Reconciliations must rapidly adapt to T+1

Banks know that the deadline for shorter US trade settlement times is fast approaching, and there is much to do to make data management and reconciliations processes ready. **Yogesh Shenai**, senior product manager for SmartStream, tells *Future Banking* how the transition to T+1 will affect reconciliations, and how banks can ensure their processes are ready in time.

Shorter settlement times pile pressure on banks in different ways, not least because they have to ensure that many disparate processes operate in an efficient and timely manner. Any failure to meet the new deadline will be costly, not only in terms of cash, but also customer satisfaction and reputation.

Faced with the incoming T+1 settlement regime in the US – and the fact that all major global markets will inevitably follow suit at some point – potentially huge pitfalls lie in wait for the unprepared. Inevitably, the biggest pressure is felt in the reconciliations process, on which the entire settlement process rests.

A shorter timescale and an ever-growing volume of data, partly due to the richer data sets required for the ISO 20022 payment standards, mean that reconciliations infrastructure that is often built on a patchwork of fragmented legacy systems and manual processes could struggle to cope.

The efficiency of the reconciliations process determines the speed of settlement, and any mismatches or missing data will see the post-trade process grind to a halt. Banks can ill afford this under the new regime, as they have always struggled to some extent to achieve seamless reconciliation in the past.

Far too many banks still rely on manual processes in the reconciliation cycle, particularly when it comes to managing exceptions. Any discrepancies between the two parties' recording of a trade must be identified and resolved faster than ever. Any exceptions that are not dealt with immediately can severely erode confidence in the banks and the broader financial system.

Any fines that result from delayed trades will increase trading costs, as well as leaving a bad taste in customers' mouths. As a result, any manual processes that are involved in trade matching have just become enemy number one. These processes already tend to involve large teams of people, so are slow, laborious and highly inefficient, so they should already be high on the list for improvement, but T+1 intensifies the call for automation across the market.

"T+1 fundamentally depends on automating the trade life cycle, which may look very different depending on someone's role," says Yogesh Shenai, senior product manager for SmartStream. "For instance, the life cycle of a buy-side asset manager is different compared to a broker or a custodian or any other intermediary.

"It is important that any reconciliations system offers configurable workflow tooling, and is capable of tracking multiple parallel life cycles for any trade," he adds. "Banks need solutions that offer configurable workflow components which can deal with both synchronous as well as asynchronous life cycles."

Yogesh Shenai, senior product manager

The complexities of matching data

T+1 not only brings its own challenges, but it exacerbates other problems with which banks constantly struggle. A prime example is the need to manage a rapidly growing volume of data while ensuring that it is accurate. This means banks must work hard to guarantee high-quality data is going into an increasingly efficient and automated infrastructure.

That is no simple task, as the data banks are consuming comes in a dizzying variety of forms – some highly structured, some entirely unstructured, such as information in PDF invoices or printed receipts. The reconciliations infrastructure must be able to handle all of it, all at once, with very little margin for error.

That is why the market is turning towards automated solutions. Having accurate and up-to-date information about each trade, clear and efficient processes for resolving discrepancies, and robust controls are the prerequisites for meeting T+1, and automation is the only way to guarantee these elements are in place.

Building those automated processes in-house will be too expensive, too proprietary in nature, and – most important of all – too slow. So, banks are turning to external organisations that can help them to deliver on time, and that have the necessary experience and insight to help them review their current infrastructure

and identify where the most advantageous operational improvements can be made.

"At the core of the affirmation and settlement process is a highly performant and configurable matching engine," says Shenai. "However, it is equally important that the matching system is supported by 'business aware' data validation and enrichment services so that match rates improve."

"Where there is missing reference data, such as securities or standard settlement instructions (SSIs), the system must offer effective exceptions management to work through the problem in the most efficient manner," he adds.

Some research into post-trade processes suggests that many market participants are still conducting up to 20% of reconciliations offline using systems built in-house. In some parts of the market, that percentage could well be higher. Those manual processes greatly increase the risk of missed settlements and associated costs, so both buy-side and sell-side firms are coming to terms with the need to automate.

In doing so, banks may be able to look beyond the challenges that T+1 settlement brings and, perhaps, realise tangible opportunities to boost efficiency. The process of scrutinising technological infrastructure and working practices should, if done thoroughly, reveal precisely where inefficiencies reside, thus refining decision-making processes, and enabling banks to identify peers and service providers with quality data.

Ultimately, banks should use this review to decide on a reliable, proven reconciliations system, which should be able to handle multiple asset classes, be volume-insensitive, and be capable of dealing with new and existing data formats. In an ideal world, it should allow the organisation to move away from the traditional end-of-day reconciliations processing and lead to the adoption to a real-time, intraday approach. That kind of efficiency delivers the competitive advantage that banks crave.

Product suites that can provide fully controlled reconciliations architecture are out there, as are solutions that add on comprehensive exceptions management and sophisticated reporting capabilities across all asset classes. Ultimately, they provide a holistic view of the data flowing in from the disparate sources that affect the T+1 settlement cycle.

"Depending on the asset class or account set-up, the trade data from the front office may be received from a variety of internal systems and in many different formats," adds Shenai. "Our reconciliations solutions, for example, offer unique, workflow-driven capabilities to not only normalise the data so that it can be matched, but also to enrich data by performing look-ups against your static and reference data so that there is never a mismatch due to nomenclature or missing data."

Putting the AI into reconciliations

The product suite that Shenai describes is able to provide a comprehensive level of automation for data management and reconciliations because it relies heavily on the deployment of artificial intelligence (AI), as well as cloud technology.

Using a powerful AI engine, SmartStream is able to deliver immediate results from reconciliations process that once would have taken days or weeks. Securely hosted on the cloud, the solution is also able to learn and improve with every iteration as it incorporates observational learning functionality. It is designed to be faster, easy to use and increasingly intuitive.

Banks will also need solutions that are asset-class agnostic and able to handle a wide range of reconciliation types. The T+1 environment will also require them to implement solid controls and comprehensive exceptions management capability.

"We recognise that large volumes of data in a huge variety of non-standard formats and structures are still checked for accuracy and completeness using spreadsheets – or the tasks are not done at all," notes Shenai. "The combination of our business expertise, gained over four decades with over 2,000 customers across the globe, and our dedicated Innovation Lab team – a collaboration of ultra-smart mathematicians and data scientists – enables us to deliver a tool that can match any data, for any reason, in an instant."

Regardless of the data format or how low its quality, AI is capable of reading, analysing, learning and identifying what needs to be compared. It can then present a list of unmatched records or disputes for investigation. Compared with burdensome tasks like Excel automation, transactional reconciliations, checking data between systems, managing exceptions and validating regulatory reports all become straightforward processes.

"Once you have put a system in place which automates, say, 99% of your trade settlements, that is still not sufficient, as that remaining 1% requiring human intervention may still expose you to significant risk," Shenai remarks. "Where there is missing static or reference data, such as securities or SSIs, AI offers exceptions management capability to work through the problem in the most efficient manner.

"An example of this is its 'exception storming' capability, which effectively avoids flooding the system with duplicate exceptions for the same problem, such as missing or invalid SSIs," he adds. "Resolving the problem once – by, for example, adding the relevant SSI – can automatically progress all the stuck trades through the life cycle."

Reconciliations need not be a stumbling block in the transition to T+1, and with AI used wisely, banks can, for once, get ahead of the curve, rather than running to catch up. ●