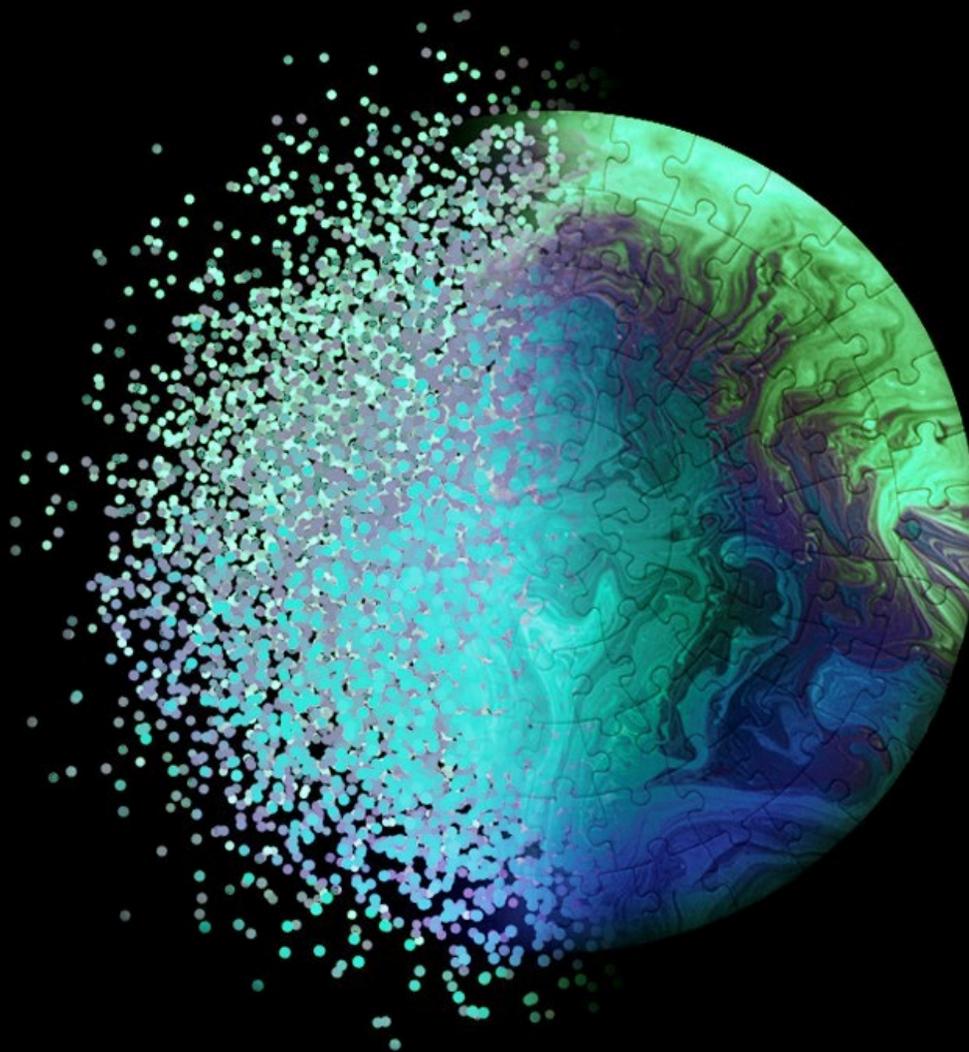


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COVID-19 and the extended enterprise

Impact on the third-party service provider landscape for investment management

Responding to COVID-19 today to build an improved extended enterprise

The COVID-19 pandemic has had an unprecedented impact on organizations, and business operations in the investment management sector have needed to adapt to 1) changes in the workforce, 2) use of new tools and technologies, and 3) new ways of interacting with their extended enterprise. Investment management organizations are dependent on a variety of critical service providers to operate successfully. And while the need for understanding and managing the risks of outsourcing critical services isn't new, operating in the COVID-19 environment has amplified these risks, presenting new challenges in achieving resiliency.

More specifically, COVID-19 has heightened existing or, in some cases, introduced new emerging risks across domains (such as business continuity / resiliency, financial health, and cybersecurity), which can lead to increased exposures within the extended enterprise. For instance, many firms have rapidly adapted their operations and business continuity approach to cope with a new way of working and, in certain situations, an overwhelming volume of issues.

This evolution in the third-party ecosystem requires a refreshed approach to oversight techniques in order to effectively and efficiently 1) manage risk, 2) enhance performance, and 3) reduce costs.

Organizations should focus on evolving risks within the extended enterprise (such as third-party service provider risks) that have been amplified as a result of the COVID-19 pandemic and the dynamic fluidity of the current environment.

Extended enterprise challenges heightened by COVID-19	
1	Resiliency – Depleted resources adjusting to a more distributed working environment, potentially leading to greater difficulty in maintaining operational resiliency and opportunities for control compromises and undetected fraud
2	Financial health – Market volatility, difficulty collecting payments, and cash flow challenges may affect operational stability
3	Technology – Hastily implemented technologies and increased use of new or unmanaged tools may lack sufficient security controls to protect data
4	Regulatory – Shifts in operating models to address the changing environment may affect the ability to meet service obligations and related regulatory compliance requirements
5	Fourth-party or subcontractor – Service providers' increased dependency on their own third parties elevates vulnerability due to lack of transparency



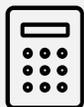
*In order to identify the most important risks to the organization, start by understanding the top issues associated with each of your critical third-party service providers. Then, utilize a detailed action plan targeted at addressing these specific challenges in your extended enterprise in order to **move from responding to recovering, to ultimately thriving in this disruptive environment.***

Prior to taking any immediate actions, it is imperative to understand how COVID-19 has affected your most critical third-party service providers and how their evolving business operating model could—in turn—affect your business.

Fund accounting and administration:

Outsourcing of portfolio and fund accounting and administration are largely combined and highly interrelated services that have likely been challenged by the rapid transition to a virtual service delivery model, and thus it's important to consider:

- Accuracy of GAV and NAV calculations
- Timeliness and completeness of financial statements
- Effectiveness of compliance controls subject to Rule 38a-1
- Effectiveness of liquidity risk management program



Custodians:

Services provided by custodians are critical to safeguarding assets and when disruptions occur, the impact can be widespread. Consider:

- Accuracy and completeness of money movements
- Efficient tracking and oversight of consolidating and adjusting journal entries
- Success of settlements and cash breaks
- Risk associated with securities lending programs and collateral recovery
- Timeliness of access to previously negotiated lines of credit
- Completeness of reconciliation items and timeliness of investigations of unreconciled items
- Acceptance of physical certificates for privately issued securities



Middle-office and investment operations:

Front-to-back capabilities are emerging with the promise to simplify technology, solve data quality, and provide a scalable and cost-effective operating platform, given the imperative to leverage these capabilities in an environment of accelerating margin compression. Consider:

- Increased operational risks from trade processing hand-offs and swivel-chair data entry
- Availability of transparency and decision rights into further outsourcing of collateral management, securities lending, cash management, and reconciliation break resolution
- Availability of data and expertise demanded for performance measurement, attribution, analysis, and reporting
- Security and account master quality delivered through data-as-a-service offerings and alternative vendors
- Accountability as additional investment compliance components are externally managed



Valuation services:

The use of pricing and valuation data to drive investment decisions and risk analysis has continued to expand. Given the heavy reliance on these sources in the wake of COVID-19, consider:

- Accuracy and availability of information to complete valuations, use of subjective judgments, and agreement in comparison with market movement
- Elevated pressure on fund boards and valuation committees to provide appropriate fair valuations
- Increased use of disclaimer language emphasizing uncertainty
- Existence of documentation to support input into model and why decisions were made
- Use of orderly transactions by pricing vendors
- Increased dispersion amongst pricing vendors for the same financial instrument



Transfer agents:

System interruptions, outages, and delays are felt the strongest by transfer agents, largely because of their direct client interactions (whether for record maintenance, account balancing, or transaction processing). Consider:

- Timeliness of processing routine shareholder servicing requests (for example, subscriptions, redemptions, or maintenance requests)
- Availability of call center personnel
- Timeliness of mailing shareholder transaction confirmations and monthly statements
- Accuracy of cash reconciliations associated with shareholder transactions and cash reporting for portfolio management
- Effectiveness of corporate actions processing



Get ready – A checklist to start taking action and address COVID-19 immediately

- ✓ Identify and inventory third parties that support or manage **critical business processes most at-risk for disruption or fraud**
- ✓ Investigate and understand the **impact and locations for the identified list of critical service providers** (and critical fourth parties, where relevant)
- ✓ Evaluate contracts, including **service levels, payment terms, and insurance coverage**
- ✓ Closely monitor third parties' ability to meet services levels in a **distributed IT environment**
- ✓ Increase scrutiny of **third-party valuation and pricing policies and procedures**, particularly when applied to bonds or alternative securities with less liquidity
- ✓ Apply **continuous oversight and monitoring** of third-party business continuity and disaster recovery practices
- ✓ Establish or refine **contingency processes to identify alternative service providers or in-house solutions** in the event a third-party service becomes unavailable
- ✓ Explore assistance with third-party risk assessment delivery, including tools as a means for **increased third-party oversight without adding headcount**
- ✓ Track and **monitor location of services** and service delivery implications connected to the **gradual "reopening of doors"**
- ✓ Explore and **embrace new digital approaches** and processes to accommodate capacity strains, including **digital controls testing and automation**

Begin to thrive – Innovative techniques designed to help identify and manage risk

Risk sensing

Cognitive risk sensing tools can help organizations develop an understanding of the risk landscape across an extended enterprise ecosystem. In cases where organizations cannot establish direct connections with service providers, technologies that access multiple data sources may provide important insight. Cognitive engines can gather and analyze information from multiple external data sources, including digital and social media, broadcast and print media, regulatory sites, blogs, survey data, and other specified sources. These vast data sources can produce signals or indicate trending that provide intelligence on an extended enterprise, illuminating risks that might otherwise be difficult to identify.

Direct connection

Organizations should consider establishing a new model for how they connect and collaboratively build relationships with third parties, especially in an extended ecosystem which supports critical business operations. A "right-sourcing" model that encourages more direct contact with critical providers on an ongoing, iterative basis is necessary during the response and recovery phases. Firms should consider virtual techniques requiring providers to complete new questionnaires, surveys, or health checks to gain more actionable data.

Digital controls

Digital controls can support automated monitoring of third parties and facilitate testing through the use of data extraction, scripting, and analytical interactive dashboards to drive meaningful business outcomes that align with strategic priorities. Digital controls harness data across the enterprise, overcoming limitations of traditional control approaches, bringing visibility to the bigger picture and efficiencies across programs. For example, digital controls can automate the data collection and analysis of key middle-office activities such as trade processing and reporting, thereby reducing the need for traditional manual intervention.



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