FAST, EFFICIENT RECONCILIATION
IN THE WAKE OF BIG DATA AND
THE REGULATORY TSUNAMI

How to Improve Operational Efficiencies & Compliance

by James Carney

Learn:
• Why technology becomes so critical as data complexity increases
• How to maintain compliance with efficient electronic tools
• How to drive operational efficiencies and cut costs
No matter your industry, Big Data is a hot topic. With multiple information sources, systems and requirements come increased complexity, risk and opportunity. Never before has the financial industry had so much data to work with—and such a need to manage it efficiently.

The data management problems that boutique and mid-market asset management firms wrestle with increasingly center around improving operational efficiency, reconciliation and compliance.

Despite the surge in Big Data and information technology, many of the asset managers I speak with still rely on paper statements as part of their reconciliation process. Under increasing regulatory scrutiny and cost pressures from scaling their businesses, firms are looking for ways to mitigate risk, reduce turnaround time for reconciliation and improve their data quality and consistency.

Recently, I spoke about these issues with an asset manager and a service provider to the industry. I wanted to learn their perspectives on some of the changes taking place in the asset management industry and some of the issues asset managers and operations staff wrestle with on a daily basis.

| When it comes to reconciliation, firms shouldn’t underestimate the importance of having high-quality data. | You want the cleanest source and the one with the most data elements that you can compare against. | Asset management firms need to find an efficient way to bring in large amounts of information from multiple custodians if they are to work efficiently. |
Key Takeaways

• In the era of Big Data, the pace and complexity of financial markets has increased significantly. Everyone is being asked to do so much more. Add to this new demands of the heightened regulatory environment and we have a situation that is straining personnel and capital resources. Introducing technology tools to better leverage staff and ensure you are compliant can have a huge payback—and give you peace of mind.

• While new technology applications can have a tremendous impact, there can be short-term disruptions as workflows change. It is important to take the time to plan how you will introduce an application into your firm to minimize distractions and help with adoption.

• New technologies and compliance issues are also impacting how firms handle their reconciliation processes. Firms looking to increase efficiencies and reduce errors are streamlining their daily activities by introducing new approaches for accessing high-quality, custodial-level data that has already been normalized.

• Audit trails for reconciliation processes are also becoming very important and aggressive firms want extensive details that enable them to go back in time to see how they did their matching, who was involved, how it was resolved and more so they can actively investigate any issue that arises.

• Firms looking to take their reconciliation to a new level should consider some of the robust capabilities that are on the market today. There are solutions capable of reconciling the widest range of financial instruments, accounts, positions and processes on a single platform.

• In addition, when it comes to reconciliation firms shouldn’t underestimate the importance of having high-quality data. You want the cleanest source and the one with the most data elements that you can compare against. Asset management firms need to find an efficient way to bring in large amounts of information from multiple custodians if they are to work efficiently.
Top Technology Challenges

Pam, what do you see as the top technology challenges today?

We need to be much more aggressive on so many more fronts today than we were in the past, given new regulatory and compliance requirements. This has introduced a range of challenges. One specific example relates to the enormous amount of information we are required to maintain today for audit purposes. So much is subject to regulations that require information to be catalogued, monitored, reviewed and retained. We now need document archiving, email archiving, instant message archiving and more. This raises many new maintenance and cost considerations from a technology perspective.

Another challenge centers on getting internal buy-in to implement new technologies. There are so many more tools available today and integrating them into the internal workflow can take time. We have CRM, back-end management systems, risk management tools and more. Every change or new capability that alters the existing workflow is going to negatively impact our investment professionals’ productivity in the short term. They all pay out over time, but people don’t like change and don’t want to have their routines upset, even for a little while. So getting quick adoption for applications that impact a broader group of people can be tricky.

How are you handling these challenges?

For new regulations, we’ve deployed lots of tools that have really helped us with risk management and I feel more confident than ever that we are in a good place now. Our portfolio management system, for example, has a very robust compliance component. While it involved a lot of ramp-up time, the payback has been huge. The same is true for our archiving tool. While it takes a lot to maintain, it enables us to watch things we are supposed to be watching and easily prove we are doing so.

Regarding buy-in, I think it is really important to get organized from a business perspective and know how you want to introduce new technologies so you don’t unduly affect productivity. You have to plan how you want to get things into the internal workflow. Then when people see the benefits, they are more likely to get on board faster.

What broad trends are impacting operational efficiency?

New technologies are enabling us to do more and more. For example, ten years ago a month-end reconciliation of positions was all that was required. Now we bring in daily transactions so our portfolios are more current than they’ve ever been from a cash transaction standpoint. We’ve done this by introducing new approaches for aggregating data for reconciliation, replacing time consuming and costly processes. We see this on many fronts—the workload we are now able to handle each and every day given technology tools that improve our productivity is staggering.

What specific operational challenges do firms like yours wrestle with on a daily basis?

Dealing with multiple custodians and not having normalized data. We deal with about 80 custodians and each one has a different format for their data so it requires a lot of manpower.
to reformat it or write programs that can do that—and if something then changes at the custodian, you have to do it all over again. In order for us, and probably the majority of larger asset management firms out there, to efficiently reconcile accounts from multiple custodians it’s crucial to get normalized data. The service you provide at ByAllAccounts does that, and it has substantially enhanced our workflows and turnaround times.

“Getting timely, normalized data that is sourced directly from the custodians is essential for operational efficiency.”

Pam Presswood, Director of Information Systems, Luther King Capital Management, LLC

Regulatory Climate

Stephen, as a service provider to the industry, you see things from the other side. What major changes have impacted your business?

The new regulatory environment has impacted us as well. Just as asset management firms need to tighten their businesses to cope with new compliance considerations, so have we. We have introduced a lot more rigor in our due diligence process when working with our clients. For example, in the past we would have asked more general questions about their processes to ensure data accuracy. Now we want to see them in action. Likewise we might have asked them if they had a SAS 70 in place, now we want to see the document and know it was handled by a reputable auditing firm.

As an outsourcer of reconciliation services, what trends are you seeing in the market on this front?

Regulations are underscoring the need for a good audit trail today. Reconciliation is a pretty simple concept when you think about it. All you have to do is match up a number from your trading system to the number from your custodian, or what a broker provides if you are matching a confirm. In today’s environment, however, there is much more needed. If you have to go back in time to see how you did a matching when there was a broken trade, you need a good audit trail. The aggressive firms recognize this and how important this information is for the smooth operation of their business. When working with our clients we often use their existing systems, but we also have a solution that is very robust. It enables us to look at the aging of
reconciliation breaks, how long something has been outstanding, who the person is working on it, the resolution for a reconciliation break that happened historically, the custodian we dealt with and more. So many clients are asking for this detail now.

**Reconciliation**

Are there new challenges today when it comes to reconciliation?

The level of complexity in securities markets continues to increase. When I first started in the reconciliation business things were pretty straightforward—you had stocks and bonds. Today there are many more derivatives and the rate at which products are coming to market continues to accelerate. The ability to handle this becomes more challenging because there are more data points involved. With a stock, the elements of reconciling a trade are the quantity, price and fees associated with the trade. With derivatives you may have to derive a value yourself based upon another instrument or an index, or a value that you get from a third party or multiple parties.

How are firms dealing with this?

As complexity increases, technology becomes critically important. All of this stuff is easily handled if you have low volume. If you have one trade and it has a credit default swap or some kind of equity swap, you can likely reconcile it in Excel. As soon as you start increasing volume, it becomes very challenging to do a thorough job and have good record keeping. There’s a lot of risk tied up in the process and the whole point of reconciliation is to identify differences in how you saw the trade and have an opportunity to work it out before everything settles. When you start to deal with billions of dollars, the amount of money that could be left on the table is huge.

So are there still firms that are doing reconciliation manually?

I see smaller firms doing that. I would say there are a large number of small fund administrators and asset management firms that don’t have a good portfolio accounting system and are doing it manually or using technology at a very cursory level. Then there are firms that have a portfolio accounting system with some sort of reconciliation software built in, but it isn’t robust so they don’t have the ability to create that audit trail I said was so important. For larger firms, a comprehensive reconciliation capability is mission critical.

Do you think these smaller firms understand the operational efficiency that technology offers?

I don’t think some firms are aware of the limitations of a manual process. They may feel that they can handle things in Excel if they have low volume. They may even be spending a little more time on referencing and keep a paper trail, printing off what they did as far as matching to show that the positions they had on this day reconciled with what their custodian said. How they got there, however, usually isn’t in any sort of documentation. So the information and clarity isn’t there to retrace their steps if there is a problematic trade.
Given the heightened regulatory environment you mentioned, what do you recommend firms do regarding reconciliation?

First and foremost, leverage technology. Given the overwhelming amount of complex information that is coming into an asset management firm’s systems every day, I would say it’s virtually impossible to effectively reconcile accounts without a good application in place. Otherwise it’s a drain on staff time and prone to error. I recommend firms look for standalone software that is specifically designed to do reconciliation. These capabilities generally have more robust features than you can get otherwise, including the ability to provide an electronic audit trail. As pressure from regulatory authorities continues to escalate, this will become more and more important.

“You need to leverage the right technology for your firm’s needs to maximize efficiencies on the reconciliation front.”

Stephen Van de Wetering, CEO, Empaxis Data Management, LLC

In addition, you can’t underestimate the importance of having high-quality data. You want the cleanest source and the one with the most data elements that you can compare against. Custodians are the best source of this. For larger asset management firms that use multiple custodians, I recommend finding a solution that enables you to efficiently access this information to feed your internal systems with detailed data that has already been vetted for you.

Conclusion

I predict that just as the wealth management industry is diverging into two types of firms—one at the low end (“for the masses” if you will), and one at the high end—the asset management industry is reaching a critical point. The need for greater distribution of investment product across multiple platforms, without adding staff, is contributing to the need to shorten reconciliation cycles. Tighter regulations make transparency and record-keeping more critical than ever.

Outsourcing reconciliation to a specialized technology provider and pairing that with the highest possible quality of reconciliation-ready data can deliver electronic audit trails, eliminate manual data entry, drive down costs and improve operational efficiency for your firm.
About Luther King Capital Management (LKCM)

Headquartered in Fort Worth, TX, Luther King Capital Management is an SEC-registered investment advisory firm founded by J. Luther King, Jr. in 1979. LKCM provides investment advisory services to high net worth individuals, foundations, endowments, investment companies, pension and profit sharing plans, trusts and estates and other organizations. As of June 30, 2012, LKCM had approximately $10 billion in AUM. For more information, visit www.lkcm.com or call 817.332.3235.

About Empaxis Data Management, LLC

Headquartered in El Segundo, CA, Empaxis Data Management provides high-caliber, highly customized back-office outsourcing and reconciliation services for asset managers and hedge funds across North America, Europe and Asia. With over $30 billion in AUA and growing, Empaxis provides its clients with a robust, highly flexible back-office processing and support service that can be tailored to fit each client’s unique business vision while ensuring robust scalability and cost efficiency. For more information, visit www.empaxis.com or call 310.356.5831.

About ByAllAccounts

ByAllAccounts, the financial advisors’ choice for data aggregation since 1999, is the only service that retrieves, enriches and consolidates reconciliation-ready account data from any custodian. ByAllAccounts’ patented aggregation engine, through which hundreds of billions in assets flow daily, aggregates all client account data—from any source—within an advisor’s wealth management platform or trust accounting system for a truly comprehensive view. Thousands of advisors rely on ByAllAccounts to save administrative time and costs, mitigate risk associated with having incomplete information and grow revenues through client referrals and new business development. ByAllAccounts integrates seamlessly with all of the most popular wealth management platforms. For more information, visit www.byallaccounts.com or call 781-376-0801.

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