

International Banking & Capital Markets Conference*

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*connectedthinking

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Preventing the Next Operational Crisis

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Agenda

How Did We Get Here?

Is The Time Bomb About To Explode?

The COO's Agenda

Some Ideas To Consider

Question & Answer

How Did We Get Here?

The Drivers Of
Operational Complexity

The Drivers Of Operational Complexity

- Product Proliferation & Volumes
 - Maturing Product Portfolios
 - Reduced Margins
 - Global Market Efficiencies
 - Increasing Transaction Volumes

The Drivers Of Operational Complexity

- Outsourcing & Offshoring
 - Vendor Management for Privacy Issues
 - Additional Privacy Legislation
 - Since 1998, over 80 laws in over 55 countries were passed in areas of financial privacy, data protection, and security breaches
 - Since January 1, 2003, over 40 new privacy laws in the US were promulgated. Many laws apply to business-to-business context, not just to consumers

The Drivers Of Operational Complexity

- Regulatory Creep
 - A shift from after-the-fact to real-time transaction compliance
 - Patriot Act
 - Regulation NMS
 - Community Re-investment Act
 - Additional Enforcement Efforts by Regulators
 - 100 New Examiners focused on AML (NY Fed)
 - New AML fines and supervisory actions
 - Expect regulatory burdens to continue to rise
 - Regulation continue to be more “invasive” and linked to business practices to promote the greater social good

The Drivers Of Operational Complexity

- Mergers & Acquisitions
 - Merger Activity Has Slowed
 - Operational & Technology Issues Remain From Prior Transactions, Such As Multiple:
 - Front Offices
 - Clearing Functions
 - Risk Management Technologies
 - Operational Locations
 - Few Have Done the Hard Work of Integrating Technology & Operations Due To In Part:
 - Cost
 - Execution Risk

The Drivers Of Operational Complexity

- Rapidly Aging Transaction Processing Infrastructures
 - 10 To 20+ Years Old For Core Technology that supports:
 - Credit Card Processing
 - Mortgage Servicing
 - Securities Clearing & Settlement
 - Wire Transfers & Payments
 - Inflexible Infrastructures Have Introduced
 - Manual & Semi-Automated Workarounds
 - Staff Dependencies & Skills Shortages
 - Replacement Costs Are in the 10's or 100's of Millions(\$)

Is The Time Bomb About To Explode?

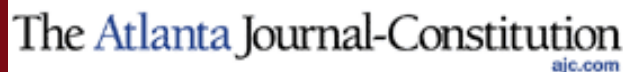
Recent Operational Failures – Headlines

Computerworld

List of Data Breaches Grows – “New York based insurance giant plans to start notifying about 970,000 people of a server theft that potentially could compromise their personal data”



Stolen Mutual Fund Manger computer raises privacy fears – “Laptop contained sensitive data on nearly 200,000 retirement accounts”



Volatility marks hedge fund universe – “By some accounts, up to 50% of all hedge funds collapses are the result of operational failures”



Security breaches rise at financial firms – “More than three-quarters of the world's biggest banks and financial firms suffered an external security attack in the past year and half experienced an internal breach”



Money center bank warns its customers of possible identity theft – “Sensitive customer account data was put at risk when a trio of laptops were stolen earlier this month from three employees’ cars”

The Factors Discussed Have Led To

- Complex Operational Processes
- Technology & Organization Structure Requiring Constant Care & Feeding
- A “Get Through The Day” Environment
- Technology & Operations Organizations Must Be Ruthlessly Tactical
- Few Strategic Initiatives Undertaken

The Results

- Minor failures grow in severity and scope.
- Maintenance costs of legacy platforms & workarounds continue to grow.
- Budgets dedicated to maintenance rather than strategic projects
- Competitive deterioration and client defections due to an inability to service their needs from a trading & operational perspective.
- Acquisitions used to leverage a superior operational platform
- Poor operational risk & compliance leads to regulatory scrutiny & large fines.
- Losses due to errors & fraud occur as control of front office activities deteriorates, particularly in newer complex products.
- Poor trading decisions & decreased performance occur due to operational infrastructure not keeping pace with product and trading innovation.

The COO's Agenda

Agenda For Fundamental Change

- Set specific operational effectiveness goals and objectives
 - Go beyond generic goals
 - Drive objectives to business process level
- Get a better handle on the current environment
 - Understand end-to-end processes, technology, people and issues
 - Compare current operational environment to desired future state
 - Conduct a 3rd party/vendor management and data review

Agenda For Fundamental Change

- Identify redundancies and inefficiencies/opportunities for improvement
 - Focus on simplifying process, technology, business structure, legal entities
- Bite the bullet (bullets?)
 - Break down existing platforms and technologies into a series of smaller, simpler modules
 - Leverage tools like data warehousing and service-oriented architecture
 - Use the off-shore IT development market to drive down cost

Agenda For Fundamental Change

- Set up the environment for continuous improvement
 - Implementing an agenda as a pilot program
 - Apply an improved program to the broader organization
 - Consistently monitor performance versus metrics
 - Develop a dashboard framework that captures operational performance versus metrics
- Actively manage the offshoring/outsourcing agenda
 - Improvement opportunities and risk of failure are magnified
 - Implement shorter-term/tactical improvements before outsourcing/offshoring

Some Ideas To Consider

How Have These Operation Issues Been Addressed

- **Problem:**
 - A “bulge bracket” Broker Dealer/Investment Bank experienced a major failure in their U.S. Equities systems at a very critical time.
- **Impact:**
 - Loss of millions of dollars in Corporate Action Reimbursements and missed trading opportunities.
 - Reputation damage
 - Loss of clients
 - Upheaval in their U.S. Equities area
- **Solution:**
 - Focused analysis of all firm supporting services supplied to the Equities Operations. Determined root cause and recommended targeted solutions to be measured as progress was made over time. Focus led to overall increased processing efficiency and eliminated causal problem factors within a short period of time.

How Have These Operation Issues Been Addressed

- **Problem:**
 - One of the largest asset managers in North America was faced with the problem of rising volumes, increasing complexity of instruments and the need to diversify their portfolio more internationally while keeping costs in line. Unfortunately, the technology, people and process structure was inadequate, resulting in significant operational risk and cost to the firm.
- **Impact:**
 - The business was able to make measurable progress (reducing operational risk and improving efficiency) in a relatively short period of time by carefully targeting investments. They also improved current and future competitiveness through consistent comparison to market appropriate best practice.
- **Solution:**
 - The senior executive team conducted a facilitated self evaluation of the current situation, comparing current processes, people and technology to various levels of market practice (leading, lagging, market) and set a target for the next year. They next targeted the limited investment towards high impact areas and have been measuring their results on a continuous basis.

How Have These Operation Issues Been Addressed

- **Problem:**

- A major US money center bank needed to develop a global enterprise-wide risk and governance strategy to assess all operational risks.

- **Impact:**

- Consolidated and fully integrating risk detection infrastructure.
- Improved on the accuracy with strategic planning and financial forecasting.

- **Solution:**

- Conducted a review of the process design and an analysis of how the organization had previously viewed and reported risk, and then normalizing these approaches to a consistent view that would provide the most value to the overall organization. Since operational risk had not been considered in past practices, that definition and its application was uncharted in the organization. The consolidated view and transparency created from this project was the cornerstone of their enterprise and operational risk programs that are still in use today and that are considered by many to be on the leading edge.

Component example

Pre-Trade – Analytics and Decision Support Tools

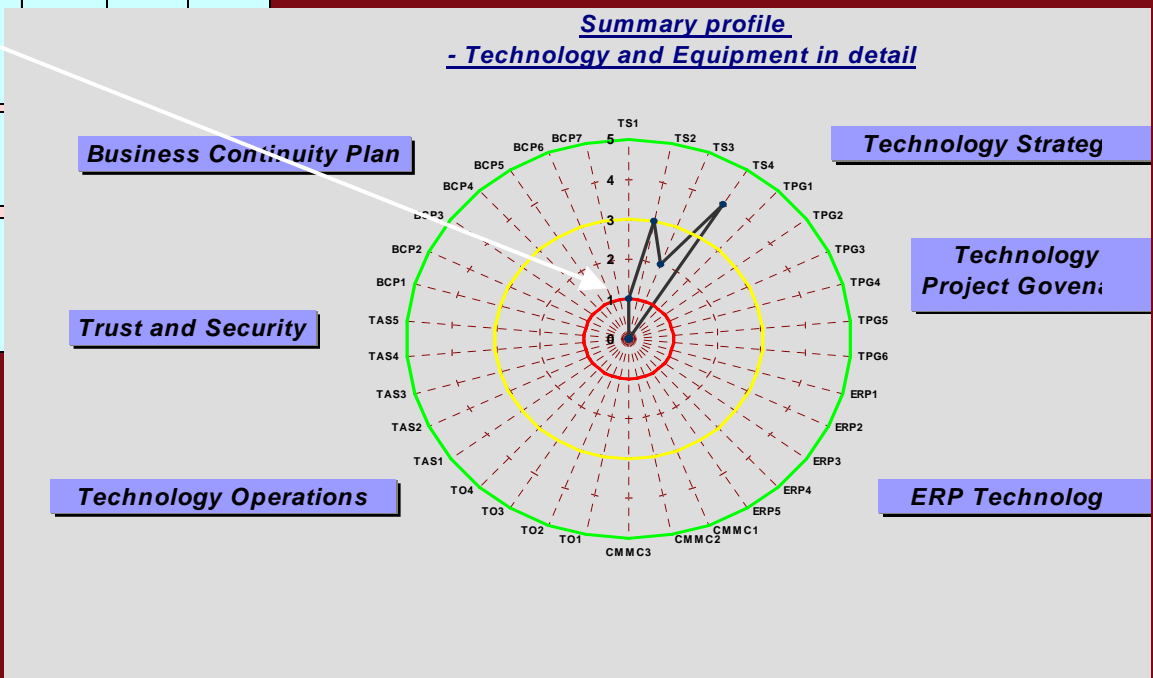
1 Investment Strategies and Market Data	IMPACTS Affects the Cost of Trade	Optimized State Criteria		
		Green	Yellow	Red
<ul style="list-style-type: none"> Investment strategies should be coordinated with market data and historical data sources. The use of portfolio modeling and data visualization, and decision support tools reduces the gap between pre-trade analysis and trade execution. The use of pre-trade analytics will help traders and their clients determine the best pricing and liquidity strategies by venue. 	<ul style="list-style-type: none"> The lack of integrated applications in trading systems impairs effective response time. Opportunities can be made or lost in the seconds it takes to analyze market data, prepare orders, determine execution venues, and, execute trades. The larger the gap between data presentation/analysis and trade execution, the greater the risk that the original economics of the transaction will be jeopardized. 	<p>GREEN - Historical/current market data should be integrated into Trading Order Management Systems (OMS) to allow for upfront analysis and modeling of orders prior to execution.</p> <p>Historical price trend data can give traders and clients/customers better information about the potential market impacts of their orders.</p> <p>Highly automated OMS and pre-trade analysis tools available on the trader's workstations facilitate better order routing and executions. This data can provide the trader/firm with a (post-trade) benchmarking metric to gauge price/execution performance and improvement.</p> <p>YELLOW - Partial price integration into the OMS exists; some portfolio modeling and analytics is performed on a frequent basis.</p> <p>RED - Not integration occurs at this level; no modeling or pre-trade analytics are used in daily business.</p>		

Graphical sample reports

Technology & operations health check

Technology & Operations Diagnostic Questionnaire								
Graphs for individual enablers Improvement solutions Pw C Capabilities \ Services to notepad /audit trail by clicking replate icon	Overall rating 1/2/3/4/5	Scope for improvement LM/H	Primary impacts of any underperformance (Suggest maximum of two)					
			Customer relationship	Financial	Process & technology	People & innovation	Reputation	Regulatory
Technology Strategy The corporate strategy includes the impact of technology on the business, using for example a SWOT analysis, together with competitor developments and market requirements of responsiveness and customer focus	1							
The technology strategy communicates to the business a clear, regularly up-dated view on ? project objectives and business cases; ? customer implications; ? timing of proposed projects; ? revenue streams and cost reductions	3							
The investment appraisal process has the flexibility to address changes in the project portfolio, using for example previously defined decision points and scenario-based reviews to change resource allocation	2							
The organisation makes proactive decisions as to the development and/or use of new and emerging technologies as a source of competitive advantage, with technology seen as enabling rather than supporting the business	4							

Ratings are mapped to specific Quantitative graphs



Question & Answer

Questions & Answers

1. How many severe operational failures has your organization experienced over the last year (over \$1m in losses)?

1. None
2. 1-5
3. 6-10
4. 11+

2. Have you engaged in any “health check” of your business(es) over the last year?

1. None
2. 1-5
3. 6-10
4. 11+

3. Do you plan to conduct a “health check” of your businesses in the next year (Indicate how many business)?

1. None
2. 1-5
3. 6-10
4. 11+

4. Do you have a process in place to target your investments and measure the impact on your operational environments (indicate how many businesses)?

1. None
2. 1-5
3. 6-10
4. 11+

5. Do you plan to institute a targeting and measurement process (indicate how many businesses)?

1. None
2. 1-5
3. 6-10
4. 11+

6. Would you conduct these activities?

1. Solely Internally
2. Seek Some Third-Party Assistance
3. Solely with a Third Party

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