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>> Whitepaper

Reconciliations

June 2017

The Road to End-to-End Automation

Inside Market Data Inside Reference Data Buy-Side Technology Sell-Side Technology

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Executive Summary

Are your reconciliations systems and processes ready to support future growth?

Financial reconciliations have come under scrutiny as firms are increasingly realizing the problems associated with often manually intensive operations, which are challenging to scale in order to meet changing business and regulatory requirements. A competitive market environment and pressure on margins have led to a focus on improving efficiencies and reducing operational overheads, and for many there are clear benefits from improving automation of reconciliations.

The volume and complexity of reconciliations that need to be performed continue to increase, and manual intervention is putting organizations at risk of failure to support business growth and prepare for changing regulatory requirements. The challenge for firms is to move away from multiple platforms and tactile systems designed to handle different internal requests for reconciliations.

An exclusive *WatersTechnology* survey, conducted in association with SmartStream Technologies, of senior data management decision-makers in international financial institutions reveals that firms continue to rely on spreadsheets, and that many lack sufficient insight into existing processes to put themselves in a position to effectively address pain points. In fact, only 19 percent are currently tracking metrics for loading and matching times, suggesting that more needs to be done to analyze reconciliations processes to ensure efficient operations.

The changing reconciliations landscape is also putting pressure on firms to replace legacy systems with new technology and, according to the survey, firms are on the hunt for scalable and flexible systems that can help meet expectations from clients and regulators alike. With recent advancements in technology, reconciliation is an area that can be automated to help firms mitigate risk, and it is now down to firms to embrace change and set the business up for future success.

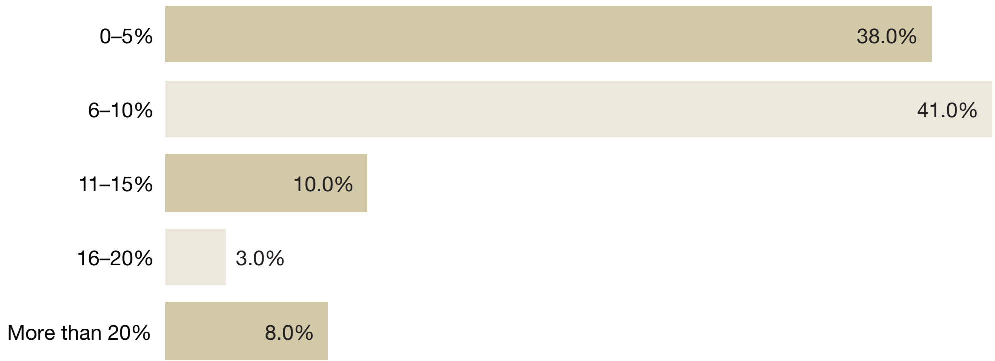
The Reconciliation Burden

Checks carried out to compare data records are typically a background task in almost any company. Whether it is a financial institution ensuring records are correct or a retail business checking its stock levels, the processes typically take place without sales professionals taking any notice and not being discussed at the top level – at least until the arrival of more stringent regulation or higher costs. Financial reconciliations have caught the attention of senior decision-makers at financial institutions as existing systems and processes find themselves under pressure to cope with the changing requirements.

In the past, performing reconciliations was more straightforward, but in recent years the complexity has increased and volumes have continued to rise. This change has led to a growing interest in automating reconciliations, with an increased appetite for reconciliations technology designed to help firms improve auto-match rates and gain insight into the reconciliations process.

The market is now at a stage where end-to-end automation is possible to achieve when implementing a robust data governance framework and a single reconciliations platform backed by complete and consistent reference data. In today's market, however, fully automated processes are not the reality for most and, in turn, auto-match rates are suffering. The global *WatersTechnology* survey of 100 senior financial technology decision-makers from both buy-side and sell-side firms revealed that over 60 percent experience more than 5 percent breaks in reconciliations, and 8 percent of respondents have breaks in as many as 20 percent or more of the transactions on which they performed reconciliations (**see Figure 1**).

Figure 1: In what percentage of the transactions do you experience breaks in the daily reconciliation process?



In many cases, lower-than-expected auto-match rates may be caused not only by inadequate systems supporting reconciliations, but likely also by problems with other factors impacting the process, such as poor underlying reference data, widely distributed teams, and manual and paper-intensive processes. For most, the main challenge is inconsistent and poor reference data, and firms are increasingly investing in data-cleansing and mapping projects in a bid to get the foundation right for all post-trade services. Reference data is seen as the ultimate driver for improving reconciliations performance, and working with a single source of complete and standardized reference data is key to reducing breaks in reconciliations.

Changes are also being made to address inadequate or outdated systems, with one problem being the use of multiple systems within one organization and a lack of centralization. In some cases, firms may have been operating with legacy systems that have been unsuited for meeting changing demands from the reconciliation teams. To cope with increased flexibility, some have then added manual-intensive processes or tactile systems, creating a silo-based environment that needs to be broken down to facilitate end-to-end automation in reconciliations.

In addition, lack of governance and segregation of duties in reconciliations is causing data problems. Instead of having a common workflow across departments, many firms have decentralized teams and operate with different processes within the same organization. Another concern in reconciliations is the team structure, as reconciliation teams that are responsible for both performing reconciliations and investigations could have to change data inputs to close breaks. This data should ideally be changed by dedicated teams to avoid the risk of data being changed only for the purpose of the reconciliation and not at the source level.

To complete a full data overhaul, however, the processes adopted also need to change. Right now, firms continue to rely on time-consuming manual and paper-intensive processes, with some needing to print paper reports and screenshots for sign-offs on paper. This could have been done in electronic dashboards, creating an audit trail that can be easily managed and monitored. In addition to reducing the paper trail, firms are in need of improved visibility into reconciliations, in terms of both access to data and insight into ongoing investigations, and in terms of performance metrics, which could help the organization identify pain points.

The Regulatory Impact

One of the main reasons to act now is the risks firms are facing, and regulatory fines have been at the forefront of discussions. Fines have not only increased in size, but also proven to be detrimental to share prices. With this in mind, meeting changing regulatory requirements remains a top priority, and for reconciliations current discussions are centered around developments in the European marketplace.

In Europe, the Markets in Financial Instruments Directive (MiFID) II and Markets in Financial Investments Regulation (MiFIR) are looming, and the new regulation defines reconciliations as a mandatory requirement. Under MiFIR (Article 15, Chapter 7, RTS 22), firms will be required to reconcile trades executed by the front office with what has been reported to the regulators. Considering the amount of data that goes into performing reconciliations and the time it can take to change existing systems and processes, meeting these new requirements by January 2018 has started ringing alarm bells.

One of the reasons many firms are having problems being agile and responding to regulatory change is the limitations of the processes adopted. The *WatersTechnology* survey confirmed that some firms still use spreadsheets to perform reconciliations, and manually intensive processes can make it challenging to scale operations to a level that will soon be required by law. The general trend, however, is a move away from processes that fail to offer firms opportunities of having a holistic view of data across the firm and adequate control of data.

Considering the increase in data that needs to be managed, reconciled and reported under MiFID II and MiFIR, there is a growing realization that reconciliations may continue to be exposed to change and firms need to address data and system requirements now. Silo-based environments make it difficult to run searches and could indicate a heavy reliance on data owners at critical times. There can also be technical limitations to the use of spreadsheets, such as the maximum number of characters in a field, which would impact reconciliations processes. For most, the ever-changing regulatory environment has underlined the need for firms to address pain points in reconciliations and combine good-quality reference data with flexible and scalable processes and systems.

Fast Forward

As firms are on a mission to improve efficiencies in post-trade services, there is growing appetite for creating a robust framework for reconciliations. According to the *WatersTechnology* survey, the most important factor driving change in reconciliations at the moment is, again, the need for improved flexibility and scalability in reconciliation systems. This need can be linked to regulatory changes and increases in volumes, but it is also likely to be a priority because of the growing complexity of trades and the interest in adopting non-standard reconciliation methods. For some organizations, the need can be addressed by replacing outdated systems with new technology, and for others it will be a case of assessing hosted solutions and outsourcing options in a bid to meet changing demands and reduce expenditure, such as high annual hardware leasing costs (**see Figure 2**).

The second-highest answer to the question about driving change was a need for improved visibility into reconciliations and exceptions management, giving users access to information at the push of a button. One of the benefits of reconciliation systems such as SmartStream's Transaction Lifecycle Management (TLM®) is that it has been designed to offer capabilities to help firms gain greater visibility into the reconciliations process, allowing users to be more proactive when exceptions occur anywhere in the transaction lifecycle. With the help of a reconciliations platform designed to replace paper-based systems, firms can experience higher straight-through processing (STP) rates and allow users to monitor exceptions and ongoing investigations to mitigate operational risk.

For some, making changes to systems and processes is also driven by new business opportunities and the potential to launch new services for clients, which was the third-highest response to this survey question. Close to one-quarter of the survey respondents were servicing external clients already, and the increased volume and complexity in reconciliations continues to fuel the demand for reconciliation services.

Figure 2: What factors are driving change in the end-to-end reconciliations process in your organization?

	1	2	3	4	5
Low STP rates and a reliance on manually sensitive processes, which could be automated	11.0%	20.0%	34.0%	25.0%	10.0%
Cost-cutting plans resulting in the organization assessing alternative options for performing reconciliations	10.0%	21.0%	44.0%	20.0%	5.0%
Opportunities to reduce the number of FTEs	12.0%	18.0%	35.0%	30.0%	5.0%
Changing accounting standards and regulatory requirements, resulting in a need to perform non-standard reconciliations	11.0%	17.0%	35.0%	32.0%	5.0%
A growing focus on eliminating operational risk and reducing manual intervention	6.0%	11.0%	38.0%	31.0%	14.0%
A need for improved flexibility and scalability in reconciliation systems to prepare the business for future growth	5.0%	10.0%	32.0%	39.0%	14.0%
Business growth opportunities relating to introducing new services for clients	9.0%	16.0%	28.0%	27.0%	20.0%
A need for improved visibility into reconciliations and exceptions management, giving users access to information at the push of a button	6.0%	9.0%	36.0%	34.0%	15.0%

Votes were cast using a scale of 1–5, where 1 denotes the statement is false or least accurate for the respondents' organisations, and 5 denotes it is true or most accurate

Whether firms are performing reconciliations internally, or also servicing external clients, the most important feature when assessing reconciliations platforms remains the same. According to the survey, the feature that is most important for firms right now when assessing reconciliation solutions is, again, scalability and flexibility. This was also the top answer from the audience at the SmartStream client conference in London when asked about the importance of the same features for reconciliation solutions, which underlines the significant market focus on future-proofing systems and process (**see Figure 3**).

According to the survey, the second most important feature for firms at the moment is the ability to perform non-standard reconciliations. This demand will resonate with vendors that are consistently being asked to perform new flavors of reconciliations, and even when it comes to cash reconciliations they see a range of differences. Firms may want to pair one side in one currency versus the other side in another, for example, and there are no straightforward reconciliations anymore. The *WatersTechnology* survey revealed that some firms are performing multi-way reconciliations across the spectrum of asset classes, while others are sticking to two-way reconciliations for all asset classes. To meet changing requests, there is a need for service vendors to offer clients flexibility, allowing users to reconcile any asset class in multiple ways.

Figure 3: What features are most important when assessing reconciliation solutions?

	1	2	3	4	5
The potential for higher STP rates	8.0%	11.0%	38.0%	25.0%	18.0%
Ability to perform non-standard reconciliations	4.0%	15.0%	28.0%	35.0%	18.0%
A single system used from start to finish with a single control hub	4.0%	10.0%	43.0%	25.0%	18.0%
Visibility into exceptions and the workflow	4.0%	1.0%	40.0%	32.0%	23.0%
Scalability and flexibility	4.0%	9.0%	25.0%	41.0%	21.0%
Hosting and outsourcing options	8.0%	4.0%	39.0%	28.0%	21.0%

Votes were cast using a scale of 1–5, where 1 is least important and 5 is most important

Opportunities for Success

The market has started to move towards separating out exception management, and some firms are creating expert teams for investigating exceptions. According to the *WatersTechnology* survey, however, 70 percent still said the same team performs reconciliations and exception management. The challenge with the same professionals performing reconciliations and handling exceptions is related to data management and governance. To ensure consistent reference data supporting reconciliations, data owners accountable for a specific data set should make changes at the source-level to close breaks in reconciliations caused by underlying data issues (**see Figure 4**).

Challenges related to patterns in breaks and data governance, however, may not surface before a firm further analyzes reconciliations and exceptions. By implementing metrics and tracking loading and matching times, firms can gain improved visibility into the reconciliation process and be better positioned to address

Figure 4: How is the reconciliation team set up?

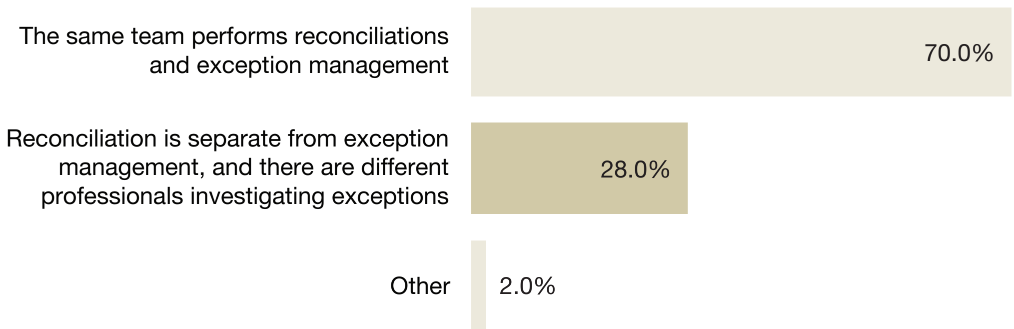
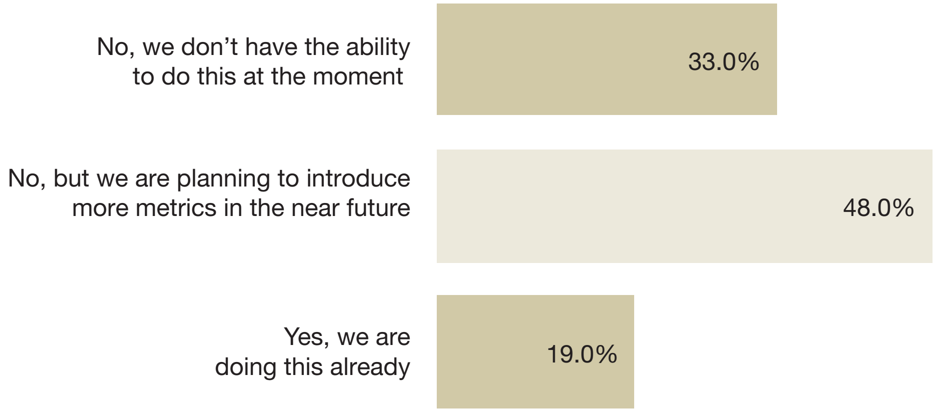


Figure 5: Are you currently tracking metrics on loading and matching times?



pain points. These opportunities are not fully leveraged at the moment, with the survey revealing that only 19 percent are currently tracking metrics for loading and matching times (**see Figure 5**).

Although surprising that not more are utilizing metrics, the majority of the SmartStream client conference audience in London had implemented metrics and, of global survey respondents, almost 50 percent were planning to introduce more metrics in the near future. Considering the pressure on firms to process and monitor ever-increasing numbers of reconciliations, it is promising to hear that firms are increasingly looking at ways to implement metrics to gain a better overview of the operations. The data needs to be measured to enable firms to address problems effectively, such as ensuring teams are adequately staffed.

The survey also examined the number of full-time equivalents (FTEs) performing reconciliations and, of respondents that said they had 1,000+ transactions reconciled daily, 20 percent had more than 50 full-time equivalents and around 50 percent had 10 or fewer full-time equivalents performing reconciliations. According to the survey, headcount can vary widely, and the number of professionals needed to process per transactions reconciled appears to differ from one firm to the next. Some firms may reconcile 100,000+ trades daily with less than 10 full-time equivalents, while others could reconcile the same number of transactions with more than 100 full-time equivalents.

The results indicate that there may be opportunities for some firms to reduce headcount by improving automation and implementing tools that would give greater visibility into the reconciliation process. In a firm that has a worryingly high number of professionals performing reconciliations, a first step should be to either implement metrics or analyze existing metrics for loading and matching times. By tracking and utilizing metrics, firms could ensure better insight into the process and be confident they have an adequate number of professionals performing reconciliations.

Conclusion

Reference data is the backbone of financial transactions, and inconsistent data is a root cause of challenges related to reconciliations. Firms are increasingly investing in reference data projects, focusing on ensuring consistent and complete reference data underpins reconciliations to fuel end-to-end automation and keep breaks to a minimum. To stand out in the marketplace, vendors therefore need to offer the latest technology coupled with the ability to support reference data requirements. The combination of quality reference data with a single platform for performing reconciliations is crucial for paving the way for automation in the reconciliations space.

Firms can no longer make do with outdated systems and processes, as the fast-paced financial markets require them to be more agile than ever before. Reconciliation requirements are changing under MiFID II and MiFIR, resulting in a rise in volume of reconciliations for firms trading European securities, and complexity of reconciliations continues to increase across the board. The goal is to manage position and transactional risk and, to do that effectively, firms now need the ability to perform a variety of flavors of reconciliations, resulting in a need for flexible systems that allow users to run non-standard reconciliations.

In a market where the focus is on leaner organizations and efficient operations, firms have clear opportunities to introduce metrics to gain improved insight into pain points that need to be addressed to decrease costs. As the volume and complexity continues to increase, firms need to utilize metrics and remain savvy to optimize operations. With recent advances in technology, there should be no need for paper-intensive processes and manual intervention in reconciliations and, instead, existing practices and systems need to be scalable and flexible.

In today's market, most important is to future-proof reconciliations, create common sets of procedures and opt for volume-insensitive systems and processes that allow for multi-way, multi-asset reconciliations.

About SmartStream Technologies

SmartStream Technologies is a recognized leader in financial transaction management software that enables firms to overcome critical transaction processing issues through increased automation.

SmartStream's industry-leading automated match rates create more proactive, exceptions-based processes that lower the cost per transaction while enabling firms to reduce operational risk, strengthen compliance and controls, and improve customer service.

As a result, more than 1,500 clients—including 75 of the world's top 100 banks, eight of the top 10 asset managers and eight of the top 10 custodians—rely on SmartStream Transaction Lifecycle Management (TLM®) solutions to deliver greater efficiency to their trading operations.

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