Broadridge®

Rethinking Reconciliation

How a global center of excellence can enhance risk management and reduce costs

Ready for Next

Are your managers spending too much time and resources collecting and reconciling data, and not enough evaluating information, optimizing operations and mitigating risk?

Reconciling activity requires financial services firms to overcome the challenge of managing across an expanding set of asset classes, currencies, business entities and markets. As regulatory demands increase, so does the cost of falling further behind the industry standard for a reconciliation center of excellence.

Reconciliation processes have historically been inconsistent and embedded within different entities creating ad-hoc, manually intensive and non-standard silos, often using spreadsheets or inhouse grown solutions. These processes have evolved incrementally due to: 1) the interdependencies involved in system expansions and integrations; 2) cost constraints; and 3) speed-to-market pressures.

The "path of least resistance" has been to maintain one-off reconciliations, rather than allocate the time and resources to implement scalable best-in-class solutions.

The need for change is being driven by:

- Increased and more complex regulatory requirements – such as BASEL III and Dodd-Frank
- Pressure to optimize firm capital, including increased collateral requirements and the repercussions associated with inaccurate or out-of-date books and records
- The cost of maintaining multiple IT applications and inconsistent processes
- The challenges of managing global and product expansion in a real-time manner

These changes require increased reconciliation staff expertise, as well as proven industry-leading technologies. In ways we will explain, the weight of combined pressures is forcing firms to consider an alternative path – **leveraging a service partner to manage reconciliation centers of excellence for labor and technology.**

KEY FACTORS DRIVING THE NEED FOR CHANGE

1. NEW REGULATIONS INCREASE COMPLIANCE AND RISK MANAGEMENT FOCUS

Repercussions from the 2008 financial crisis have increased regulatory requirements around the globe including Dodd-Frank in the U.S., the European Market Infrastructure Regulation (EMIR), and Basel III globally (see box below).

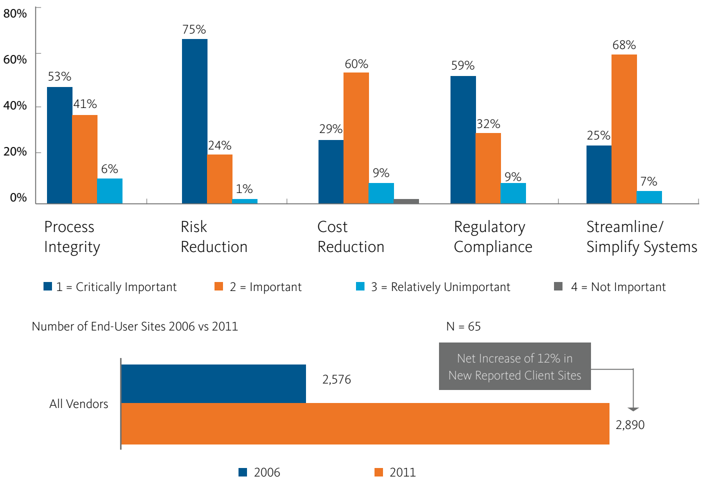
The risks and implications created by reconciliation errors, imbalances of books and records, overdrafts or trade fails elevate the need for seamless risk management and world-class reconciliation performance. Risk reduction is now viewed as a "critically important" driver of reconciliation processes by 75% of Tier 1 banks.

BASEL III – A COMPRE HENSIVE GLOBAL RISK MANAGEMENT STANDARD

The accord known as BASEL III, adopted in 2010-11, is a model for a new era in global risk management standards. It calls for more stringent reform measures on capital and liquidity requirements, e.g., global liquidity coverage. By reducing leverage limits, BASEL requires financial firms to further optimize and more actively manage collateral and capital around the clock to avoid additional costs.

One of the ways to face these capital, collateral and liquidity pressures is to create standardized, real-time reconciliation processes to ensure your books and records are promptly and fully balanced. Reconciliation tools will also need to have mark-to-market capabilities, and the ability to convert currencies and create centralized reporting with risk alerts in a real-time manner.

EXHIBIT 1
A MARKET REFOCUSED ON RISK MANAGEMENT AND REGULATORY COMPLIANCE



› Automated reconciliation has historically been an example of high adoption rates of third-party solutions.

- Them most critical reasons that leading FSIs are moving toward centralization of reconciliation are risk reduction compliance, and cost reduction
- These factors serve as a proxy for the overall concerns COOs and CTOs are articulating about the highly risk-sensitive environment in which their institutions are operating.

SOURCE: TowerGroup Global Survey of Teir 1 Banks' Reconciliation Practices, May 2011

As most financial firms will not be able to pass the costs created by these new regulations through to clients, sell-side and buy-side firms are increasingly motivated to partner with technology and labor service providers. Historically, financial services firms have primarily outsourced non-differentiating functions for cost savings. However, the BPO industry has evolved enabling firms to leverage industry expertise and operational best practices without diverting investment dollars from areas that generate competitive advantage.

2. AUTOMATION ADDRESSES GLOBALIZATION REQUIREMENTS AND RISK

Financial services firms operate in global markets around the clock, driving demand for multi-entity reconciliation functions. Firms are challenged to clear, reconcile and settle trades in real time and report and correct any problems quickly. Sell-side and buy-side firms trading globally face the additional risks of currency conversion, capital charges, execution delays and mark-to-market requirements.

Additionally, as a result of the 2008 financial crisis, buy-side firms are increasingly faced with reconciling more diverse information sets while avoiding costly errors and optimizing collateral.

These firms are also spreading trading and collateral across multiple prime brokers, CCPs and custodians, significantly increasing the importance and complexity of reconciliation processes for buy-side firms.

As global securities markets never sleep, risk managers must respond faster by focusing less on gathering information and more on evaluating risk “hot spots” and understanding trends quickly, wherever and whenever they emerge. Reconciliation systems must be able to adjust for local market nuances quickly and cost-effectively. Automated reconciliation services have become a key to managing and prioritizing counterparty risk, managing capital, meeting deadlines, optimizing collateral and reducing associated costs.

3. EXPANSION OF INVESTMENT INSTRUMENTS AND TRADING VOLUMES FORCE MODERNIZATION

Trading volumes have increased across many instruments and asset classes – especially derivatives, foreign currencies and fixed income – in part due to the growth of high-frequency trading (HFT). New regulations are expected to increase trading volume and transparency in the OTC derivatives market, which in turn will impact liquidity and increase collateral requirements. Operations areas will also continue to face increased workloads and other demands while facing pressures to reduce costs and improve processing service levels, often without the necessary investment funding.

“Engaging a leading financial technology and BPO provider reduces the time needed to consolidate and match data, affording the flexibility and ability to handle growing trade volumes and providing a broad view of their risks and opportunities to new initiatives, instruments and markets.”

JAMES BLACK, VICE PRESIDENT – PRODUCT MANAGEMENT AT BROADRIDGE

4. LABOR COST PRESSURES PROMPT THE NEED FOR OPERATIONAL EFFICIENCY

Reconciliation activities account for about 30-40% of firms' total back-office labor costs, and the vast majority of this cost cannot be passed through to customers. The pressure to reduce backoffice costs and keep them aligned with firm revenues has fallen heavily on operations departments. Adopting a centralized reconciliation function and partnering with an industry-leading service provider for time-consuming manual reconciliation tasks helps financial services firms achieve significant cost savings, while also increasing speed of information and accuracy.

In Summary: Given the continued pace of new regulations, increased risk management focus and global market expansion, financial services firms recognize that adding new reconciliations incrementally within silos is not a cost-efficient way to achieve enterprise goals. Since many reconciliation processes are performed on-demand or with high frequency, firms also face a transition risk in implementing changes.

A "PARADIGM SHIFT" – CENTRALIZED RECONCILIATION OUTSOURCING SOLUTION

Centralization of reconciliations through an outsourcing provider is the next evolution for our industry. The combination of BPO solutions with industry-leading technology enables these providers to deliver scale and efficiency benefits. Centralization can range from a global hub to smaller units, all providing standardization across business lines. BPO reconciliation functions can be implemented quickly and cost-effectively, with minimal expenditure, by firms on both the buy- and sell-sides. They offer 24/7 access to data with standardized global risk-management processes, increased flexibility to respond to local markets requirements and reliable operational best-practices. Furthermore, BPO providers often reduce exception rates in excess of 25% while offering best-in-class Service Level Agreements and ongoing investments.

A multi-currency global reconciliation outsourcing strategy across the front, middle and back offices and all layers of a firm and its strategic partners (affiliates, custodians, counterparties, etc.) increases straight-through processing (STP) rates while eliminating manual steps, input errors and labor-intensive silos. These functions can frequently accelerate the speed to market for new products, services and regulatory changes offsetting expanding cost pressures on capital, liquidity and collateral.

"Centralized reconciliation functions represent a paradigm shift for the industry. Historically, financial firms spend 30-40% of back-office costs gathering and preparing information as part of disconnected reconciliation processes. Partnering with an industry reconciliation leader can leverage global centers of excellence to create standardized risk management processes. This increases firms' ability and agility to enter new global markets, expand products, and comply with more complex regulations while significantly reducing costs and risks."

MIKE ALEXANDER,
EXECUTIVE VICE PRESIDENT AND CHIEF OPERATING OFFICER
BROADRIDGE BUSINESS PROCESS OUTSOURCING

By reducing firms' FTE staff costs and capital commitments for new technologies, the centralized functions also increase flexibility to reallocate investment dollars to your firm's core differentiating services. With experienced global reconciliation staff in place, a flexible BPO process retains expertise and leverages it to quickly expand into new opportunities – markets, currency, asset classes, etc.

Today's state-of-the-art BPO reconciliation solutions employ versatile, powerful and multifaceted technologies with the power to quickly enable any kind of reconciliation for any type of global asset, currency or financial institution. The reconciliation function can also flag and resolve exceptions based on customizable business rules, improving the ability to identify and minimize risk exposures while responding rapidly and cost-effectively with sensitivity for local market regulations and business-model nuances.

Finally, they can address a high priority of many financial services firms: providing automated and centralized risk management across reconciliation processes enterprise-wide to help diverse financial firms identify, evaluate and remedy common and costly exception patterns in real time.

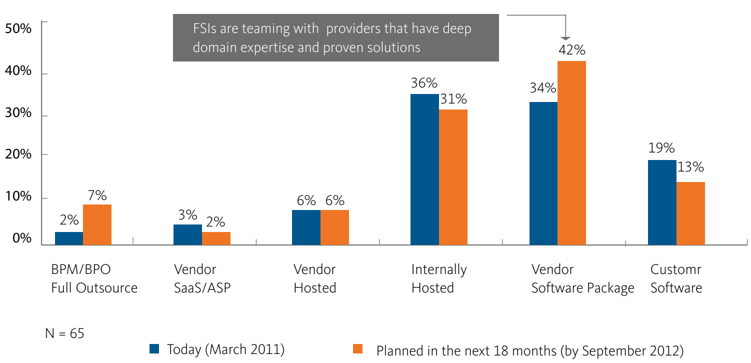
BPO RECONCILIATION ADAPTION ACCELERATED

UTILIZATION OF BPO RECONCILIATION SERVICES IS EXPECTED TO RISE BY 350% OVER THE NEXT 18 MONTHS

Tier 1 Banks have already heightened their reconciliation focus by adopting third-party reconciliation services. According to a Tower Group survey in 2011, only 2% of respondents had already implemented full reconciliation services. Over the next 18 months, respondents indicate that the adoption of outsourced reconciliation solutions will grow by 350%.

In choosing a BPO provider, financial services firms should require proven experience in implementing reconciliation solutions onschedule and on-budget. The chosen provider should also have a deep pool of talent to help clients make transitions or expand systems. The goal is to partner with a provider that can help your firm design and implement an industry-leading reconciliation utility, fully integrated with your core software and processes, onbudget and within a defined period of time.

EXHIBIT 2
BPO RECONCILIATION IS ACCELERATING



› Service-oriented architecture will be used for managed reconciliations solutions along the spectrum from simple matching to data acquisition to exception identification.

• That firms are overcoming their suspicion of solitions “not invented here” is demonstrated by the 42% FSIs who plan on moving to vendor reconciliations solutions over the 18 months.

ACHIEVING CENTRALIZATION IN FOUR STEPS: TECHNOLOGY AND OPERATIONS, EXPERTISE, RISK AND COST

As cost pressures and regulatory requirements continue to rise, financial firms should assess their current reconciliation capabilities across four key areas: Technology and Operations, Expertise, Risk and Cost.

STEP 1: DEVELOP A ROADMAP OF CENTRALIZED RECONCILIATION FUNCTIONS

Technology and operations provide the critical foundation for supporting enterprise-wide reconciliation transparency. Firms should also assess their current or planned capabilities to identify processing gaps that increase risks to the firm.

Reconciliation technology and operations must seamlessly handle inbound and outbound data mapping, matching and exception management across all global asset classes, with the business intelligence to provide value in new ways – by improving risk management and by enabling the optimization of business relationships.

Self-assessment: Technology & Operations Key questions firms should ask themselves to evaluate their reconciliation technology and operations are:

- Does our reconciliation model enable our firm to achieve a high level of control and risk management?
- Do we currently have the agility to rapidly support new regulations with the scalability and flexibility to expand into new markets and asset classes or introduce new counterparties?
- Can we handle the specific exception management processing requirements for all our needs, globally?

- Does our reconciliation technology integrate easily into other critical systems and vendor technologies while fitting into our future architecture?

- Do our reconciliation technology and operations support the needs of our expanding global business community?

- Can we provide operational support in multiple local time zones, or do our global offices operate in silos?

- Are we able to consistently reduce our exceptions by 15-20% each year?

STEP 2: EVALUATE YOUR FIRM'S EXPERTISE

Reconciliation and exception management require a seasoned staff with strong domain knowledge, including the ability to evaluate and adopt the industry's best practices across business units.

Self-assessment: Expertise

Key questions firms should ask themselves in evaluating their reconciliation expertise are:

- Does our staff have the specialized reconciliation knowledge and experience to support all of our global businesses, products, markets, and currencies?

- Is our team aware of best in class reconciliation practices and experienced in evaluating and implementing them?

- Does our operating model support continued expertise development in the reconciliation domain to meet changing regulations?

- Can we operate around the clock and respond to volume peaks and troughs across global products and markets?

- Do we have the staff to oversee the enterprise reconciliation processes and understand gaps in the business process?

STEP 3: EVALUATE YOUR OPERATIONAL RISK MANAGEMENT

A consolidated reconciliation function can be the key to enhanced risk management by: 1) identifying potential exposures before they occur; and 2) providing the expertise to appropriately respond to exceptions and issues, before they escalate costs and risks.

Self-assessment: Risk

Key questions firms should ask themselves in evaluating their risk management effectiveness:

- Do our reconciliation capabilities and measurements adequately allow us to monitor operational and counterparty risk in real-time around the globe?

- Does our reconciliation technology provide the scalability required to meet compliance and regulatory commands?

- Will our firm be exposed to increased operational risk if key reconciliation staff members unexpectedly leave the firm?

- Do we have a contingency plan in place?

- Can our reconciliation capabilities handle the specific processing requirements of all of our business needs and report global activity in clients' preferred currency?

- Could we reduce our risk exposure by reevaluating our operating model?

- Are we able to properly age open items and identify trends and conduct causal analysis in a systemic manner?

- Are we able to mark to market our open reconciliation items in a multi-currency manner?

STEP 4: ASSESS YOUR OPERATING COSTS

As operating expense pressures continue to mount, financial firms must continue enhancing reconciliation while achieving cost savings and conserving capital.

Self-assessment: Operating Cost

Key questions firms should ask themselves in evaluating the cost of supporting their reconciliation capabilities are:

- Are we able to reduce costs in excess of 30% and minimize ongoing investments while continuing to optimize capabilities without reducing service and risk?
- How much time and money are we spending on reconciliations and do we have a front-to-back-office technology and operations strategy that keeps costs manageable?
- Can we reduce operating costs by reevaluating our operating model?
- Do we have the resources to support new products and regulatory requirements in a cost effective manner?
- Can we reduce our fixed costs tied to supporting our reconciliation capabilities and move to a variable cost model that allows costs to fluctuate with our volumes?
- Are technology maintenance and development costs undermining our reconciliation footprint expansion ability?

CONCLUSION

ENGAGING A RECONCILIATION SERVICE PROVIDER IS BECOMING THE "NEW NORMAL" FOR ACHIEVING INDUSTRY-LEADING RECONCILIATION

The benefits of working with an experienced service provider have evolved beyond cost-savings to include expertise and best practices without the costs of capital investments or staff expansion and expertise. The optimal partnership offers greater control and process standardization while enabling financial services firms to focus on current business needs including increased regulations, risk management requirements and cost pressures. As a result, leading firms are embracing the outsourcing of their reconciliation operations and technologies to attain the operational efficiency and transparency provided by a state-of-the-art utility.

Firms should select a reconciliation solution that is expandable – capable of enabling the addition of new reconciliation and global trading instruments and volume, in response to emerging issues and opportunities.

Finding the right partner in this area is essential to achieving the end-to-end operational controls your firm needs to grow business, reduce operational risk and realize cost savings. Be sure to seek a partner with proven functional expertise and deep understanding of your business based on an in-depth assessment, plus the flexibility to operate within your environment.

This is where Broadridge comes in.

For more information about Broadridge products and solutions, please contact us at marketing@broadridge.com or +1 844 836 6773.

Broadridge, a global fintech leader with over $4 billion in revenue and part of the S&P 500 Index, provides communications, technology, data and analytics. We help drive business transformation for our clients with solutions for enriching client engagement, navigating risk, optimizing efficiency and generating revenue growth.

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