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Best practices in reconciliation

10 steps to greater productivity and performance

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The decision to automate reconciliation presents both a challenge and an opportunity for firms: a challenge to stay competitive and an opportunity to make dramatic improvements in efficiency and client service.

The secret success ingredient

Reconciliation is an often overlooked and undervalued activity, seen as a mundane—albeit necessary—function best avoided.

Done right, reconciliation is crucial to two of the most important determinants of your organization's success: front-office performance and client satisfaction.

Unfortunately, reconciliation at many firms remains a laborious, time-consuming and risk-laden process, where staff are forced to trawl through reams of spreadsheets and tick off every transaction manually. This approach is inefficient and unsustainable, severely limiting firms' ability to compete.

Automating reconciliation processes and implementing exception-based workflow best practices offers firms easy wins in the quest for greater productivity, performance, efficiency and profitability. Plucking this low-hanging fruit today is a simple and obvious way to position your firm to prosper in whatever market conditions the future may hold.

This document explains why automated reconciliation is quickly evolving into a competitive necessity. It details the costs and risk associated with manual reconciliation and the benefits to be gained from automation. It also outlines a 10-point checklist for optimizing reconciliation process efficiency, and weighs the pros and cons of alternative solutions—in-house, third party or web hosted.

Ultimately, the decision to automate reconciliation presents both a challenge and an opportunity for firms: a challenge to stay competitive, and an opportunity to make dramatic improvements in efficiency and client service.

High cost of manual reconciliation

Automation has become imperative for the asset management industry. A powerful combination of forces—challenging economic conditions, increasing trading volumes, intense and globalized competition, a growing onus on transparency and greater regulatory scrutiny—are creating ever more demands for accurate and timely reconciliation. And with daily reconciliation now seen as industry best practice, and real-time reconciliation on the horizon, those pressures continue to escalate.

Yet all too often the trade and portfolio reconciliation process between an asset manager and its various counterparties, as well as internally within the firm, remains labor intensive, error prone and costly.

Reconciling those external and internal data flows by manually "ticking and tying" each transaction and position record is a time-consuming and tedious process—especially since investment managers typically have multiple custodians and other service providers. Not only does the task divert staff time and attention from higher value activities, but it is liable to result in unnecessary expense, significant mistakes, customer frustration, reputational damage, missed investment opportunities, and potentially even compliance problems and regulatory fines.

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Non-automated reconciliation: The pain points

Any breakdown in the automation chain will impact your firm's resources and risk profile. These costs and risks may take the form of:

- Exposure to operational risk from unmatched items.
- Account errors that mean portfolio managers don't have an accurate picture of how much cash or securities they have available with which to trade.
- A month-end reconciliation cycle resulting in day-to-day investment decisions being based on old or inaccurate data.
- A period-end reporting fire-drill focused on "getting reports out the door" rather than on producing them correctly in a controlled and predictable manner.
- A temptation to "plug in" data just to make it reconcile.
- Poor client service, with its impact on client and asset retention.
- Staff time that could be spent on more value-added functions.
- Employee discontent and turnover from lower job satisfaction.
- Lack of operational scalability to meet changes in business volumes and take advantage of growth opportunities.
- Inaccurate performance numbers, potentially raising compliance concerns.

The business upside: Five competitive advantages from automation

The asset management industry is facing a tougher economic, investor and regulatory landscape that will intensify competition between industry participants. As a new report by consultancy Casey Quirk observes[1], rather than simply outperforming similar-looking firms with similar value propositions, successful players will win by competing through differentiation.

How can firms achieve that differentiation? The simple answer is satisfied clients. Increasingly inflows will go to those firms that can combine investment performance with strong client service and a reputation for trust and reliability. Asset managers that excel at communicating their strategies are often successful in retaining assets, even when their investment returns are less than stellar. Satisfied clients are also more likely to invest additional sums in that manager's funds.

Reconciliation has a central role to play in achieving those goals. The quickening pace of the market and more demanding client expectations have made high quality reconciliation a competitive necessity. Replacing an error-prone, manual file-matching process or creaky legacy system with a time-saving, accurate and automated environment offers significant advantages on multiple fronts.

1—Informed investment decisions

Actionable information, delivered via user-friendly dashboards, is also the cornerstone of effective front office decision-making.

Portfolio managers and traders depend on up-to-date cash balances, transaction details and portfolio positions—derived from timely, accurate, reconciled data—to make better investment decisions and minimize the firm's risk exposure.

For example, having more cash than they thought could result in portfolio managers missing trading opportunities and underperforming their benchmark. Or where a position is misvalued they may fail to hedge the exposure properly.

2—Increased productivity and business growth

Manual reconciliation processes that took days or weeks can be done in hours by leveraging an automated, exception-based reconciliation solution. Staff previously devoted to mind-numbing ticking and tying can be empowered to focus on more energizing, higher-value functions in operations, client service and other areas of the company, which can help to grow the business, increase revenues and streamline costs.

[1] *The Roar of the Crowd: How Individual Investors Transform Competition in Asset Management,* November 2015, Casey Quirk

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Moreover, because systems can handle the reconciliation process faster and with fewer errors, firms' operations departments do not have the same scale constraints. As a result, they can support greater volumes—from increased trading, new client acquisition or new lines of business—without having to ramp up staffing levels.

3—Improved client service

Clients are demanding more and better access to relevant data. Sophisticated client reporting in particular has become an essential part of the customer experience—as seen with the emergence of interactive portals.

Attracting new clients and retaining existing ones depends on cutting edge technology that allows you the flexibility to service investors how they want to be serviced. We all now expect access to financial account information and investment insights on any device, whenever and wherever we are. And we expect that information to be current and error-free. Having to inform clients that their account details are wrong, or that the investment performance must be restated due to data errors is not a recipe for satisfied customers.

Similarly, providing portals for internal users has become an important part of the service mix. For example, equipping relationship managers with mobile, interactive tools allows them to better engage with their end clients while on the road—including by sharing account information, reviewing and revising investment strategies, and creating opportunities to cross-sell relevant products and services.

However, before clients see that data it has to be cleaned and checked—and that means properly reconciled, using a strong workflow, at least daily.

4—Service delivery control

By automating the reconciliation process, and switching to an exceptions-based environment, firms can gain enhanced visibility into their counterparties' service delivery, and identify where process improvements can be achieved.

With the aid of sophisticated investigative tools and reporting capabilities, management can track where breaks occur. Armed with intelligent insights into their business and counterparty interactions, and the quality of service they receive, firms then have the power to review—and where appropriate renegotiate—agreements with their service providers.

5—Enhanced compliance

An automated reconciliation and exception management system reduces errors and operational risk, ensures standardized procedures, and maintains accurate activity records and audit trails for regulatory reporting. A firm that fully automates its processes is in a much better position to demonstrate compliance when required, and keep pace with ever tightening and more complex regulatory requirements.

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Figure 1: **Custodian reconciliation**

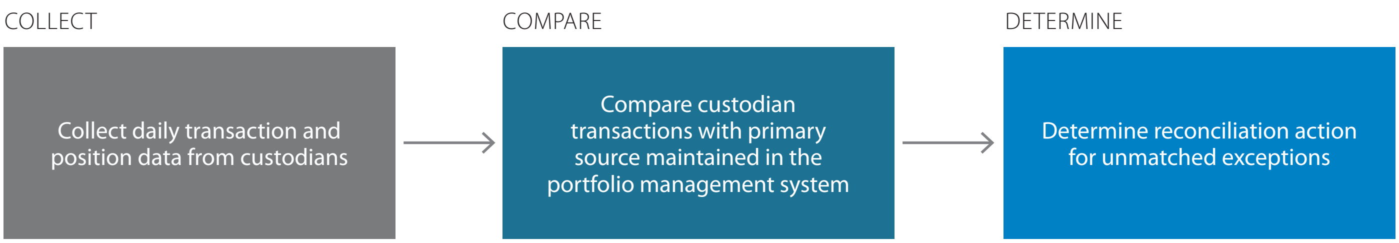
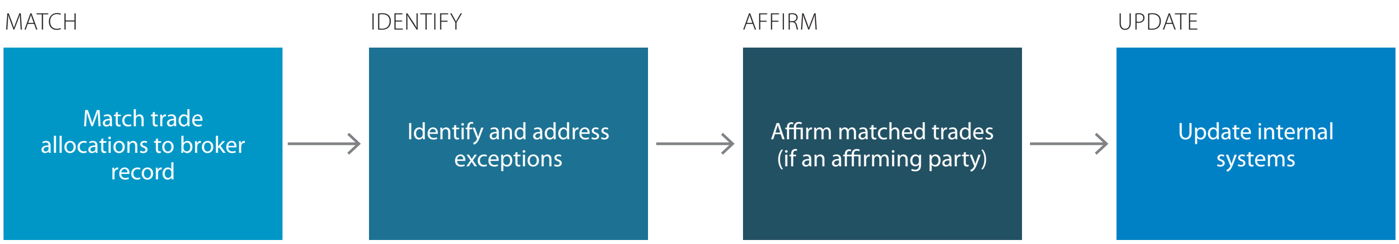


Figure 2: **Broker reconciliation**



Best practice workflow model

Automating the reconciliation process can bring significant benefits—provided the right solutions and processes are adopted. So what does implementation of a best practices reconciliation environment entail?

The first step is to identify the various stages needed in the reconciliation workflow. There is no "one size fits all" process, since different asset managers have different needs. However, most firms implement some form of custodian reconciliation, as that is the last check before sending out client reports (Figure 1).

In addition, some firms opt for a greater level of scrutiny by self-affirming, adding broker reconciliation to their workflow so they can catch and control issues further upstream (Figure 2).

Once the specific workflow stages have been identified, firms can focus on making each operate as efficiently as possible, and thereby ensure the whole reconciliation process runs smoothly.

The reconciliation workflow can also be applied to any area where there is potential for data discrepancies. This could include conducting NAV reconciliation with a fund administrator, or reconciling other internal systems, such as the portfolio management system (PMS) with the order management system (OMS).

Whatever process you adopt, regulators advise you to fully understand your areas of risk so you can design policies and procedures to limit exposure.

Implementing an effective reconciliation environment requires a solution that can capture, validate, match and reconcile data between your portfolios and a wide range of external parties.

Automating reconciliation: 10 steps to greater efficiency

Once the best practices have been identified and established, the next step is to introduce appropriate technology to automate each step of the workflow puzzle.

Implementing an effective reconciliation environment requires a solution that can capture, validate, match and reconcile data between your portfolios and a wide range of external parties. And when breaks occur, a sophisticated solution will assist the exception management process by automating as many functions as possible, thereby increasing efficiency, cutting costs and reducing errors.

Key capabilities to look for when considering a reconciliation IT framework are:

1. Flexible data capture with automated access to two unique sources of account activity:
   - Primary: Internal source (such as data held in your order management system).
   - Secondary: External source (such as custodial data aggregation service, clearing house, custodian website).
2. Centralized electronic data collection, aggregation and normalization from the widest possible universe of counterparties, with daily connectivity and the ability to deal with multiple file types.
3. Immediate transaction amendment capability, enabling staff to add or replace data and track exceptions.
4. One-time mapping configurability to automate rudimentary or recurring steps of data collection and processing, enabling the user to focus solely on exception management.
5. Customizable rules-based matching engine with user-defined tolerances.
6. Sophisticated investigative tools to identify exception root causes, and aggregate similar exceptions for long-term resolution.
7. Automatic exception prioritization and assignment to ensure staff remain focused on areas of greatest impact, with the ability to mark and set aside pending items to be resolved later (for instance if reconciling after a re-org or if the custodian is late in reporting).
8. Management dashboards, customizable by role, to provide a clear view of critical, enterprise-wide data, including breaks by portfolio, group, date, age or other criteria.
9. Production and efficient distribution of easy-to-read, high quality reports to provide full visibility into cash, holdings, transactions, trial balances and security masters.
10. Audit trail support to record all actions undertaken during the reconciliation process.

Technology deployment options

When it comes to implementing a best practice reconciliation framework, asset managers can choose from three broad options:

- Build—Use internal resources to design and build a solution.
- Buy—Purchase commercially available technology.
- Outsource—Hand off the process to a third party.

Whichever option you choose, it is vital to dedicate your technological and business resources to those strategic differentiators that will provide the greatest competitive advantage.

Figure 3: **Technology deployment options**

	Pros	Cons
Build	• Develop the specification to meet the firm's exact needs • Full control of the solution's future destiny	• Costs of using internal technical and business expertise in technology development • Potential lack of expertise • Risk of deployment delays, resulting in outdated solution • Ongoing maintenance expense and need to keep pace with market, regulatory and technology evolutions • Distraction from core
Buy	• Leverage proven solution, built by experts • Benefit from pooled R&D in future system development • In-house customization potential	• Cost of purchase and implementation, and ongoing maintenance • Deployment lag time • In-house IT staff costs • Need for future upgrades
Outsource	• Avoid large, upfront capital investment • Leverage IT and business expertise • Rapid deployment • Immediate access to updated functionality as it becomes available • Provider is responsible for keeping pace with market and regulatory changes	• Ongoing contract fee • Perceived lack of control and data access

A case study

A $1 billion U.S.-based asset management firm had one person doing all its reconciliation manually at month-end using paper custodial statements and some online tools.

With about 850 accounts, the process took more than a week. It meant investment decisions were made based on stale and potentially inaccurate data. And when errors occurred they might not come to light until well after month-end, causing a ripple effect of problems in the meantime.

The firm decided to implement straight-through processing technology to automate the connections and integrate data between its systems and external parties such as custodians, brokers and securities data providers.

This enabled the asset manager to automate its trading, settlement and account reconciliation.

Without having to increase staff, every account is now reconciled daily, and a process that took more than a week has been cut to approximately three hours. Exceptions are uncovered immediately. By noon, clients can get accurate positions as of the previous day's end. And portfolio managers and traders know they are working with the most current, accurate data available.

While automation in itself may be no guarantee of success, a scalable and repeatable process will provide the foundation for stability and growth—and a measure of protection against market uncertainty.

Meeting the challenge, seizing the opportunity

In the face of soaring trade volumes, increasingly complex transactions and mounting pressure for faster reconciliation, investment management firms today face both a challenge and an opportunity. The challenge is to meet the growing market demand for accurate, real-time reconciliation regardless of volume levels. The opportunity is to increase efficiency, eliminate error-prone manual intervention, and reduce the labor and infrastructure costs associated with reconciliation. Fortunately, technological solutions exist that enable a firm to both meet the challenge and seize the opportunity.

Introducing automated processes wherever possible across an enterprise's operations—with all the cost reduction, error minimization and scalability advantages automation brings —is one of the most effective ways for industry participants to gird themselves for whatever changes and challenges lie ahead. While automation in itself may be no guarantee of success, a scalable and repeatable process will provide the foundation for stability and growth—and a measure of protection against market uncertainty.