

# THE MARKET 'GAP' IN SECURITIES RECONCILIATION: HALF THE MARKET; HALF SATISFIED

*Peter Patch*

*The following is an extract from the Summer 2003 issue of the Journal of Securities Operations, which is available by subscription from Securities Operations Forum ([www.soforum.com](http://www.soforum.com)).*

## EXECUTIVE SUMMARY

For a broad array of large to moderate-size brokerage, banking and asset management operations, automation of securities and cash reconciliation is pervasive, but satisfaction with their solutions is not. The securities market is split: Half the market is satisfied with their securities and cash reconciliation solutions. However, half the market reports a notable 'gap' in their satisfaction-on both the securities and cash side(s) of the reconciliation equation.

The dissatisfaction is rather more pervasive among the brokerage firms-both large and small, for both securities and cash reconciliation. Among banks and buy side firms, the larger firms are somewhat more satisfied, while the smaller firms express more concern.

Losses from lack of timely or accurate reconciliation have been a virtually universal experience. A substantial majority of respondents acknowledge those losses have been incurred on both the securities side and the cash side, and for most, those losses have been incurred as recently as within the last three years. While for most, the actual dollar amount of recent losses was under \$100,000, for a significant minority of respondents, the loss exceeded \$1 million - and for a pained handful, the loss exceeded \$5 million over the past three years.

More than half indicate that their securities reconciliation solution may be subject to reappraisal over the next two years-with one in four indicating such a reappraisal at least probable, if not definite. On the cash side, less than half believe they may be reappraising their solution, and only one in seven report that such a reappraisal is probable. So while there remains a window of opportunity for vendors to add value to securities reconciliation, the opportunity for vendors on the cash side is more limited.

There are a number of functions which are of substantial value in securities reconciliation, including

- Reconciliation with specialist internal systems;
- Reconciliation of records with an out-source provider;
- Reconciliation & monitoring of post match and pre-settlement trade status with other parties; and
- Reconciliation of corporate actions processing vs. expected values.

With regard to spending, internal/external connectivity and security/recovery are at the top of the list. However, both exception processing and reconciliation are among areas that represent almost as large a share of the IT development

budget. When the subject shifts to the growth in spending, exception processing and reconciliation are at the top of the list, along with external connectivity, with as many as 30% of respondents increasing their budget by amounts averaging between 15% and 20%.

There are a number of factors that are critical to vendor appraisal, and their reconciliation solutions. Three of the most important are:

- Rules based matching capability
- Highlighting potential fails, and
- Automating exception management.

However, the most important factor for more than three out of four is value pricing-that the vendor solution is 'value priced' for the functionality provided.

When these factors are examined in relation to leading vendors, each of the major market participants show a distinctive array of strengths that accounts for their success within the market. No firm was a market leader-or even among the leaders-in every category. However, some firms showed strength across several of the important criteria, while other firms appeared especially strong in terms of the value pricing of their offer.

In short, while half the market expresses a high level of satisfaction with their reconciliation solutions, the other half is dealing with gaps in their satisfaction and their reconciliation solution. There are large numbers of firms who are likely to be reassessing their securities solution-and for somewhat smaller numbers, their cash solution-over the next two years.

Spending on reconciliation and exception processing is on the rise for a significant share of these firms. However, while each vendor brings a distinctive array of strengths to the market, no vendor can claim to have fully solved the reconciliation problem in terms of both key functional capabilities and the value pricing challenge.

## ***SPECIFIC FINDINGS***

**Profile of respondents:** The respondents were fairly evenly distributed across brokerage, banking and asset management, with almost all respondents expressing familiar with both securities and cash reconciliation.

- 80% report familiarity with both cash and securities reconciliation.
- Almost equal proportions are active in Brokerage, Banking and Asset Management.
- Half are active across these industries; while about half are primarily focused on just one of these areas.

**Material Loss:** All respondents reported having incurred a material loss due to failure of timely and accurate reconciliation, both for securities and for cash. A substantial majority of these report a loss within the last three years. For most of those reporting a loss in the last three years, the loss was under \$100,000, but for some (one in four for securities, one in eight for cash), the loss was as much as \$1 million. For a few, the loss on securities was in excess of \$1 million, and as much as several million dollars-but less than \$5 million.

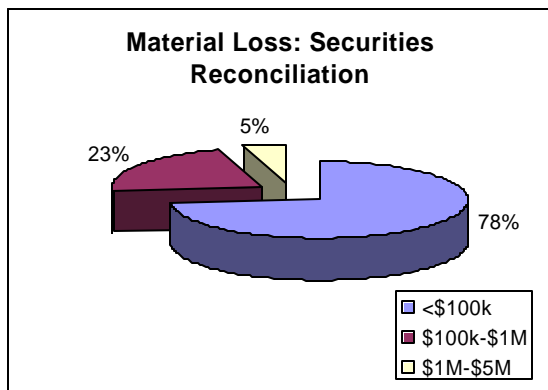
- 100% report having a material loss from failure to reconcile cash and securities on a timely and accurate basis.
- A substantial majority (about two thirds) report having had a material loss within the last three years.
- Of those reporting a material loss from securities reconciliation in the last three years, one in four report a loss of as much as \$1 million. 5% report incurring a loss in excess of \$1 million, and as much as \$5 million.
- While 100% report incurring a material loss from cash reconciliation, just over half report that loss was incurred within the last three years.
- For one in eight, that loss on the cash side was as much as \$1 million. For almost 7 in 8, that loss on the cash side was under \$100,000.

**Vendor Assessment Criteria:** What are the most important vendor & reconciliation solution

attributes? This is measured using the proportion who consider each attribute to be 'significant' or 'essential' to their solution. More than two in three consider (a) rules based matching; (b) highlighting potential fails; and (c) automating exception management to be of particular importance. However, the most important factor is clearly value pricing-being value priced for the functionality provided, which is deemed significant or essential by more than three in four.

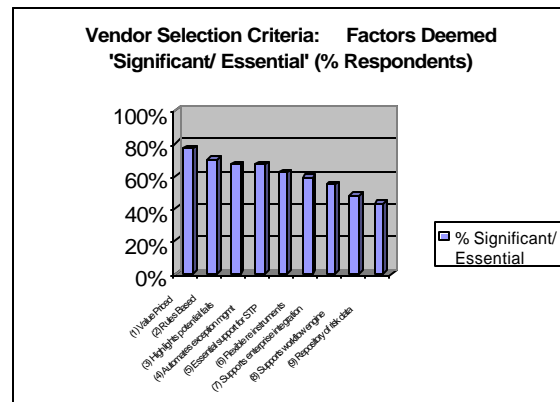
Material Loss: Securities Reconciliation

	<\$100k	\$100k-\$1M	\$1M-\$5M
% Respondents	78%	23%	5%



The proportion identifying each factor as being significant or essential is as follows:

(1) Value priced for the functionality provided	77%
(2) Provides rules based matching capability	70%
(3) Effectively identifies & highlights potential fails	67%
(4) Automates exception management	67%
(5) Provides essential support for STP	62%
(6) Flexible across instruments and business lines	59%
(7) Supports enterprise wide integration	55%
(8) Supports workflow processing engine	48%
(9) Serves as a valuable repository of risk data	43%



## CONCLUSION

While there are significant areas in which the market is less than fully satisfied, all market participants are committed to existing solutions for both securities reconciliation and cash reconciliation. There is a need for more complete and robust solutions, particularly on the securities side of the market.

However, given existing commitments, new or improved solutions need to arrive sooner than later, and represent significant value to the market. This is especially true on the cash side, where the opportunity to penetrate the market appears to be closing. The same holds true on the securities side, although there the market window may remain open for a while longer.