



Controlling Operational Cost and Risk

By Marc Spanos, Mutual Fund Accounting Product Manager, Eagle Investment Systems.

It's not surprising that risk management and cost containment remain high priorities for fund companies and service providers. Investment portfolios such as mutual funds, hedge funds, separate, and institutional accounts require investment accounting to help manage risk and produce financial statements to prove to investors that their portfolios are accurately represented. The industry is moving towards implementing one accounting system, whether in-house or outsourced, to help streamline processes and reduce systems cost.

An Investment Book of Record (IBOR) is a set of investment data that is maintained with the primary purpose of supplying timely and accurate data to the front office of an investment manager to support the investment decision process. Equally important to servicing front office needs, a well-constructed IBOR supports middle-office business functions such as calculation of daily security level performance measurement and portfolio attribution, oversight of the back office or custodian, management reporting, client billing, and client statements. The IBOR is typically processed on a trade date basis, meaning any trades are recognized as part of the investment book on their market trade date.

The Accounting Book of Record (ABOR) is the investment book that supports the back-office operations. In most cases, the ABOR is maintained by an outsource provider and is typically the official book of record which will be the basis for financial statements and audited annually. The ABOR supports back-office business functions such as daily NAVs and other unit valuations, regulatory reporting, fund administration, transfer agency, and custodial services. It is processed on a trade date +1 basis for US 40 Act funds,

meaning trades are recognized as part of the fund and NAV one business day after the trade is executed.

Historically, investment managers have relied on their back-office service providers to provide the ABOR for their investments. Given the level of expense (technology and operations staff) required to manufacture the back-office ABOR, many leverage that ABOR data to source their front office and perform various middle-office business functions.

Over the past 25 years the range of investment products has burgeoned. Investment companies have grown not only organically but globally, and consequently, recognized that they could no longer rely on the back-office ABOR to meet their ever increasing business demands. Several strategies emerged to meet these demands to cope with the loss of control of investment data. Some firms have applied more pressure on their back-office service providers to provide accurate and timely trade date information, while many firms implemented an internal IBOR. Outsourcing the middle office entirely has become the recent trend.

Given the level of complexity, risk, and expense (technology and operations staff) required to support an IBOR, fund companies and fund service providers have recently begun to implement investment accounting systems that support both the IBOR and ABOR on a single transaction set, along with a single operations team. To accomplish this and recognize the cost savings, firms must implement an investment accounting platform which allows for a single transaction set to be used for both TD+1 NAV calculation, and TD+0 IBOR.

Today's investment accounting systems must support multiple dimensions of the same data set, and also allow for control

and flexibility as to which date a transaction will fall into. It is imperative for these systems to store multiple dates on a transaction (trade date, settlement date, NAV date, post date) to control the ledger/NAV period that a given transaction falls into. These same dates must also be stored on a portfolio's positions, transactions, cash activity, income activity, and market values to accurately report trade date positions and cash, and to also calculate performance measurement on current day market values. This data must be accessible and therefore should be stored relationally and be easily extracted to be delivered to downstream or upstream systems. Firms often require security and portfolio data on a real-time basis. Data storage from a systems perspective must be real time and occur at the time of transaction to meet the demands of the front office.

Reducing operational risk and system automation remain key factors for investment firms when seeking out back-office systems. Today's leading accounting systems can accommodate these requirements while seamlessly navigating the sophisticated investment types and processes that exist in today's global investment companies. It all boils down to cost and level of risk, and investment firms rely on their vendors and outsourcing providers to reduce both of these factors.

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