

Intensive collaboration realising investment managers operational excellence

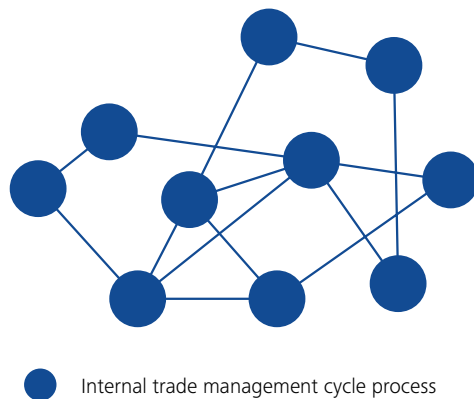
Jordy Miggelbrink
Deloitte Alumni

The May 2013 edition of *'Performance'* published by Deloitte described the characteristics of investment management organisations that will be able to competently respond to the massive shifts in the economic, regulatory and investment landscapes and therefore will be best equipped to survive the next decade. Our perspective requires that investment managers optimise their focus on investment strategies and philosophies. This can be effectively achieved by a process of continuous improvement in organisations' operational (trade) processing environment.

We concluded that the optimal change strategy for trade cycle management should be focused on long-term mutual collaboration with partners who can offer specialised or enhanced levels of support to the business operation. This approach will ensure the business is best positioned to resolve the complexity of the challenges that will continue to be presented by the ever-changing investment landscape.

Demands for increased transparency

Forthcoming regulations, for example EMIR, require trade reporting within pre-defined timeframes from the moment trading takes place. Regulations within the insurance sector (Solvency II) also have an indirect impact on investment management parties. These enhanced regulations require investment management organisations to adjust their operational procedures to deliver increased transparency, demonstrable risk-based modelling, and improved 'look-through' reporting functionalities. Beyond the need for increased transparency driven by regulatory requirements, investment managers must also deal with investors' changing demands. Requests for information, sometimes within short time frames, take a toll on the operational processing of investment management organisations. Failure to obtain accurate and complete information within timelines required by investors can put the investment manager at risk. Increasingly, potential investors' due diligence processes will probe into a firm's operational trade processing procedures.



The current operational 'starting point'

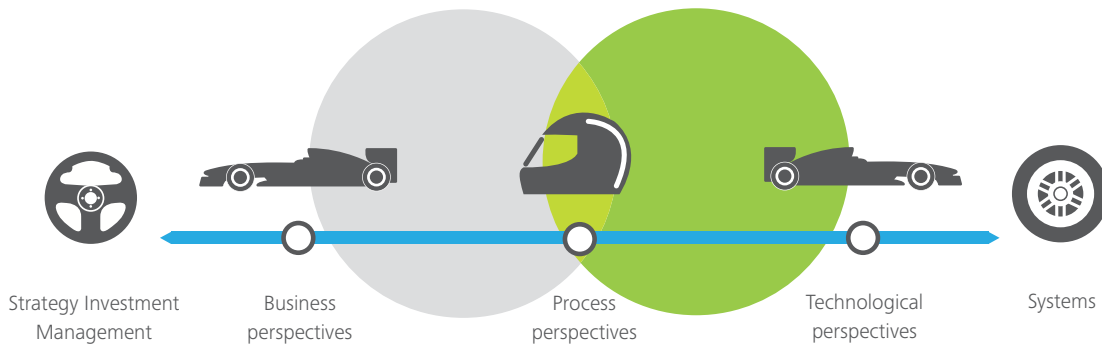
Off-the-shelf Trade Cycle Management solutions are increasingly being selected to standardise both system and operational processes with the objective of improving investment managers' margins. These solutions deliver an increased rate of straight-through processing and provide greater transparency.

The software solutions implemented, however, generally only support a (small) part of the operational process. Consequently, new functionalities are often delivered without consideration of further up-stream or down-stream processing or are inefficiently built on top of or alongside existing legacy systems. The implementation of multiple standardised off-the-shelf solutions to try to effectively support the complete trade management cycle results in extra software licence fees and related operational costs.

Besides the increased implementation complexity and extra operational costs of this approach, many well-known software vendors increasingly seem to have difficulties in foreseeing and adapting to the challenges of complete operational processing in their off-the-shelf solutions. Vendors can be reluctant to change or adapt their 'standard' product offerings and thus the investment management organisation must find their own specific solution(s). This may result in redundant implementation of support tools, a need for increased internal system-to-system reconciliation and accordingly increased operational risks.

Implementation example

It is not uncommon for an investment management organisation to have implemented one specific solution for the functions of 'order management', 'compliance' and 'trading' and a second and third etc. for functionalities like 'accounting', 'data management' and 'settlement'. This situation leads to multiple-translations between systems in the different parts of the organisation likely to cause operational incidents. For example, the investment manager might have the transaction code



'BU', 'BO12', 'Opening', 'BUY' or a numeric code for reflecting the execution of a trade, depending on the department and solution implemented.

While these incidents are being reactively resolved, the organisation is consequently exposed to uncertainty in its trading position, affecting the truthful prediction of settlements and the verification of securities and cash held with custodians.

Additionally, from a technological perspective, having to support multiple legacy software systems presents a significant challenge. Legacy technologies, often developed in the early 1990s, are increasingly unable to meet current requirements for real-time information and web-based reporting.

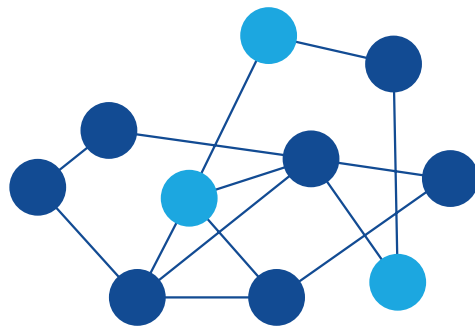
The strategy should be 'simple'

The experiences described earlier demonstrate that investment management operational processes must work faster and smarter with the objective of minimising errors and omissions. The numerous challenges presented by this strategic goal should be met by forming a close long-term collaboration with a specialist and knowledgeable partner. The objective, to proactively prevent data quality and processing errors from occurring in the trading environment, will reduce the need for unwanted additional reconciliation, internal reporting and monitoring.

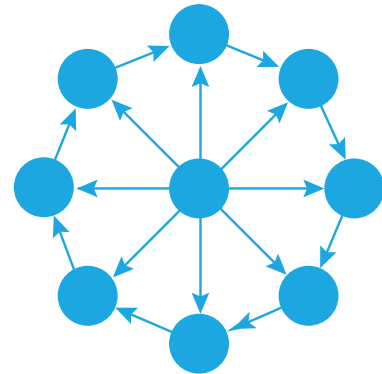
The strategic approach is preferable both from a technological and a business perspective. To optimise all aspects of the trade management cycle into one solution, the investment strategy and investment philosophy of the organisation must form the core of the architecture. The solution must be built around the business (rather than adapting the business processes to work with a fixed solution).

The investment management operational environment should be perceived 'as one' cycle, reusing the same events from different perspectives. Without this approach it is impossible to define one complete roadmap: unnecessary resource-consuming challenges will be presented when front- to back-office functionalities are not considered in relation to each other. The total trade management cycle must be defined from start to finish with all data being validated at the point of first entry. Functional exceptions are managed as one encapsulated event instead of being repeated and corrected at each translation interface between each sub-system and component.

In order to gain greater levels of efficiency, investment managers increasingly share their support functions and/or outsource highly-commoditised operational functions to specialised outsourcing partners



- Internal trade management cycle process
- External trade management cycle process



- Optimised trade management cycle process

Complementary collaboration: more than the sum of its parts

Outsourcing to a partner

In order to gain greater levels of efficiency, investment managers increasingly share their support functions and/or outsource highly-commoditised operational functions to specialised outsourcing partners. These secondary operational processes will generally not differentiate the investment manager from competitors so consequentially costs associated with technology, staff and real estate could potentially be reduced.

One of the lessons learned during various client missions is that operational and financial risks are not reduced if the trade management cycle processes have not been optimised before the outsourcing partner begins executing this day-to-day business. Effectively nothing will change except the location of the proceedings.

In addition, regulations outline that the investment managers' organisation remains responsible for outsourced functions, so outsourcing the risk of processing errors is not an option. This may in fact adversely impact the accuracy, completeness and timelines of reporting financial transactions and statements. When differences appear the investment manager must be in control of the identification, investigation and explanation of errors and all corrective actions. Consequently extra reconciliation processing must be implemented to ensure that the outsourcing party is in control of the execution of the operational processing.

Innovative specialised (software) partner

Defining the trade management cycle as one organisation-wide operational process enables investment managers to identify the consequential events required at the various points in the front-, mid- and back-office environments. In the earlier example, 'execution of a trade', the investment manager can identify the data discrepancy when the data is first entered into the trade cycle. Consequently a potential breach is identified at the earliest possible opportunity, preventing problems from manifesting themselves further down the line in the operational process and improving the quality of accurate prediction of settlements. Such a strategy will have a direct positive impact, reducing the operational risks of the investment manager and ensuring that operational processing costs are controlled.

Current off-the-shelf standardised legacy solutions are not ready to meet the enormous challenges of the new post 'credit crunch' investment management environment. Furthermore, given the ever-increasing complexity of financial markets, investment management organisations must be fully focused on their key objectives and not distracted by inefficient operational processing. Intensive mutual collaboration with a software partner specialised in investment management will strengthen the investment managers' mission and organisation. A software partner with expert knowledge and flexibility, able to assess the investment manager's needs, based on the newest technological and functional perspectives, will give the investment manager the best chance to succeed in today's complex asset management industry.



Conclusion

Based on our extensive market experience within the investment management industry we recognise the struggles investment managers encounter in their day-to-day business. We believe that the overriding key to success is to allow the manager to focus on investment strategies by enhancing their trade management cycle, working smarter and with the lowest possible number of data related incidents.

To meet these challenges it is essential to form an intensive mutual collaboration with a specialised party who is committed for the long term. Achieving an operational investment management process, which is based on accurate, timely and fully accessible financial positions, facilitates the right investment decisions and generates absolute returns benefiting the investment managers' clients in the long term.

The option of outsourcing could lead to advanced levels of efficiency and decreased trade management cycle budgets. However, if the trade management cycle has not been optimised the question remains: is outsourcing enough to survive the ever changing market circumstances and will future changes be adequately implemented by the outsourced partner? The investment management organisation remains responsible for the functions outsourced and liable for the resulting risks. Given the constant changes in the investment industry and continuous technological developments in operational information management, we believe that the investment management sector will see a shift towards intensive long-term mutual collaboration with innovative software providers. This tactical approach enables the optimal implementation of solutions which are technologically and functionally at the top of the range.

The experiences described earlier demonstrate that investment management operational processes must work faster and smarter with the objective of minimising errors and omissions