

Case study 2

John Read, senior vice president, global product and strategy, at Northern Trust, explains how the firm provided fund administration and derivative processing for a distressed portfolio of a global multi-strategy manager.

Client

A large global multi-strategy investment manager who segregated a large portfolio of distressed assets.

Background:

Northern Trust was engaged by an organization to provide fund administration and derivative operation outsourcing services for a portfolio of distressed assets. Upon transition of securities, Northern Trust was responsible for processing positions and events retroactively and reporting a net asset value as of a prior date. The fund manager and investors were adamant about independence of valuations as well as automation of the operations process. The portfolio consisted of thousands of open positions ranging from physical securities to highly structured derivative instruments with one thing in common: exposure to distressed assets. The outsourced activities covered the entire spectrum of Northern Trust derivative lifecycle management services including trade capture, confirmation matching, reconciliations, valuations, active collateral management, and reporting.

Solution:

A highly complex instrument range included the following: CDO liquidations; CDSs on asset backed securities, commercial mortgage backed securities and residential mortgage backed securities; and variable funded notes. Additional requirements came from the attributed intensive lifecycle event write-downs and cash activities processed for these structured instrument types, which included approximately 1200 positions. An automated model was developed by Northern Trust fully to support these complex products.

Immediately upon review of the asset list, both parties agreed that for any solution, a replication and validation exercise of the prior six months historic cash-flow movements and events was required. A



daily XML trade file was developed by Northern Trust and the client to deliver FTP automation and STP for both organizations, including the necessary data attributes for each instrument/asset type. Northern Trust had already implemented the Misys Summit Must application to structure and process exotic trade activity and further extended the instrument coverage by utilizing the CDS on asset backed securities capability within the module.

The second solution included Northern Trust partnering with Markit to launch and implement the reference cash-flow database (RCD) service to calculate interest shortfalls, write-downs and all reimbursements, both historically over the six month period and going forward. A daily XML position file is extracted from the Northern Trust Misys summit system and loaded onto the Markit RCD. The application returns an XML file providing cash-flows and event data. Northern Trust leveraged an existing proprietary reconciliation tool to compare the two event files and resolve and communicate discrepancies back to the client. To date, Northern Trust has validated and managed approximately 13,000 credit events, settled cash on 10,500 of those lifecycle events and processed a number of CDO liquidations since going live.

As part of the implementation process, Northern Trust arranged for various preferred vendors independently to value the positions at a historical date agreed by client and vendor. An in-depth model methodology validation and market data

comparison was completed, and a preferred vendor selected. Northern Trust facilitated further conversations to assist the fund manager's and investors' agreement of fair value. This led to Northern Trust providing active collateral management services to the client using Colline, a specialist collateral management system integrated within Northern Trust's derivative infrastructure.

Northern Trust provide a centralized solution for collateral requirements, covering all OTC products under the International Swaps and Derivatives Association (ISDA) agreements and providing independent valuations across all instrument types. Northern Trust has a team of professionals focused exclusively on the client's collateral management activity and highly automated processes require limited manual intervention. This facilitates efficient and accurate collateral management, safekeeping and settlement processes on behalf of the client.

Benefit to client:

By leveraging Northern Trust's extensive connectivity capabilities, derivative system strength, knowledge base, and process controls, our client was able to integrate ahead of an aggressive schedule. Through the use of Northern Trust's valuation vendor relationships, the client received additional comfort in the valuation of the complex portfolio. By independently validating historical and on-going events such as cash-flows and CDO liquidations, Northern Trust closed out potential gaps in position and valuation reporting. Although the portfolio consisted of structured instruments covering illiquid underlying exposures, the client could rely on Northern Trust to perform all derivative operations functions that would otherwise have required it to implement dedicated derivative systems and/or hire additional operations support, thus allowing it to focus on more important asset management functions. ■