Front and center: transforming the front-office

Why fund managers must adopt more sophisticated operating models and technology

In the race for success, the front-office has some catching up to do across asset managers. Pressure from both regulators and investors is forcing managers to take a hard look at their front-office operating models. Today, they are implementing new processes and technology to develop models that are more sophisticated, cost efficient, customizable and globally scalable, with agile technology as a key enabler.

Front-office transformation can have a significant impact on a manager's entire value chain. Strengthening capabilities in the front-office makes it easier to deploy enterprise-wide improvements in areas such as risk management, client reporting, product development, compliance and settlement.

Internal improvements, however, are not the only drivers. Growth is critical, as well. Today, both traditional and alternative managers are increasingly competing for investment dollars from the same groups of investors: retail, institutional and high-net-worth investors. They need wider product offerings with better margins to seize this opportunity, which requires managers to become more flexible and efficient by raising the level of sophistication in their front-office.

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Trends impacting the front-office

We have identified six major trends impacting the front-office today. Each trend has its own unique drivers and affects asset managers in different ways. Each one also requires a direct response. But it is critical to note that each trend should not be viewed individually. Asset managers must take a strategic and holistic approach to addressing all of these shifts – with enhancements directed at organizational structure, processes and technology – in order to maximize their investment in front-office transformation.

1 Adopting a global operating model and a holistic view of portfolio and risk management

Underlying this trend is the need for managers to achieve improved access to emerging markets – to seek out both new investors and assets – as well as alternative investments across the globe. These moves are complicated; however, by the shifting and more stringent risk management and regulatory requirements. These mandates compel managers to monitor global positions for compliance and disclosure requirements.

To accomplish these goals, firms must give their portfolio managers and risk management teams a holistic view of transactions and exposures so they can effectively monitor global portfolios. In most cases, this means empowering them with the ability to effectively aggregate and analyze data from multiple systems, trading venues and geographies. Managers also must adopt suitable technologies to effectively and efficiently capture and execute transactions, such as creating a global blotter.

How managers are responding: The ultimate goal is to rightsource front-office capabilities and supporting functions. Investments in portfolio and risk management technologies should enable straight-through processing and seamless transfer of information across global teams. They also must reassess front-office roles and structures, including serious consideration of employing shared services to help drive the effectiveness of a global operating model.

2 Shifting to an enterprise-wide view of the front-office

Post-crisis regulation, increasing investor demands, and both internal and external risk management priorities are increasing the number and diversity of stakeholders who must take part in front-office decision-making. Business managers and client-facing professionals, along with investment professionals, are demanding a seat at the table when firms choose to make operational or technology changes.

Forward-thinking organizations are considering the entire enterprise. They are looking beyond traditional middle-office and back-office functions to solve process and technology challenges and maximize the effectiveness of the front-office.

How managers are responding: They must begin by structuring supporting functions to be strategic partners to the front-office. This involves aligning and enabling operations to better inform investment professionals, rather than merely processing transactions. Technology can play an important role here. Rather than having to build and support their own systems, firms can look to technology vendors with the capability of delivering solutions that create efficiencies across products and business lines. They can also benefit from solutions that integrate data and information flows to and from the front-office. One example of this is Investment Book of Record solutions that show cash and positions in near real-time, along with future forecasts and backward-looking analysis.

3 Enhancing pre- and post-trade compliance capabilities

Funds today are subject to more pre- and post-trade rules and disclosure requirements. They continue to evolve, increasing the regulatory burden on firms of many types. While funds are expanding their global footprints and establishing trading operations in multiple jurisdictions, regulators and exchanges are increasing their scalable, systems-based surveillance capabilities.

Clearly, higher standards for compliance and risk management require more firms to operationalize sophisticated rule sets and analyze granular data.

How managers are responding: From a process perspective, they are redefining front-office trade workflows and organizational structure to support compliance monitoring efforts. For example, some are implementing a central execution desk to increase control and mitigate risk. They are also formalizing risk management oversight and setting internal limits to make compliance and risk more manageable.

Here, too, technology comes into play. By investing in systems to automate and improve pre-trade compliance capabilities, they are reducing the workload on the front-office and compliance team. In addition to driving efficiencies, today's leading solutions also can provide managers with better intelligence because they take into account increasingly complex scenarios and requirements.

4 Meeting the increasing need for investment analytics

Across today's increasingly complex landscape, portfolio managers must rely on advanced analytics to make better-informed investment decisions. Meanwhile, the demands for comprehensive front-office reporting are increasing as investors scrutinize how returns are achieved. These drivers require firms to focus their efforts on the speed and ease with which data can be transmitted and shared across the organization.

Managers need to make progress from amassing and manipulating data to actually analyzing it to enhance decision-making within the front-office as well as downstream. For their investors, they must be able to attribute decisions and returns to fulfill increasingly complex and varied requirements, such as environmental, sustainability and governance mandates.

How managers are responding: From a technology perspective, managers are moving toward robust data analytics, rather than simply manipulation. They are looking to design stronger analytics solutions to parse additional variables that are relevant to investment decisions.

Some managers are developing dashboard capabilities. These analytical views visually depict key metric trends and enable managers to explore data for making investment decisions more effectively and evaluating the process for making those decisions.

5 Strategically evaluating infrastructure complexity and costs

Many firms are facing downward pressure of management fees and margins, with institutional investors questioning the costs versus the returns of active managers. Firms are also realizing that certain technologies are no longer differentiators in many parts of the value chain.

To remain competitive, managers must consider new methods for improving efficiency and reducing costs in areas that do not increase alpha. These include the strategic use of outsourcing and evaluating the utility and cost effectiveness of maintaining multiple legacy and proprietary systems against investing in leading-class solutions from established vendors. In this new economic landscape, managers need to continuously seek solutions that integrate applications, tools and data, and reduce their reliance on resource-intensive tools they internally design and maintain.

How managers are responding: They are re-examining their legacy systems and processes, with an eye toward two approaches: (1) rationalizing legacy applications and systems; and (2) strategically outsourcing or automating so-called utility processes. For example, many managers have turned to robust, secure cloud-based applications from proven vendors to reduce their maintenance efforts.

6 Preparing for shortened settlement cycles

The Depository Trust & Clearing Corporation (DTCC) is leading an industry initiative to shorten the time frame between trade execution and settlement from three days (T+3) to two days (T+2) for all DTCC-settled products. These encompass equities, corporate bonds, municipal bonds and unit investment trusts. The intended goal is to reduce institutional exposure, members' market risk and liquidity risk.

Because of this significant change, firms must implement processes and technology to enable faster discrepancy resolution in processing allocations and agreeing to settlement instructions with custodians and prime brokers. Across the spectrum, the buy side, sell side, custodians and primes will need to coordinate to modify default settlement settings, standing instructions and cover/protect and ex-date provisions.

How managers are preparing: As the deadline nears for the shortened settlement cycle, firms must continue to monitor requirements and apply them in the context of their firm's processes and, particularly, systems.

They are working to further automate their trade execution and processing functions. This begins with assessing the capabilities of their current systems to further automate trade processing, reconciliation and settlement processes. Managers are also exploring new releases of vendor-supported solutions and evaluating the readiness of service providers.

How EY can help

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