The Cost of Reactive Controls

In today's investment operations, errors are an unfortunate fact of life, and asset managers must have a comprehensive controls framework in place to manage them effectively. However, when an error occurs, the tendency for most firms is to react by implementing manual controls rather than taking a holistic approach to assessing their overall framework. This reactive approach can lead to an over-saturation of controls, resulting in lost productivity, increased costs, and an increased risk of human error. In this paper, we explore some of the hidden costs of manual controls and identify four key risks that firms should consider when implementing a new control.

BEFORE ASSESSING YOUR CONTROLS FRAMEWORK, CONSIDER THESE FOUR COSTS

When confronted with an error, firms tend to react to that error specifically rather than assessing their overall controls framework. Management asks two questions: How much did the error cost and what control failed? These questions typically stem from the board placing downward pressure on management for expedited resolution, especially in the case of a high-cost error. When a team is experiencing repeated errors, the pressure to add controls quickly magnifies, resulting in excess and unmanageable controls.

Applying a manual control is unquestionably a simple and effective tool providing the hypothetical 'safety net' your compliance team prefers. Although it seems like the de facto solution, it is vital to remember that controls are not free; there is always an associated cost. An over-saturated controls framework can complicate existing processes and introduce costs beyond the simple monetary loss of the individual error.

Unfortunately, errors do occur, and you must respond to them. When deciding whether to implement a new control, you should always consider these factors:

1. **Productivity Cost**

In analyzing impact on productivity, you should understand the actual time requirements for your controls and the associated cost in FTE hours. With operations teams regularly running lean, your organization may be working with limited personnel and bandwidth in danger of exceeding capacity. In this scenario, control points become rushed, if not entirely overlooked as a 'box to check' without spending the necessary time to understand the underlying risk.

2. **Actual Monetary Cost of Errors vs. Cost of the Control**

With each error, your firm should take the time to analyze the actual monetary risk you will be mitigating through this control and determine if the cost of the control will outweigh the cost of an additional error.

3. **Human Error Cost**

There are also impacts to your personnel to consider when implementing controls. Repetitive, mundane tasks exhaust your analysts, and a tired analyst makes mistakes, increasing the likelihood of errors costing money to the firm.

4. **Key Person Cost**

Manual checks do not diminish your key-person risk; attrition may increase if your departing analyst is a subject matter expert on your controls.

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BEFORE ASSESSING YOUR CONTROLS FRAMEWORK, CONSIDER THESE FOUR COSTS (CONTINUED)

When implementing a new control, it's essential to evaluate the above factors to ensure you are creating balanced, efficient controls for your operations team that manage risk effectively. It is likely that the total time and monetary cost of additional manual controls may exceed the price of a more holistic and automated approach to risk management. Overall, it's important for firms to take a more complete approach to risk management, rather than just implementing manual controls when an error occurs. By evaluating the hidden costs of reactive controls and assessing their overall controls infrastructure, firms can create a balanced, efficient controls structure that manages risk effectively.

HOW MERADIA CAN HELP

As trading strategy continues to evolve, your firm cannot afford to have a controls framework that does not support your growing business. Reevaluating and rebuilding your framework can be a daunting task, but Meradia consultants' extensive front-to-back subject matter expertise can be leveraged to help analyze and regain control of your operations and ensure your framework is scalable for future growth.

Jill Stassel brings 10 years of front- and middle-office experience to Meradia's clients. Jill improves operational structures by serving as a strategic project manager with a deep understanding of technical systems and the ability to build a strong rapport with the front office. She has led all stages of product implementation from mapping out the product journey in the front office to ensuring the proper conversion in middle and back offices. Jill has worked closely with fixed-income instruments and municipal bonds throughout her career and has substantial expertise in the middle office, in both domestic and global settlement and matching.

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