). This means

that, when selecting technology for the back office, you need to ensure you will also cater for those front office needs. You need to look at the full chain from trade concept on the dealing desk through all the back office functions. There are two, essential, things to consider:

- excellent communication front-to-back
- simplicity in execution in the back

Excellent communication is an obvious one. From a system point of view, this means the back office system needs to be easy to interface to other systems. XML messaging, an open interface, and a clear data design all contribute to easy communications between systems. Luckily, interfacing is getting easier as systems providers embrace these facets.

Simplicity in execution is not always recognized as an essential ingredient to the success of a system selection process. What I mean by this is that a back office system needs to be able to process individual units well, without getting hung up on the entire panoply of financial instruments.

Going back to our restaurant, the chef has really become more 'middle office.' He does the final assembly on the plates, pours on the béarnaise sauce just so, and is the quality control for the kitchen operations. Several sous-chefs are responsible for grilling the fish and meat, preparing the vegetables, and boiling the potatoes. A good back office system does not try to be the chef, but rather sticks to the preparation of distinct, individual ingredients. It ensures it can process the units of a complex financial transaction, and does that excellently, without worrying too much about the sum of the parts or how the pieces fit together for the trader – that's the job of the front office system.

### **Expensive Fallacy**

Many people will disagree with that last statement, saying that it is essential that back office systems can understand all aspects of all financial instruments being traded. I think this is an expensive fallacy.

Just take a relatively simple instrument, such as a repo. Repos come in various guises – fixed term, open term, fixed rate, variable rate, indexed rate, cross currency, with call options, with rights of substitution, packaged together as a basket, with a tri-party agent ... and more. The repo market is evolving constantly – rather like diners' tastes – and front-office specialist repo systems have to evolve to meet that demand.

To force your back office system to likewise change whenever a new twist on repo trading arises is simply doubling your technology investment cost. It's far better to keep the back office system simple, and leave the business intelligence in the front office system. You can put other controls in place to ensure your trader is not taking excessive risk and understands his true profit and loss on his necessarily complicated trading strategies. But don't believe that you have to put the same intelligence and complication into the back office system. You'll only be testing your back office systems developers against your front office ones!

Of course, you can avoid this back office/front office system struggle by getting a 'front-to-back' system for particular parts of your financial operations. This makes sense for some trading products and for some shops, but is not always the optimal solution. Careful consideration has to be given to the benefits of having a single front-to-back system for a business vertical versus the potential overlap in back office processing with other back office systems processing other parts of your trading.

Like creative diners, traders, by nature, are always dreaming up special orders and will have requirements for individual transactions that don't fit the menu. Good front office technology will be designed to cope. The back office system needs simply to process the simplified components coming from the front office. Following this approach gives you the most benefit from true STP – seamlessly from the diner, to the kitchen, and back again!

Bon appetit! ■

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