

IBOR: Improving Buy-Side Decision Support with Position-Level Transparency

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Accurate and timely security and position data provide the foundation for front and middle office decision support. Last month, Charles River discussed issues that buy-side firms face managing security data. This month we turn to position data management challenges and discuss how

the Investment Book of Record (IBOR) addresses these issues by providing portfolio managers and traders with real time position-level transparency. Ensuring that firms are utilising consistent and high quality position data is essential to improving decision support, lowering operational risks and dealing with growing product complexity.

Position Management Challenges

Generating intraday positions and cash balances for the front office can be difficult, especially for firms that trade around the globe or firms that don't receive a reliable position file from their back office accounting system or service provider. Even if positions are properly represented at the beginning of the trading day, keeping those positions and cash balances current throughout the day is difficult enough that many firms forgo trying. This leaves portfolio managers to work with an incomplete view of their positions and impacts their ability to optimally invest available cash, resulting in missed opportunities, suboptimal returns and potential compliance violations.

The traditional back office Accounting Book of Record (ABOR) treats positions as accounting entities that are updated daily. But portfolio managers and traders require a real-time, investment-centric view of positions. The lack of position data appropriate for front office use emerged as a major pain point for investment managers several years ago, driven by growing trade volumes, increasing product complexity, and the inherent difficulty of managing global trading operations. Financial technology vendors responded by creating the Investment Book of Record (IBOR), designed to provide the front office with real-time cash and positions.

First generation IBOR implementations integrated existing ABOR systems with the front-office trading book (TBOR). This architecture worked reasonably well for small firms operating in a single geography, but failed to perform region-specific processing intraday fast enough to be useful for large, globally disbursed asset managers. Since these architectures still rely on the firm's existing ABOR, they can't deliver an independent view of positions.

Second generation IBOR systems are purposebuilt for the front office, delivering both the requisite speed and scalability for multi-region processing, without requiring an ABOR. In the relatively short time that commercial IBOR solutions have been available they've seen significant and broad buy-side interest. Several trends are driving the increasing adoption of IBOR:

- Increased outsourcing of back office operations that necessitate an independently maintained view of positions
- Investor and regulatory demands for greater transparency into risk exposures and portfolio performance requires up-to-date position data
- The growing complexity of investment strategies, products and instruments that require closer monitoring of positions, hedges and cross-asset exposures

An Independent View of Positions

The industry trend toward outsourced back office services requires that firms have the ability to audit their service provider's position data. By establishing an independent and auditable view of positions, IBOR decreases operational vulnerability to service outages and dependence on the back office service provider. Firms with no accounting system lack visibility into start-of-day positions and available cash. As an independent data source, IBOR provides accurate position and cash data both start-of-day and intraday, saving firms the cost and operational overhead of implementing back office accounting solutions and services.

Minimizing Trading and Compliance Risk

Trading errors resulting from stale or inaccurate intraday position data trigger compliance violations, fines and potentially large losses. Significant trading losses blamed on spreadsheet position valuation errors highlight the need for automated position management solutions. By ensuring that investment managers are trading on timely, accurate and complete information, IBOR reduces the possibility of oversold positions, compliance violations and potential losses. By replacing manual position management with a configurable, auditable, and automated solution, IBOR helps firms minimize spreadsheet risk.

Firms with trading desks across multiple time zones and geographies require fast and configurable reconciliation before “walking the book”. IBOR lets firms determine the scope of each reconciliation – running across all positions, or a set of positions, at specified times to prepare for next-day trading in different regions.

Compliance departments need the ability to retrieve and/or reconstruct historic positions for faster, more informed responses to regulatory inquiries. Many back office systems are unable to correctly reconstruct or retrieve historic positions, forcing firms to use time intensive and error prone manual position reconstruction. IBOR lets the middle office investigate and respond to regulatory inquiries and compliance violations faster by capturing and storing historic position snapshots that can be easily retrieved for reporting.

Avoiding Under-Investment

Un-invested cash can be a significant source of tracking error for both actively managed funds as well as index funds that seek to replicate a fully invested benchmark. Intraday cash balances can differ significantly from start-of-day balances obtained from an ABOR, depending on that day’s trade activity, redemptions, subscriptions, cash flows, maturing swap contracts, free receipts, deliveries and corporate events. Back office cash data may also be incorrect due to synchronisation lags with source systems. By capturing real-time inventory and trade status information, IBOR provides portfolio managers with accurate intraday cash balances, helping them remain fully invested.

Understanding Portfolio Performance and Risk

By maintaining a consolidated view of positions across asset classes, portfolios and funds, IBOR provides a firm-wide view of risk exposures. Traditional silo-based views of individual asset classes burden operations staff with manual risk aggregation tasks that rarely present a current or realistic view of exposures. Effective hedge construction and accurate risk analysis also require current position data as inputs.

Properly enriched position data is central to realistic performance measurement and attribution. Securities must be correctly classified and valued and corporate actions must be applied. Fixed income and derivative cash flows introduce further complexity. IBOR’s ability to feed performance measurement and reporting systems with accurate and enriched position data in near real time allows managers to satisfy institutional clients’ demands for greater visibility into portfolio and fund performance on an intraday basis.

Supporting Increased Product Complexity

Growing adoption of new investment instruments and derivative-based yield enhancement strategies by portfolio managers requires that positions incorporating these instruments are valued correctly and in real time. Legacy accounting systems often fail to support complex derivatives such as total return swaps and credit default swaptions. In contrast, IBOR supports accurate valuations across the entire asset class spectrum. Exposures also need to be transparent across asset classes. An IBOR provides a critical safety check for flagging naked/uncovered exposures, like a portfolio that holds put options but not the underlying equity positions.

IBOR’s growing importance to the buy side is really about empowering portfolio managers to make timely and accurate investment decisions, and providing them with the data needed to analyze risk and performance in real time.

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