

FORGET “TOO BIG TO FAIL”, WHAT ABOUT “TOO SMALL TO SURVIVE”- DODD FRANK’S AFFECT ON THE ASSET MANAGEMENT INDUSTRY

POINT OF VIEW

New Business Pressures (Dodd Frankenstein)

As if Asset Managers didn't have it hard enough... Just as the nation's investment businesses began to recover from the financial crisis of 2008, along came Dodd Frank. These sweeping regulatory reforms mandated the CFTC and the SEC to beef up requirements for all types of investment managers to execute many of their OTC derivative deals through electronic platforms, process their derivative transactions through a centralized clearinghouse and report their transactions to a trade repository. This will translate into maintaining daily records of OTC derivative transactions, submitting and making available reports to multiple regulatory bodies, making margin calls and meeting and managing asset allocation of minimum capital and margin requirements.ⁱ And this is only the beginning...

Dodd-Frank requires document retention for no less than 5 years, demands registered firms to retain all internal and external electronic communication, and requires that a business continuity program and disaster recovery plan are in place to mitigate against disasters and get the firm operational within close to a business day of the incident. Now the fun is really starting. Other requirements related to incentive compensation, asset-backed securities, credit rating agencies, and incentives for whistleblowers may further impact investment management firms. All this as retirees are drawing down assets and investment firms are under continuous pressure to reduce fees to offset diminished returns.ⁱⁱ

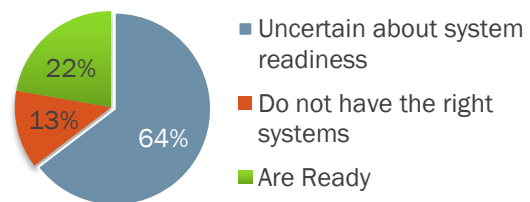
Asset management firms are struggling to assess the impact of anticipated new requirements from regulators and investors and in response, most are rethinking their operational processes and governance models. Meeting the terms of Dodd Frank will require implementing a formal compliance program, designating a chief compliance officer, performing testing, and ensuring strong compliance controls and a dedicated capability that is empowered and accountable for implementing a sustainable compliance program.

However, it is not only the regulators who are putting pressure on the investment industry to improve their procedures. Demanding and picky investors have pushed the industry for increased transparency, enhanced due diligence processes, and more extensive risk and management reportingⁱⁱⁱ. The time has come for the asset management sector to improve their business practices and with Dodd Frank looming, there's nowhere to hide.

Readiness

To make matters worse, recent industry surveys are painting a very bleak picture regarding Dodd Frank readiness. One recent study showed that 72% out of 60 asset management firms surveyed listed preparing for the new legislation as a top priority and yet 13% said they don't have the right systems in place; 64% don't know if they do. About 15% said they couldn't capture all the derivative positions, transactions, and contract data in a single repository for an enterprise wide view of risk and performance and about 53% said they didn't know if they could.^{iv}

System Readiness



Because regulators have been slow to articulate rules, fund managers have been hesitant to make technology investments. Informed industry experts, however, are raising severe warnings that asset managers are being neglectful by failing to assess their implementation needs with the information

available to them today. Experts are warning of a compliancy “traffic jam” when the investment community finally wakes up and smells the coffee. Regardless of the regulator’s final decisions, fund managers have to start deciding which execution venues to use and what platform or program will perform enterprise data management. They also need to begin defining and implementing business requirements to automate valuation and reconciliation with clearinghouses and brokers, and understanding and addressing the gaps in automation of margin calculations and collateral management. They need to have the systems in place to be able to reconcile trades with counterparties, ensure real time communication of trade details and collateral with counterparties, clearing agents, and regulators, and have the capacity for real-time reporting of positions and trades.^v Time to get started.

Technology

The recent financial crisis’ impact on investment performance, led to the underinvestment in technology infrastructure for many asset management firms. Horror stories abound concerning outdated, spreadsheet-based, ad hoc and best of breed “systems” that have been band-aided together and are limping along to get fund managers the information they need to manage their daily business. Sound familiar? It is doubtful that these “systems” will be able to interface with the newly emerging SEFs, CCPs and SDRs, perform complex margin and pricing calculations, STP, and support the new real-time reporting needs.

So, as the investment community struggles to improve their performance and attract new AUM, the cost of doing business, and the process, and technology burden just got a whole lot heavier. Investment firms are evaluating their infrastructure options and deciding whether to pursue significant internal development or outsourcing. Many are choosing the latter option or a combination of both, as outsourcing allows firms to leverage third party service providers’ technology investments, reduce costs and receive high quality, specialized levels of service.^{vi} New Dodd Frank technology solutions are popping up like hotcakes. However, the real challenge for this sector will be its ability to assess current processes and systems, understand their gaps to the new legislative requirements and fully grasp the program change and enhancement requirements positioning them to

develop the right program and choose the solutions that fit each player’s unique situation

Mergers and Acquisitions

Industry experts are predicting that for many small and medium sized players M&A will be the answer to regulatory implementation woes. In 2009, a large wave of mergers and acquisitions occurred as a result of diversified financial institutions divesting their non-core investment management capabilities^{vii}. This trend continued into 2010 as industry conditions improved and funds strategized to retain existing clients and capture new assets under management and source product innovation. As a whole, the industry is likely to be at the beginning of a multi-year M&A cycle as smaller managers will need to increase their scale as a means of not just protecting their stake holds, but also driving efficiencies as a function of economies of scale^{viii}. A successful M&A strategy may be just what investment companies will need to protect margins, improve operating efficiencies and achieve compliancy.^{ix} However, melding firms and assets is complicated and costly and often does not realize the promised synergies. Mergers are challenging, time-consuming and expensive without a clear plan, set of goals and expert maneuvering to deliver the desired and predicted cost savings.

Competiveness Strengths

Investment managers have to start their change programs today to become competitive in new regulated markets. Defining appropriate projects will require reviewing current processes and programs to identify gaps in compliancy and mobilizing cross-functional resources to implement system, process, and organizational changes that will enable the business to successfully compete in the new marketplace. Fund managers should embrace the new legislation as an opportunity to take a hard look at their processes and systems with an eye for optimizing their pre- and post-trade procedures and developing an accurate assessment of risk and risk adjusted returns.^x The new business practices and systems will need to analyze and report important information concerning tax and collateral management to optimize financial decision-making. In order to respond to the challenges of increasing regulation and evolving investor expectations, asset management firms will be forced to strengthen their

focus on operational excellence, governance, compliance, transparency and risk management – all while out performing their competitors.

Change Programs

The far-reaching change programs demanded by new and more challenging government regulation and greater investor scrutiny will require planning and careful execution. Projects that do not have defined goals and metrics will lack the strategic impetus to stay on track and produce relevant, integrated and sustainable results as the regulatory environment continues to evolve. Putting in place a well communicated, centrally adopted change plan is necessary to keep a competitive edge in an aggressive marketplace. “In this environment of changing regulatory mandates and investor demands, asset managers have the opportunity to strengthen their business by proactively rebuilding their capabilities. It will be imperative for firms to carefully evaluate their present business practices, overlay future market demands and clearly understand the workflows necessary to produce vital, strategic change”, stated Satori Consulting Partner, Charles Harkless, “How quickly and effectively asset managers adapt to their new environment will determine whether they are leaders or followers in the emerging marketplace. Enacting an exacting change program is an imperative for survival and future success”.

THE SATORI PERSPECTIVE

The future, as uncertain as it tends to be, is certain to bring a period of considerable change for investment management firms and the clients and service providers with whom they work. The complicated regulatory environment, new technology, increasingly educated consumers, vigilant and far-reaching regulators and a push for more transparency, faster turnaround in reporting, and centralized, standardized processing, and contract terminology add new complications but at the same time herald opportunities that investment managers must learn to decipher. Formulating the right strategy to extract the greatest possible benefit, designing the necessary programs and continuously adapting to the changing environment will require skill, expertise and the right partner to help achieve the desired outcomes and

take advantage of the abundance of new opportunities.

THE SATORI DIFFERENCE

Satori Consulting is well positioned to work with investment managers to effectively navigate the challenging regulatory environment. Our strong understanding of the financial and regulatory space, changing technology needs, and deep expertise in developing solutions and managing complex projects makes us an ideal partner to drive and support required transformational change. We approach every project with our client’s broader strategic needs in mind and assess the organization within the confines of current regulatory expectations. We partner with our clients to define and execute change programs that will ensure a seamless and coordinated transition to regulatory compliancy.

ⁱ http://www.mmexecutive.com/news/Dodd_Frank_derivatives_reform_SimCorp_CFTC_Tower_Group-221600-1.html

ⁱⁱ . <http://www.pwc.com/us/en/asset-management/investmentmanagement/publications/assets/am-state-of-the-industry.pdf>

ⁱⁱⁱ http://www.hblr.org/2011/07/investment-mgmt/#_ftn9

^{iv} http://www.mmexecutive.com/news/Dodd_Frank_derivatives_reform_SimCorp_CFTC_Tower_Group-221600-1.html

^v http://www.mmexecutive.com/news/Dodd_Frank_derivatives_reform_SimCorp_CFTC_Tower_Group-221600-1.html

^{vi} http://www.mmexecutive.com/news/Dodd_Frank_derivatives_reform_SimCorp_CFTC_Tower_Group-221600-1.html

^{vii} <http://everydaytenacity.com/asset-management-marketing/trends-and-consolidation-investment-management-industry>

^{viii} <http://www.pwc.com/us/en/asset-management/investment-management/publications/assets/am-state-of-the-industry.pdf>

^{ix} <http://www.pwc.com/us/en/asset-management/investment-management/publications/assets/am-state-of-the-industry.pdf>

^x http://www.mmexecutive.com/news/Dodd_Frank_derivatives_reform_SimCorp_CFTC_Tower_Group-221600-1.html

At Satori Consulting, our mission is simple—to work side-by-side with clients to discover opportunities and solve problems. We strive to provide both comprehensive and expert service, mindful of every client's unique needs. Our team of highly-skilled management consultants brings a wealth of industry and functional experience to provide wide-ranging services in project and program management, risk management, change management, organizational effectiveness, strategy and advisory, business process engineering, performance management, and infrastructure and technology.