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OPM: why bother?

Operational performance management (OPM) is critical to routinely measure, monitor and attribute poor performance and reduce or eliminate operational risk says **Graham Mellor**.

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Increasingly, in the flight to specialised investment mandates, more and more financial firms have begun to 'chase alpha'. Brave moves to differentiate performance have been characterised by the rapid 'sophistication' of strategic and tactical asset allocation and the types of financial instruments and funds used.

Today's market is characterised by:

- Fast evolving, high volume, continuous-process investment and financial transactions.
- Demand for immediately available and accurate financial information.
- The need for more sophisticated operational processes; 'zero-error' quality control.

Every good Operations Director knows that operational errors, including needless lags in processing, are not only unacceptable but can be exceedingly costly. However, catching these errors and delays is a major challenge.

A new mechanism

Basis Point Group has created a mechanism for effectively measuring operational value at risk (OVAR) through every step in an institution's operations – a standard, comprehensive means of quantifying the stability of operational processing. The mechanism OPERA* is easy to understand, measuring performance against contractual obligations as well as the reasonable expectations of clients and regulators.

Modern operations departments are a mission-critical component of what should be an integrated modern investment and financial management process. An array of accounting and actuarial operations and risk measures and methodologies have sprung up to address the need for better control and to limit 'realised risk'. Each attempts to improve understanding at the tactical or process level, not measure the effect on the client. However, none has as yet met BPG's three key principles: simplicity, outcome measurement and comparability.

Six Sigma, KRI's, loss databases and many other process and environment-centric approaches now proliferate to help manage front-back co-ordination and operations. However, few projects have provided measurable economic benefits – quantifiable improvements in quality and reduced operational risk.

OPERA Philosophy

Relying solely on old accounting and liability-based approaches to measure and control Operations is out of step with reality. Not having a clear view of how the organisation should react to, for example, changes in pricing mechanisms, makes a firm a potential casualty of 'under the radar' risks and challenges.

Every financial and investment services firm argues that it is different from others. While this may be true from a geographic, product, liability, fiduciary or marketing standpoint, each firm manages money in one form of account or another. Every transaction in each account has at least one counterparty and each should be recorded successfully and on time by each participant. Complexity lies in the rules used to measure timeliness and success. Understanding client-based rules for timeliness and successful completion provides a foundation for standardisation.

BPG set about designing and using OPERA to enable the aggregation and monetisation of information that is easily accessed from a firm's existing systems and data stores. The method delivers a bottom-up calculation of account-based performance (accuracy and timeliness) of processes. Highlighting events that were not completed provides a measure of 'Unrealised Risk'*.

Unrealised Risk describes the key quantitative outcome that OPERA delivers – an assessment of the stability of operational processing, highlighting where losses are most likely to occur. Measuring stability in this manner provides an overall assessment of a firm's and its counterparties' timeliness, identifying the variability or volatility in the reported measures, pointing to areas for further investigation and issue resolution.

OPERA can calculate unrealised risk periodically or in real-time as a single value index, whereby an increase in the index value is an increase in operating risk. All operational deviation is captured in the index value and allows stack-ranking by process, group, size, number, risk or client impact. The ultimate goal of operational performance measurement is to improve productivity, allowing more efficient, targeted investment in business improvement projects, systems, training and infrastructure.

Basis Point Group is working with leading financial services firms to create the largest available database of Unrealised Risk. Our goal is to add progressively more data, indices and derived information into the OPERA database and associated performance model, generating more quality and volatility standards for operations in the financial industry, enabling meaningful comparisons of performance among financial organisations. ■

Graham Mellor is Lead Partner at Basis Point Group's London office. *OPERA and Unrealised Risk are registered trademarks. To read more (including Basis Point Group's Operations Performance Indexes for the US Government Bond and Mortgage-backed markets) visit **www.fsteurope.com** and click 'The Publication'.