

# Investment Management Review

A Quarterly Update for the Investment Management Industry

- Entering the SMA Marketplace  
The Janus Model
- SMA Trading  
Evolving Trends and Best Practices
- How Dynamic Alpha and Beta Management Leads to  
Proactive Asset-Liability Management
- Derivatives  
The Benefits of Independent Valuation
- Asset Management  
The Canadian Marketplace
- The SEC's Chief Compliance Officer Regulations  
One Year Later

## Operations Performance Measurement

A Framework for Success

# Operations Performance Measurement

## A Framework for Success

Robert A. Fawls  
Managing Partner, Basis Point Group LLC

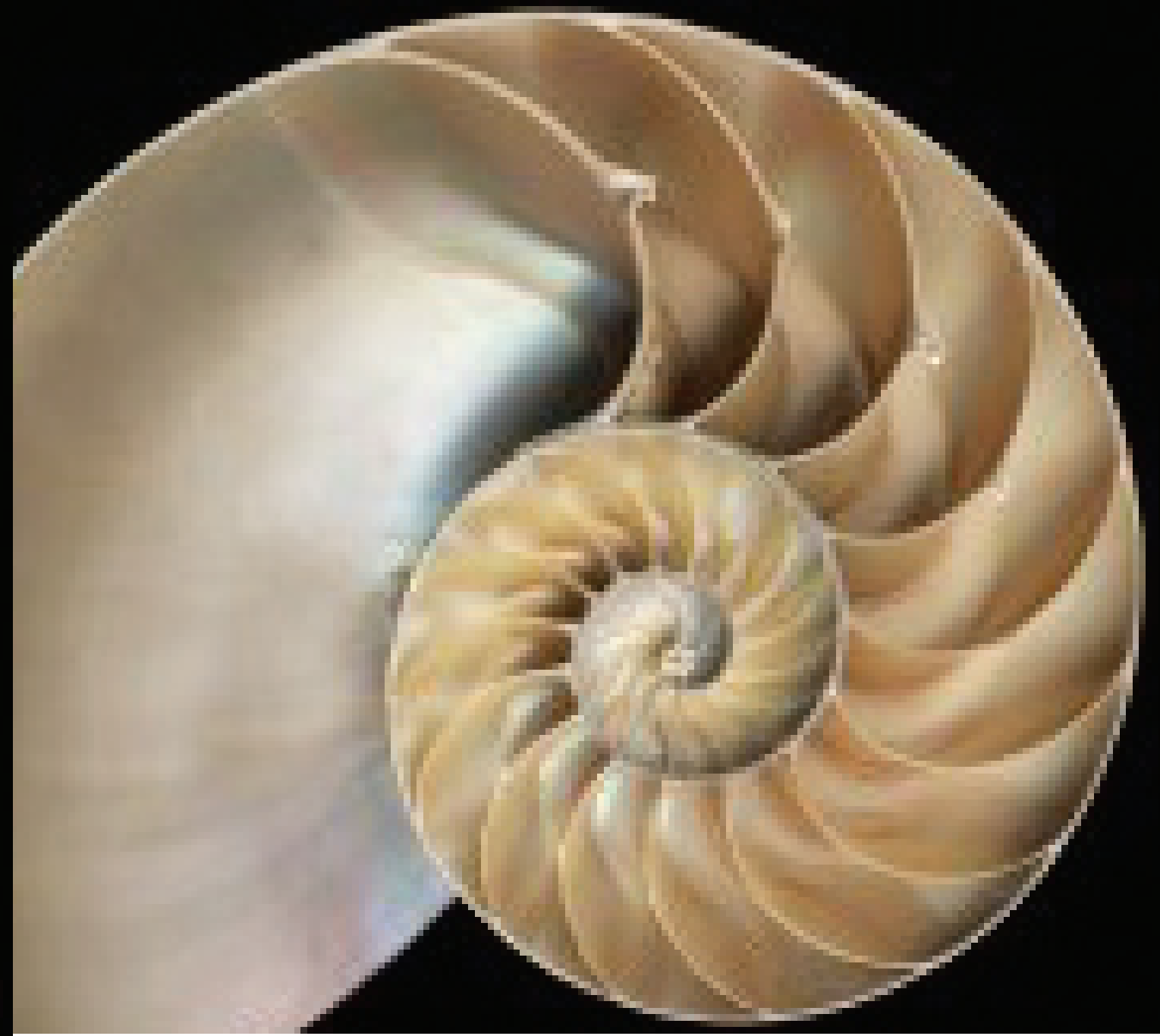
Senior managers of money management firms need a systematic means of measuring operational performance to provide a clear understanding of where margins are being eroded and which initiatives are cost beneficial. Operations in this context encompass everything that is not investment research or pure portfolio management, although we could argue that the effectiveness of the systems that support these activities is also measurable.

As assets under management have grown, regulation has increased and operations have become complex, high-volume, continuous process environments. Clients expect investment firms to accurately capture, validate and post every transaction that affects the integrity of any

security position or cash balance in their portfolio. Errors are not acceptable and accuracy in the presentation of each client's statement is the expected level of performance. Anything less would lead clients to believe that the firm was incapable of performing its fiduciary responsibility of safeguarding the client's investments.

### Where we've come from

New products and investment instruments continue to be introduced, complicating operations processing and a firm's abilities to assure accuracy. Investment operations measurement is heavily influenced by, and often constrained by, the industry's accounting roots.



Generations of investment operations managers and support staff have been trained to understand reconciling custody and broker statements as a basic control step to verify the accuracy of client assets, which often requires many days to consolidate at month end.

Timeshared trading, recordkeeping and client reporting applications were created in the 60's and 70's to track client assets more efficiently. Controls revolved around the monthly trial balance and statement reconciliation. The evolution of sophisticated quantitative analytic and decision-support models required real time views of client portfolios, forcing improvements in recordkeeping applications and posting processes that affected trade date positions. Networks grew more complex and international investing expanded dramatically.

"Best of breed" applications evolved to support different functional groups. Connected by periodic batch data feeds in complex job streams, order of execution was critical to assure accuracy and consistency across applications. Automation was augmented with additional manual control, input and correction processes to assure that these complex creations functioned properly. Client account, security master and other critical information was duplicated throughout the firm, causing conflicts, errors and losses. Data warehouse applications were then implemented to collect, mediate, translate and store data from different systems to facilitate reporting and attempt to improve data controls.

New investment product and instrument applications have further decentralized processing and dispersed critical investment process control information. Today's operating environments are riddled with complexity and lack consistent, reliable measures of operating performance. Despite the billions that have gone into automation and sophisticated trade and position reconciliation processes, significant errors continue to occur and a 'good day' is one where nothing goes wrong.

### Evolving better investment process controls

Sarbanes Oxley and Basel II have driven management's focus to operations. They imposed initial operations

risk assessment frameworks to better understand different operational risks. These frameworks are largely retrospective and are not intended to generate data that would be useful for running the day-to-day business. Also the measurements used have limited value in managing high-volume operations. Collecting financial loss information through internal self assessments is an important step forward, but the transaction volumes and complexity overwhelm the usability of their static measurements.

Investment firms need a comprehensive operations measurement framework that utilizes more sophisticated process and risk control metrics. Managers need to know that:

- a** all transactions have been captured and processed properly
- b** potential issues are identified before they become errors and
- c** all of this was done in the most efficient process with the lowest risk possible.

This framework must be able to produce the accounting- and risk-based measures that currently exist, but it must also provide immediate, actionable measures of process quality and potential monetary risk. Operations performance measures exist and a comprehensive framework can be implemented in using data produced in each firm's daily operations.

A structured framework for measuring operations performance allows a firm to measure its operational effectiveness (was it done right?), its transparency (can we prove it?) and its processing efficiency (was it done at the lowest possible cost and risk?). Measuring these process attributes allows managers to take incremental actions that improve processing. It allows them to assess the impact of their decisions to better leverage their people, process and applications. Consistent, quantitative measures allow managers to reconfigure processes

*A structured framework for measuring operations performance allows a firm to measure its operational effectiveness (was it done right?), its transparency (can we prove it?) and its processing efficiency (was it done at the lowest possible cost and risk?)*

faster, in a controlled manner, tracking the effects of each action to assure the expected results.

Easily understood, real-time process controls allow managers to take a pro-active view of their process decisions. Quantifying the relationship between different metrics reinforces the intrinsic, experience-based understanding good managers already have of their operations.

Accepting a standard framework allows the industry to establish meaningful performance benchmarks allowing direct comparison of processing organization and capabilities, and provides a better understanding of organizational and operational models that work best. Standards will lead to significant efficiency gains that aggressive firms will be able to capitalize on to gain competitive advantage.

For money management firms, a useable operations performance framework must:

- Concisely measure performance that leads directly to the source of performance problems
- Standardize measures across firms, as AIMR did for investment performance calculation
- Identify direct cause-effect relationships between people, process and technical actions and risk/performance changes
- Tie activity measures to on-going costs providing a better understanding to maximize internal process investments
- Use data produced by the organization in the normal course of business
- Quantify risk in monetary terms
- Identify actions and inefficiencies that affect process and information quality

© 2006. Reprinted with permission from the author.

Basis Point Group LLC, a global firm, focuses on operational performance improvement for investment and financial services companies.