

ISChronicle

Investment Solutions Consultants

Spring 2009

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A Chronicle of the Investment Management Industry



Welcome to the Spring 2009 Edition

Welcome to the Spring 2009 edition of the ISChronicle. We received a lot of positive feedback on the article in the last edition of the Chronicle on running successful Client Reporting projects, so in this edition we have continued the theme with an article on running successful data management projects, something

which we at ISC have many years of experience in.

In addition we have also included a White Paper on OTC derivative processing, written in partnership with Checkfree (Fiserv) in response to commitments made by the major dealers to the Fed at the end last year. As always we hope

that you find these insights useful and edifying and welcome your feedback on these and any other topics.



Sean Sprackling
Partner
ISC LLP

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Successful Data Management Projects

Data Management has been the subject of increased focus in recent years. Many firms have realised that without a coherent data management strategy, success in a wide range of projects cannot be guaranteed.

It is unusual these days to come across an organisation that has not spent time and energy implementing some form of data management solution. These range from the simple single data vendor storage and onward transmission type service to the more sophisticated and complex multi vendor, "golden copy" construction offering. Some of the more forward thinking organisations are even realising that reference data does not need to be constrained to security or instrument data, but that the same disciplines can be adopted when looking at other classes of reference data (for example client and portfolio data).

Even in today's turbulent economic times and despite downward pressure on budgets, a recent survey indicated

that a majority of firms are increasing their investment in data management rather than cutting back.

Despite this increased focus and attention, data is still cited as one of the leading causes of project failure in our industry. This leads us to conclude that despite its trivialisation in certain circles, the implementation of a robust data management solution can be a complex undertaking. This article is aimed at data management professionals and seeks to illustrate a series of "do's and don'ts" which may alleviate some of the problems typically found in such departments. These activities are practical in nature and are based on things which I have seen working in some data management functions or contrarily not implemented or only partially implemented and therefore the cause of problems in others.

Understand what your clients wants

This would seem to be a remarkably simple premise, but

equally remarkably, it is one that is commonly overlooked. The effort required in data coverage and data cleansing activities can be substantial. It therefore seems sensible to prioritise these efforts by addressing those areas or data attributes considered crucial by the recipients of the data. Talking to clients about their requirements provides the additional benefit of formulating an understanding of data and how it is used amongst the staff working in the data management area. This is a crucial step in building the client/service provider bond necessary for high quality service but is often missing in practice.

Implement SLAs with your clients

In common with many service delivery functions, the data management team is never mentioned when things are going well, but receives substantial publicity when something goes wrong. Implementing Service Level Agreements (SLAs) provides a simple mechanism to assess the performance of the service

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Talking to your clients is a crucial step in building the client/service provider bond

“...You must learn from the mistakes of others. You can't possibly live long enough to make them all yourself...”



Be careful what you ask for...many of the data vendor offerings in the market are very complex

Successful Data Management Projects

free of the emotion that always seems to be prevalent when things are not going well, thereby ensuring that the perception of the service provided is based on fact. In instances where SLA targets are being missed, this also provides data managers with an early opportunity to analyse causes and implement remedial strategies. Do not however underestimate the effort required to build the tools you will need to measure performance against SLA as automating this can involve substantial complexity.

Research your market

As mentioned in the point above, the provision of a high-quality service is partly about perception. It is important that people in the organisation regard you as the most knowledgeable people when it comes to data. Furthermore, in order to provide the best service to your clients, it is necessary to keep abreast of developments in the data space. Market data vendors and services change frequently. Just because vendor A provided you with the best price/coverage combination when you implemented their solution doesn't mean that this is still the case. A sensible review programme should be put in place to confirm that the solutions taken still offer the best in terms of quality and value.

Question data quality

Just because data is being provided by a reputable vendor with a good name in the market doesn't mean that the data is accurate or complete. Even the most renowned data vendors have known quality issues in certain areas.

Be careful what you ask for

Some of the leading data vendor offerings have seen an explosion in content over the years. In some cases, this has been achieved by cobbling together multiple disparate sets of data. This has resulted in many of these becoming

very complex. It is wrong to assume that data provided by a vendor is what you are actually looking for just because the attribute names match. It can be the case that you will need to look at a number of vendor attributes to derive the required value. For example, a source attribute may differ and depend on an instrument type classification.

Stick to your guns

If you are building “golden copy” records from multiple sources, treat client requests for alternatives with caution. The golden copy represents the preferred view of that data within your organisation. There may be valid reasons why people wish to deviate from this, but they should not be allowed to do so just on a whim.

Be religious about exception processing

Provision of high quality data in a timely fashion is at the core of any data management mission statement. It is essential to build mechanisms to enable the rapid review of data exceptions or potential problems if this principle is to be met on a consistent basis.

Purge data

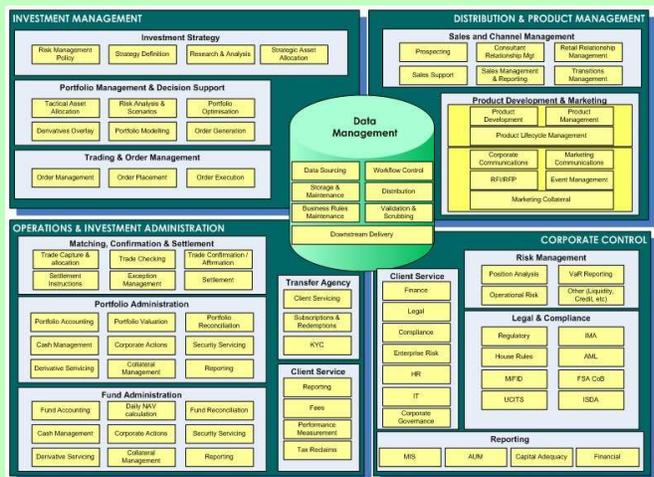
Data archiving or purging is usually one of the first items to be de-scoped if a data management implementation project begins to experience pressure against targets. It may not be possible to implement a data purging process immediately for these reasons; however this is definitely something that should be addressed as soon as possible. Many data management installations struggle to perform all of the data collection, manipulation and publication activities required in a busy processing window. The capture and manipulation of unnecessary data is precisely that, unnecessary.

Talk to your peers

The well known American humorist and writer Sam Levensen once said

“You must learn from the mistakes of others. You can't possibly live long enough to make them all yourself”

I imagine most people would agree that learning by knowledge acquisition is often more efficient than trial and error. Yet despite the freedom with which people are prepared to discuss their experiences, the vast majority of us continue to re-invent the wheel.



Data sits at the heart of firm's logical models...

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Successful Data Management Projects

You can rest assured that any data management related problem you may be grappling with has either been encountered and resolved by one of your peers, or may be resolved simply by talking to like minded people with different experiences.

If you or your organisation has already addressed all of

the above, stand up and take a bow. You are in a very small minority of organisations looked up to and envied by your data management peers. If, like the vast majority you have not considered some of these points or have tried to address them but not succeeded, I urge you to try again. I cannot guarantee that conformity will bring success, but it will certainly

be an improvement on where you are today.



Mike Patti
Partner
ISC LLP

ISC Announces Launch of an Outsourcing Review Service

Investment Management outsourcing has moved forward from the late 1990's and is now a maturing science. Contracts are being renewed for the first time and in some cases for the second time. There is a realisation that the relationship with the provider has to mature into a true partnership.

ISC has recognised that the operating models of administrators are becoming true multi-client platforms, looking to provide a more comprehensive service than just fund accounting.

To achieve efficient and reliable outsourcing, the point of isolation (the functional and technical division between the parties) must be truly understood, robust and flexible to change. Geoff Edwards, ISC Partner, explains, "Providers of outsourced services want to demonstrate an improved ability to handle complex asset types, fund structures and regulatory change. Additionally these providers want to deepen relationships by offering a broader service, demonstrating an ability to service more middle office functions and provide an extended range of post-accounting functions such as; collateral management, performance measurement and client reporting, either as bundled or unbundled services. ISC under-

stand these issues and have an extensive history of delivering change to this market."

ISC have therefore launched a new service targeted at Asset Managers that have outsourced, or are reviewing the option to outsource and the administrators that provide such a service. The **Outsourcing Review Service** provides a fast-tracked operational and structural review against established metrics, best-of-breed models and peer groups. The review will provide critical advice to three groups.

Investment Managers reviewing the option to outsource:

The review will identify the appropriate points of isolation for the Investment Manager given the operational structure of the organisation; Where in the lifecycle of a transaction does outsourcing occur and what are the most appropriate mechanics at that point. Further, the analysis will identify the set of functions that can be most efficiently bundled as part of the initial transition. Where no point of isolation is evident the review will identify the roadmap to this point, as a foundation to the outsourcing decision.

Investment Managers who have outsourced:

The review will recommend any changes to existing structures that provide operational advantage, economy of scale or cost efficiency. The process will identify improvements to data structures, processes and technology that deal with manually intense tasks, points of duplication and error in order to reduce operational risk.

Again the review will provide a roadmap for change and a commentary on how the two parties (outsourcer and administrator) can deepen relationships and move up the value chain by transferring other functions not outsourced at present.

Administrators providing outsourced services:

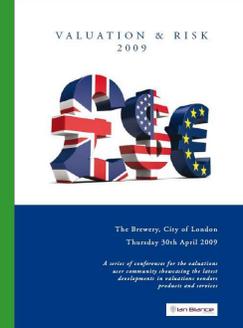
ISC will use their extensive and demonstrable knowledge across all functions of investment management to provide a fast-tracked analysis of how to; improve the management and provision of data, strengthen or change the points of isolation, recommend solutions to functional challenges and how to move clients up the value chain through the provision of additional services.



Geoff Edwards
Partner
ISC LLP

Spring 2009

Valuation & Risk Conference 2009



Recent developments in the global financial markets have increasingly focused attention on the approach to the *valuation of financial assets* held by institutions, either on their own behalf or that of their customers. There have been a number of *high profile losses* and failures that have been directly attributable to the mis-pricing of assets.

Consequently, because of our reputation in this area ISC were invited by the organisers (Ian Blance Consulting) to participate in this vendor conference that included the likes of:



For more information on the conference or the vendors, please contact sean.sprackling@iscllp.com



“...An efficient post-trade process that captures, enriches and routes contracts to the appropriate destination will eliminate material confirmation backlogs...”

Geoff Harries, VP Product Strategy, Checkfree Investment Services Software

OTC Derivatives: Taking the next steps to Operational Excellence

This article was originally published as a joint White Paper with Geoff Harries, VP Product Strategy CheckFree Investment Services Software:

The stall has been firmly set out. The recent letter from the Operations Management Group (OMG) to the Fed set out some tough, but clear, guidelines for organizations to adhere to. The OMG letter outlined some major operational guideline changes in which 85% of electronic trades are to be processed on T+0 and 94% of confirmations are to be processed without modification, including novations. This means existing silo based platforms and manually intensive operational procedures are no longer viable. The pressure is on for institutions to improve internal operations, which will mean a cultural shift for many organisations. As a result, firms need to address the way OTC derivatives are processed across multiple sub asset classes in order to manage operational risk more effectively. Firms can take a number of practical steps to meet the seven key goals and deadlines highlighted to the Fed.

Reducing Operational Risk

There are four main areas identified by the OMG for improvements which will deliver operational efficiency through required changes in procedures, process and IT infrastructure.

Electronic processing of eligible trades to enhance trade date confirmation issuance and execution

To process trades efficiently through electronic platforms, certain building blocks must be in place. An adoption of FpML as the lingua franca of OTC automation is essential to ensure interoperability with counterparties and market infrastructure.

The challenge lies with front-end trade negotiation tools, which do not contain all of the reference data information necessary to create a valid FpML message. Passing contract details to a specialised post-trade event management system ensures that trade enrich-

ment and validation occurs in an automated environment, eliminating the need for additional manual intervention.

Elimination of material confirmation backlogs

An efficient post-trade process that captures, enriches and routes contracts to the appropriate destination will eliminate material confirmation backlogs. The industry benchmark for operational efficiency is constantly being raised and these targets can only be achieved by investing in scaleable solutions supporting the adage of “get it right first time - every time”. This is only possible to achieve by removing the main cause of bottlenecks, errors and rework, namely manual processes. Manual intervention should be limited only to where business exceptions fall outside of a pre-defined automated process.

Risk mitigation of paper trades

There has been a rapid expansion in the use of derivatives structures across a number of investment vehicles. With this growth comes the operational pressure to deal with the increasing volume of events, both pre-trade and post-trade. Volumes have been handled as a siloed department with manual input to third-party terminals. This was typically viewed as an appropriate solution; however, as the number of contracts increases, so do the number of post-trade events. Whilst spreadsheet upload acts as a temporary solution to bulk process transactions, it does not offer the resilience, scale and compliance necessary to support core OTC derivative investment strategies.

Streamlined trade life cycle management to process events between upstream trading and confirmation platforms and downstream settlement and clearing systems

Post-trade event management is the only way to effectively

control the by-products of OTC derivative investments. With each open trade there are a number of outcomes that need to be managed over the trade lifecycle. From the point of confirmation to the eventual termination or novation, management of the contract is crucial as it may be amended, increased, decreased or partial events may be applied to sections of the contract. Streamlining the lifecycle is only part of the challenge. Equally important is the ability to manage and monitor the contracts that are in play on top of the new volume entering the process.

Operational response

There are a number of different options available for firms looking to make the transition from manually intensive operational procedures to the desired state of automation and control.

Point-to-Point

This involves developing a single asset class strategy to solve the immediate challenges of trade confirmation automation across a specific electronic platform. This approach is most relevant when the derivatives operation is separate from the cash securities and other asset classes. Establishing an integrated internal front-end system into the post-trade process provides a reference data management framework that enables contracts to be processed more efficiently.

Multi-Asset Class

If the requirement for automation cuts across a number of OTC derivatives products and other asset classes, then a multi-asset class approach needs to be considered. Capturing trades and contracts from multiple order management and trading systems is complex, but not uncommon. Organizations gain economies of scale through specialization in the front office in terms of people and process and consolidating with a single post-trade processing platform, that

OTC Derivatives: Taking the next steps to Operational Excellence

supports the operational aspects of confirmation, settlement and post-trade event management. An OTC derivatives post-trade event management solution can sit within a single solution, capable of supporting multiple business models for trade confirmation and settlement. This can extend across geographies and instrument classes, providing the efficiency of a single interface to manage all exceptions, and providing connectivity to underlying market infrastructure.

Reducing Systemic Risk

Reducing systemic risk is also of paramount importance when looking at the whole process. The following three industry goals relate to the industry's commitment to improve the infrastructure to reduce the systemic risk of the OTC derivatives market.

Global use of central counterparty processing and clearing to significantly reduce counterparty credit risk and outstanding notional net positions

There are currently several initiatives underway in the market to provide on-exchange clearing for OTC contracts. This is seen as a necessary step to reduce systemic risk by allowing for exposure netting and centralised position management. Some contract types already have facilities in place, such as LCH.Clearnet's Swap-clear service for rates contracts, or ICE and Clearport in the commodities markets. The credit market has seen raft of new entrants, however other

contract types, such as equities, may take longer to follow suit. This is because the roadmap towards central clearing will be drawn up once the volumes of electronic processing of these products increase.

Continued elimination of economically redundant trades through trade compression

One of the few positive outcomes from the recent turmoil was the efficient way in which the various facilities for trade compression worked. Also known as "tear-ups" these services allow dealers to ensure reductions in unnecessary exposures. This can be achieved by netting off matching positions and allowing market participants to reduce counterparty credit, funding liquidity and operational risks. Used by the dealers and the larger managers, the services provided by Markitwire and TriOptima have become a sine qua non for all derivative users – so much so that during 2008 the large investment banks "tore up" more than \$30,000 billion worth of credit derivatives (the equivalent of almost half the notional amount outstanding on these contracts at the start of the year).

Central settlement for eligible transactions to reduce manual payment processing and reconciliation

Intrinsically linked to the question of central clearing, the industry requires the use of central services to simplify the often convoluted web of manual processes and multiple

reconciliations. All participants, including dealers, managers, custodians, outsourcers and prime brokers are involved in this process. Therefore a central point for settlement (such as that provided by CLS bank for Deriv/SERV's Trade Information Warehouse) needs to be implemented for all products.

Operational Response

The above industry initiatives may seem somewhat removed from sphere of the average asset management user of OTC products, but there are some important operational implications embedded in these developments that the industry needs to respond to:

Liquidity Management

In illiquid times, liquidity becomes of paramount importance. The onset of central clearing for OTC products will put a further onus on operational procedures. Managers will not only need to respond, but anticipate margin calls emanating from the clearers and/or dealing counterparties. Some may already have these procedures in place for exchange traded products. For others this will require the implementation of margin calculation processes to value contracts and perform what-if forecasting. Timely communication of this information between front, middle and back offices is also necessary to ensure that fund managers have the requisite information on a daily and intra-day basis. Exactly how dealing counterparties will pass-through these exchange requirements to their asset management clients remains to be seen. It is likely that there will be a hybrid model of OTC collateral management and ETD margining existing side by side – processes that do not necessarily co-exist in current operating models. What is certain however is that cash will be king and the occurrence of managers using stocks as collateral will diminish.

Reconciliation Processes

As a corollary to the above, cashflow reconciliation processes will also need to be exam-

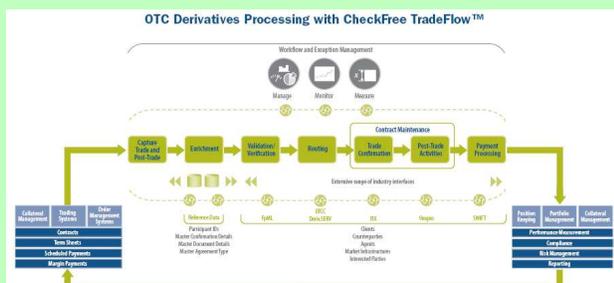
ISC & Derivatives

ISC offers our clients a short-form Derivatives Operational Health Check service. The service provides a structured review of managers' existing derivative operations, systems and processes from front through middle to back office in order to provide pragmatic advice designed to expedite the delivery of the robust and scaleable operating model required to manage derivatives. The service covers the following functions:

- Portfolio modelling and risk management
- Compliance (including UCITS III regulations)
- Trade execution and messaging
- Confirmations, novations and terminations
- Pricing and valuations
- Collateral management
- Lifecycle payments and settlements
- Performance and client reporting
- Data management
- ISDA documentation
- Governance structures

For more information on this service, or to discuss your knowledge requirements in the derivatives area please contact:

Julian Manfredi
Partner
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Tel: 07983 431 401



CheckFree TradeFlow helps streamline the processing of OTC derivatives by improving operational capabilities, reducing risk, providing real-time status management and removing operational bottlenecks.

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Next Editions:

In upcoming editions of the ISChronicle we will be looking at other issues in the Investment Management world, including:

- Running a 21st century consultancy
- Liability Driven Investing
- Securities Finance and Collateral Management

ISC Recruitment Update

We currently have the following positions open:

- **Compliance Rule Codifiers (Contract)**
- **Business Analysts for a number of outsourcing projects (Contract)**
- **Senior Consultant and Consultant positions at ISC (Permanent)**

For more details on any of these roles please send your CV to: recruitment@iscllp.com

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ined to ensure that managers have the correct tools to reconcile to the clearing and settlement systems and dealing counterparties. This may require changes to the current processes or the implementation of new reconciliation tools. These processes will need to include both collateral and margin amounts as well cashflows from the actual contracts themselves to ensure proper cashflow management. Clearly automating these processes will require connectivity and agreed data formats with counterparties, as

well as exception processing for efficient management oversight. The increasing pressure from the likes of OMG is welcomed in many quarters as it will require organisations to not only consider new IT infrastructure and operational procedures, but also change their mindset as to how confirmations are processed. Only with this new focus can organisations hope to reduce the number of paper trades through the use of electronic platforms, eliminate material

backlogs and streamline the OTC trade lifecycle.



Geoff Harries
VP, Product Strategy
CheckFree Investment Services Software



Sean Sprackling
Partner
ISC LLP

ISC launches CSI Resourcing Subsidiary

ISC is proud to announce the launch of our new IT resourcing division CSI Resourcing.

CSI Resourcing will provide our clients with IT development and support resources in both the Finance sector and beyond.

To lead these efforts we are also pleased to announce the appointment of industry veteran, Jeremy Jones. Jeremy previously worked with Gresham Computing and has over 18 years of experience as a Sales/Recruitment professional.

Commenting on the launch Mike Patti, ISC Partner, said: "We are delighted to welcome Jeremy into the ISC family. The experience and domain knowledge which Jeremy brings further strengthens the ISC offering and demonstrates our commitment to providing quality technical resources to our clients."

Jeremy Jones said: "ISC is a rapidly growing business despite the current market conditions, and I was thrilled to be given the opportunity of working with such an innovative and dynamic organisation".

For further information on the services provided by CSI Resourcing and to discuss how we can help contact:

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