

# WEALTH MANAGEMENT BRIEFING

## The Client Reporting Conundrum

In this briefing document we consider the workflow around the client reporting process and the requirement for delivery of complex information whilst retaining standards for timeliness and quality of the reports delivered to the client.

In part the increased complexity of the reporting process is driven by structural changes to the marketplace, driven by the implementation of CRD and UCITS III for example. There has been a rapid expansion of the range of products available as a consequence of banks seeking to prepackage and securitise future cash flow and hedge their clients' risk. We are also seeing the expansion of more traditional asset classes such as money market funds. As these products come on line, the capabilities of core systems to correctly value open positions in these assets becomes a limiting factor in the firm meeting client demand for access to these instruments.

The drivers and challenges arising from the increased usage of these instruments are considered herein.

## Client Reporting – Workflow and Process Management

The nature of the challenge faced by Wealth Managers in respect of quality client reporting has changed in the last 2-3 years. Yesterday's innovations, such as colour printing, electronic distribution and custom report formatting, have become the market standard. The battleground has moved to the delivery of more complex information whilst retaining the same standards for timing of delivery, accuracy and flexibility.

Client investment mandates have become more complex, requiring increased diversification into new asset classes, sectors and geographies. This has resulted in increased focus on investment in alternative assets both to provide a performance uplift and to balance the portfolio.

Reports include more detailed performance attribution analysis and risk management information than existed five years ago. This is often represented graphically to illustrate the particular styles and controls deployed by the manager in a way the client can easily understand.

This development brings about major difficulties for managers in terms of producing and checking client reports. Firstly, data has to be extracted from multiple locations and sources. It is thus more difficult to ensure consistency, for example, between valuations used in risk management, performance measurement and fund accounting. Secondly, the finished product relies on more contributors as the data necessary for stock level attribution, portfolio risk characteristics and other information requires input from middle/front office personnel. Thirdly, clients are increasingly demanding that reporting be tailored to their individual requirements. Client reporting systems therefore need to evolve to meet these requirements, but more fundamentally, fund managers must ensure that the entire investment process is integrated and controlled efficiently from the front office through to the back office administration process.

## Hedge Fund Regulation

The UK hedge fund industry may split into two distinct segments – those hedge funds who concentrate on High Net Worth Individuals and the traditional hedge fund client base, and those who concentrate on Institutions and Pension Funds:

- Regulation is seen as inevitable by most industry players but is seen to be more likely for those hedge funds targeting institutions and Pension Funds;
- Regulators are keen to ensure that pensioners are protected from any blow-ups;
- Funds of Hedge Funds that target the UK retail investor (from 2007) will also find themselves subject to increasing regulation.

## It's a WRAP

Much has been written about wrap accounts over the past few years and they were described as the next big thing to hit the financial services industry. However, after the initial euphoria, it has been relatively quiet on the wrap front.

In 2006 we observed a pick-up in activity with the launch of Standard Life's proposition, Friends Provident's statement of intent to enter the market, and more recently Bravura Solutions' acquisition of The Bank of New York's transfer agency software business.

Wrap has been a clear success story in Australia with an estimated 70% of private client assets being invested in these wrappers. Consequently, software companies such as Bravura and Infocomp have been very keen to promote their systems here in the UK. By acquiring BNY's platform, Bravura is positioning itself well to build on its strategy to enter the UK and European wealth management markets.

Industry commentators are forecasting that wrap platforms will be administering £180bn AUM by 2008 and some of the early entrants claim to be close to reaching critical mass.

It will be interesting to observe how the wrap market evolves over the coming months and how technology is used to gain competitive advantage, especially by the early adopters.

## Business Activity Management

The constantly evolving nature of the operating environment forces evolution in business processes. These changes often cause inefficiencies that are manifested in lost time, lost productivity and duplication of effort, all of which ultimately lead to increased cost and risk.

Business Activity Management (BAM) is a business strategy that can identify actionable events based on combinations of real-time business and technical occurrences across many different applications and other information resources.

A closed-loop process of generating real-time alerts and taking action is not new, BAM sources data from multiple systems, not just one. BAM applies operational business intelligence and application integration technologies to automated processes enabling users to refine them based on real time feedback on operational events. Dashboards may be used to provide an integrated and consistent view of the state of the business and infrastructure in relation to plans, forecasts or quotas.

## Applying grid computing

Because of the complexity of many financial products and the increased demands for sophisticated analytics to satisfy the urge for managers to gaze into the future by running forward looking scenarios, the demand for computing capacity has grown rapidly in recent times.

There are a variety of responses to these requirements: buying a supercomputer; limiting the number of calculations; or using 'estimates' for the inputs. These may all serve to deliver the required end result, but each approach comes with its own limitations and risks. These risks are either in terms of the accuracy of the output or overly high system utilisation when the calculations are running.

The exploitation of a grid computing solution in this context may give a relatively low cost, effective solution to these resource hungry calculations since the calculations can often be broken down into a series of discrete pieces of work within a simple master-slave relationship.

## Citisoft Services

As a specialist global consulting firm, Citisoft combines strategic analysis, planning and project management skills with expert knowledge of wealth management, family office and private banking business models, processes and technology.

Citisoft's Wealth Management Practice offers a complete range of consulting services focused on private banking, wealth management and investment management. With a client base of more than 75% of the top 50 global asset managers, Citisoft is the foremost supplier of strategic planning and implementation services to the investment management sector.

## Buy side technology change

As wealth managers increase their use of alternative asset classes and trading strategies, the need for firms to account for these products correctly, control risk and utilise standard pricing and valuation methodologies becomes more pressing. The drivers for this change are varied but include the following:

- Regulatory change (i.e. Basel II, IAS, UCITS III etc);
- Falling or low returns from traditional exchange-traded markets;
- Maturing OTC derivative markets;
- Preference for absolute return-based investing versus relative return-based investing.

As a result, sell-side and hedge fund-specific software vendors are now targeting the buy side arena with trading, risk, pricing and valuation, accounting and portfolio analysis systems. Until now the focus has been on the institutional business, it is anticipated that wealth managers will soon follow.

The entrance of sell-side and hedge fund-specific vendors to the buy-side space has meant that there are now a number of platforms available to process most complex instruments throughout their trading and settlement lifecycle.

It must be noted that there are a variety of challenges in this approach. Integration of the data generated from these disparate systems (and associated spreadsheet solutions) may cause a significant overhead when client reports are required because data from various sources needs to be accumulated, cross referenced and reconciled.

These workflow challenges for client reporting are discussed elsewhere in this briefing paper.

## Money Market Funds as surrogate bank accounts

There has been a rapid expansion in the usage of money market funds by institutional investors over the last few years, this expansion has been driven by the following factors:

- Access to AAA rated deposits for investors which may not otherwise be available;
- Enhanced credit monitoring over and above that which could be supported by a non specialist organisation;
- Client cash is not exposed to the balance sheet of the bank holding the deposit;
- Risk diversification:
  - Placement of deposits with only AAA rated institutions leads to concentration risk;
  - Placement of deposits with smaller institutions leads to increased credit risk, however, access to large institutions is often not available to smaller firms;
- Same day liquidity (within constraints of cut off times).

As more wealth managers adopt the open architecture approach to managing client money we may see significant change in the treasury function. The daily sweep of funds to a pooled deposit will be absorbed into the funds' processing capabilities and the selection of counterparties for the cash management function will become absorbed into the manager selection and monitoring process, as for any other third party funds.

## Data Cleansing

Recent market and regulatory change coupled with the implementation of sophisticated instruments and trading strategies, have driven significant changes in the demand for financial time series data to support the decision making process.

The more sophisticated analytical models frequently display the greatest sensitivity to unclean data sets. Whilst one can use robust techniques to reduce the sensitivity of calculations to bad data (e.g. a median instead of a mean) clearly it is preferable to deal with the bad data before it is input to the model.

It is becoming increasingly important to ensure that not only is data accurate, but it is managed and validated in a single data management group. This team should be responsible for the maintenance of data at core level and should also own the strategy for the acquisition and cleansing of that data.

Centralised ownership and management of data should both improve the quality of the inputs to both regulatory and client facing reporting issues and potentially enhance STP rates for transaction processing.