

WATSON WHEATLEY

CASE STUDY

ASSET MANAGEMENT - FX CASH MANAGEMENT IN IRECS

INTRODUCTION

Our client had been using iRecs for two years for market value reconciliation and daily cash reconciliation. These processes had delivered considerable benefit to the company allowing granular verification of all transaction flows on a day to day basis, and the verification of positions, prices and FX rates as required as part of a market value or NAV reconciliation.

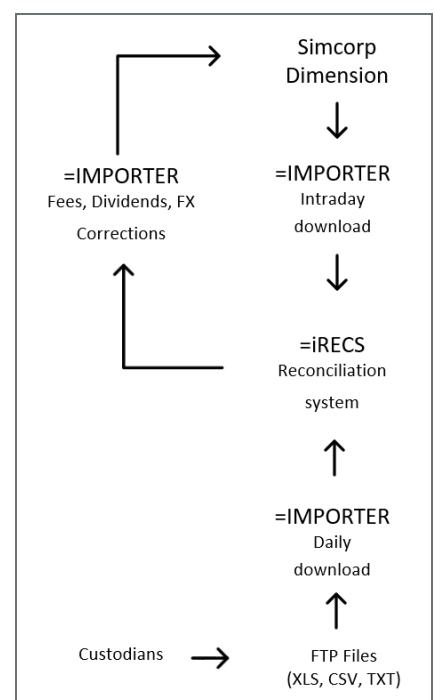
REQUIREMENT

The fund mandate required all foreign currency earnings to be repatriated to the fund's domestic currency (usually USD); a common approach in emerging markets asset management. This placed the responsibility for executing foreign exchange trades with the custodian who would aggregate to sweep the currency balances of several transactions into one. The asset manager's responsibility was to ensure these FX trades were posted to the portfolio management system (PMS) in a timely manner, and to ensure that any accounts that retained non-zero balances were quickly addressed.

The operations functions would post all FX trades on trade date to the PMS at an indicative rate (to ensure the cash effects were seen as soon as possible by the portfolio manager), and then to amend the trade on T+1 when the data from the custodian at the rate conducted in the market became available. They also monitored the currency balances at the custodians to ensure they remained at zero, or to explain why they did not so that remedial actions could be taken.

As the growth of the business continued, these manual processes became unworkable and a solution was sought through the reconciliation tool iRecs.

- \$30bn+ AUM Asset Manager.
- Emerging Market Equities.
- Simcorp Dimension PMS.
- Cash Balances, Trades, Cash flow, NAV and Market Value Reconciliation.



TRADE CORRECTION

Step 1 was to automate the uploading of corrections to the PMS based on the matching (or mismatching) of the foreign exchange contracts. Rules were prepared that took different action depending on the rule criteria: -

If the PMS FX transaction matched both the local and base currency of the custodian trade, then they were matched by iRecs and no further action taken.

If the PMS FX transaction was not matched by an equivalent custodian transaction, then the transaction was annotated by iRecs accordingly, and would remain unmatched in iRecs until the compared with custodian data on a subsequent date.

Where the local currency matched between the PMS and custodian, but not the base currency, then a correction to the PMS base currency amount was required to set it to the same value as the custodian. Transactions captured by this rule were annotated by iRecs (to indicate to the user that they formed part of this set and had been uploaded), and a listing of the adjustments (including the PMS transaction id) were posted to a file. The file was placed in a given directory for the PMS to pick it up for automated posting. The provision of the transaction id of the PMS FX transaction allowed a simple amendment to take place.

iRecs was configured to allow intraday downloads from the PMS to refresh the data in the reconciliation system. Since iRecs only extracts changes (to transactions or balances), then the amended FX trades were returned along with a reversal of the original. Running the rules engine in iRecs would, as expected, match the amended trades with the original custodian trades that had formed part of the upload. The original PMS trade in iRecs was matched with the reversal just downloaded. The elimination of the FX trade breaks in iRecs was confirmation to operations that the PMS now reflected accurately the cash flows from repatriated funds.

OUT OF BALANCE EXPLANATION

The remaining part of the problem was to identify currency balances that were held and to fully understand the reason so corrective action could be taken in a timely manner.

Finding non-zero currency balances was, of course, very simple in iRecs. The fund's base currency is part of the fund definition record, so non-zero currency balances could be easily isolated. The more difficult element was to identify the transactions that caused the divergence so remedial action could be taken.

A new reconciliation was configured in iRecs. This used the same transactions as the day to day cash reconciliation (thus requiring no further imports of data, and ensuring full data integrity with the day to day reconciliation) and leveraging iRecs ability to run multiple reconciliations using the same set of source data.

The reconciliation filters took only the flows on the custodian side. Matching was focused on sets of two or more transactions where the cash flows in the same currency netted to zero. If a currency account only had matches netting to zero, then the balance must be zero. Any movement of the balance away from zero would be reflected in unmatched or mismatched transactions. The sum of the breaks would equal the cash balance, and therefore non-zero cash balances would be fully explained by the breaks in iRecs. The workflows capability of iRecs was then used by operations to track the actions taken to resolve the problem and bring the balance back to zero ensuring all cash was repatriated.

CONCLUSION

These simple reconciliations had and are having a marked impact on the efficiency of the operations function. It provides complete control of what is otherwise a complex process, ensuring the PMS accurately reflects the real-world situation, and that cash balances at all custodians is fully managed.

The solution provided the automation of a task that was becoming a significant burden on operation, requiring an unnecessarily large allocation of resource at a critical point each day. Automation ensured the timely delivery of verified cash balances to the portfolio manager as soon as they were at their desks in the morning.

Finally, the approach provided key data to the business to allow custodial relationships to be better managed. The quality of the service provision could be accurately assessed with objective information pulled from the reconciliation system thus facilitating treatments designed to improve operational performance.