

## Case Study

# The Principal Financial Group®

## Unity™ Post-Trade Compliance Replaces Manual Processes for Independence, Control and Cost Efficiency

The Principal Financial Group partnered with Confluence to develop Unity Post-Trade Compliance. As a result, they eliminated risk with more rigorous compliance with daily testing, achieved scalability to grow without adding staff, and avoids the 14-fold increase in payroll costs otherwise required with manual methods.

### Executive Summary

The Principal Financial Group offers a wide range of financial products and services through its diverse family of financial services companies. A member of the Fortune 500, The Principal has \$304.2 billion<sup>1</sup> in assets under management and serves some 18.8 million customers worldwide from offices in Asia, Australia, Europe, Latin America and the United States.

In its mutual fund line of business, the Principal Financial Group manages 112 funds with 614 share classes – up 30 percent from 2006 when they announced the acquisition of WM Advisors, Inc. – manager of the WM Group of Funds (WM Funds) – and its subsidiaries from Washington Mutual, Inc.

For most mutual fund complexes, growth of this magnitude would have placed a tremendous strain on the fund administration back office, requiring a substantial increase in staff to meet pricing, performance, financial statement, compliance and marketing reporting demand. But the Principal Financial Group had committed to automating many of their fund administration processes, thereby enabling their back-office operation to scale, without the costs or inherent risks associated with manual processing.

With the 2008 launch of Unity Post-Trade Compliance, The Principal continued their commitment to leveraging one unified fund administration platform and centralized database. Today, they are reaping tremendous business benefits through automation and setting industry standards for best practices in post-trade compliance rigor and daily testing.

### The Post-Trade Compliance Challenge

Prior to implementing Unity Post-Trade Compliance, post-trade testing was performed by the same financial reporting team that manages the process today. The post-trade compliance process, however, was completely manual, relying on multiple spreadsheets and time-consuming data checks to make sure potential compliance issues were not overlooked.

The financial reporting team relied on the fund accounting department to provide the reporting data they needed to perform post-trade compliance tests. “The reports that came from the fund accounting system just weren’t meeting our needs,” said Sara Reece, senior financial accounting analyst at Principal Funds. “The data was designed for fund accounting needs, not compliance, and we found ourselves deciphering how to use the data from one report for multiple testing purposes. We needed data that was refreshed more frequently and we needed more flexible reporting than the fund accounting system was designed to

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<sup>1</sup> As of March 31, 2008

produce. Increasingly, it wasn't meeting the growing demand for daily monitoring of multiple tests."

The biggest challenge with the data was stewardship and control. "While the fund accounting data was accurate, we wanted the peace of mind knowing that we had control over our compliance data. We wanted control over knowing the precise origin of the data, who touched it, and how it was intended to be used," said Reece. "Basically if we are being held responsible for post-trade compliance testing we believed we should be the stewards of the data that goes into the testing process."

Lacking precisely the right data wasn't the only challenge. The fund reporting group relied on spreadsheets and manual processes to calculate test results -- a paper-intensive process which was inherently at-risk for human errors, and it was not easy to adapt processes to new regulations. Because they did not have a means of exception-based testing, the team had to carefully review each and every test for each fund to identify issues in the test results. They had no way of isolating just the test results that failed. As a result, testing was a time-consuming ordeal and, even with precise attention to detail, the risk that a violation had not been uncovered could never be completely eliminated.

From a workload standpoint the manual process of testing and identifying violations was not scalable. Adding new funds or new tests or increasing the frequency of testing would require additions to staff.

One test alone, the Securities and Exchange Commission's "80 percent name rule test",<sup>2</sup> took three weeks to prepare the rule reports annually and one and one-half weeks to review the results using Excel formulas. Imagine the anxiety experienced by the fund reporting group when the internal compliance department insisted that this particular test increase in frequency from annually to daily.

## The Solution: Unity Post-Trade Compliance

By early 2007, the financial reporting group at The Principal knew that manual post-trade compliance testing could no longer meet their needs. They wanted more control over the data, the flexibility to increase the frequency of testing to daily, and the scalability to test a growing number of portfolios without adding to staff. Their financial reporting team initiated a search for an automated solution for a post-trade compliance system.

"It was really an economic decision," said Layne Rasmussen, vice president, controller and CFO at Principal Funds. "We all agreed that we need to move to daily testing to mitigate risk, but we needed to weigh cost against risk. The cost of hiring the necessary staff to test daily would have been astronomical. We knew it was time to automate."

In their search, the Principal Financial Group pursued multiple options including a compliance system their investment advisor, Principal Global Investors, was using for pre-trade compliance that also offered post-trade testing capabilities.

In the end, they elected to join forces with Confluence to develop a solution specifically for post-trade testing and monitoring, Unity Post-Trade Compliance. "Unity Post-Trade Compliance is a robust solution," said Rasmussen. "Plus, by keeping post-trade compliance completely separate from pre-trade compliance we set up rules and test independently."

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<sup>2</sup> The Securities and Exchange Commission adopted the rule under the Investment Company Act of 1940 to address certain broad categories of investment company names that are likely to mislead investors about an investment company's investments and risks. The rule requires a registered investment company with a name suggesting that the company focuses on a particular type of investment (e.g., an investment company that calls itself the ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund) to invest at least 80% of its assets in the type of investment suggested by its name. The rule also addresses names suggesting that an investment company focuses its investments in a particular country or geographic region, names indicating that a company's distributions are exempt from income tax, and names suggesting that a company or its shares are guaranteed or approved by the United States government.

Doing so completely eliminates the risk that rules that were missed or misinterpreted in the pre-trade process are not caught during post-trade testing.”

The Principal Financial Group was already using Unity Holdings from Confluence to automate the collection, creation, confirmation and delivery of security holdings data. “It did not make logical sense to manage yet another holdings database when we already had peace of mind knowing that the Unity Holdings data was complete and accurate.” said Rasmussen. Built on a unified database, the Unity platform is designed to enable investment managers to collect, cleanse and store data once so that it can be repurposed for a variety of fund administration reporting needs.

Today they are reaping tremendous business benefits and peace of mind knowing that they have unprecedented control over the integrity of post-trade compliance data and testing processes. “With Unity Post-Trade Compliance, we are getting much more for much less,” said Rasmussen. “We are getting more comprehensive testing, more frequently – and in a fraction of the time.”

## Results At A Glance

### Reduced Costs

- Avoided the 14-fold increase in payroll costs otherwise required to achieve daily testing with manual methods.

### Eliminated Risk

- Eliminated the risk of spreadsheet errors.
- Eliminated the risks associated with infrequent testing, including the risk of potential costly compliance issues remaining undetected for extended periods of time.
- Providing independent post-trade compliance oversight to ensure checks and balances between pre- and post-trade testing.

### Elevated Service Levels

- Assuming responsibility for all post-trade compliance responsibilities, thereby relieving the fund accounting department of the compliance burden.
- Providing more timely information to the internal compliance team as a result of more frequent compliance testing.

### Increased Scalability

- Realizing the scalability to add new funds, comply with new rules, and increase testing frequency without adding staff.

## Reduce Costs

By automating post-trade compliance with Unity Post-Trade Compliance, The Principal is now completing post-trade compliance testing, reporting and reconciliation in a fraction of the time. With manual processing, one full-time staff member dedicated a full eight-hour day to complete testing for just 15 portfolios.

Scaling their back-office to perform testing manually for 112 funds and increasing the frequency of testing to daily testing would have resulted in annual payroll costs of \$485,333. With Unity Post-Trade Compliance, it simply takes one full-time staff member four hours a day to complete the daily testing, reporting and reconciliation – enabling The Principal to avoid the 14-fold increase in salary costs which would have been required to achieve the same frequency and rigor of testing manually.

## Eliminate Risk

By automating post-trade compliance, The Principal has eliminated the risk of spreadsheet errors and manual processes. Plus, they have eliminated the risks associated with infrequent testing, including the risk of potential costly compliance issues remaining undetected and unreconciled for extended periods of time.

By conducting post-trade testing on a system that is separate from testing for the pre-trade environment, all post-trade compliance rules are set up and tests are run independently. This segregation of duties has enabled The Principal to eliminate any risk that a rule was misinterpreted, set up incorrectly in the system, and subsequently applied erroneously for both pre-trade and post-trade testing.

And, because tests are performed independently in the pre- and post-trade environments, The Principal has peace of mind knowing that they have complete oversight of sub-advisors' compliance practices – an area where they desired greater rigor and control.

## Elevate Service Levels

Since implementing Unity Post-Trade Compliance, the back-office team at The Principal is delivering new levels of value-add service to the fund organization. They are now fulfilling the demands of the compliance department for daily testing. And, by assuming responsibility for all aspects of post-trade compliance monitoring, they have relieved the fund accounting team of a series of burdensome compliance tasks and report requests. They also now have the capacity to take on other data stewardship responsibilities from fund accounting, such as the time-consuming task of monthly bond rating maintenance.

From their work in setting up the compliance rules for each fund in Unity Post-Trade Compliance, the financial reporting team gained a deep understanding of the rule language for all of the funds across the enterprise. They discovered first-hand the nuances in prospectus language used to describe similar rules from one fund to another and how slight changes in wording could lead to potential misinterpretation. As a result, the team is positioned to provide service to the company's legal department by assisting them in drafting clear, unambiguous prospectus language that can be interpreted consistently.

## Increase Scalability

Through automation of the post-trade compliance process, The Principal is able to meet the demand for daily, comprehensive testing without increasing staff. Plus, they have the ability to readily adjust to future business and regulatory changes.

On a typical day, the financial reporting team at The Principal has one person who dedicates just four hours to daily post-trade compliance monitoring and testing and they are able to add more funds or additional tests with little or no impact on staffing. The staff needed to perform daily testing on all funds in the previous manual environment is estimated at 7.5 FTEs – and staffing size would multiply with each additional new fund or regulation.



*Unity Post-Trade Compliance is designed to enable the back office to automate the process of collecting and managing portfolio, holdings and security data, creating restrictions, confirming test results, and delivering the test results and exceptions.*

## Unprecedented Post-Trade Compliance Independence and Control

Today, The Principal has unprecedented independence and control over post-trade compliance, including:

- Data stewardship
- Greater frequency of testing
- More comprehensive tests
- Separation of pre- and post-trade duties and testing
- More rigorous oversight of sub-advisors' activities
- Exception-based 'pass/fail' processing that pinpoints only potential violations for review and escalation
- Automated audit trails that document testing results for all 112 funds

## Adopting a Single Platform for Back-Office Automation

The Principal's commitment to back-office automation dates back to 1999 when they began using FundStation® from Confluence (now known as Unity™ Pricing and Unity™ Performance). Today, they rely on these Unity products to automate pricing distribution and performance calculations for their 614 mutual fund share classes and more than 1,100 variable annuity sub-accounts.

When Confluence launched its ClearPortfolio™ automated holdings product (now known as Unity™ Holdings) and ClearPortfolio for Financial Statements (now known as Unity™ Financial Statements), The Principal was ahead of the industry as an early adopter of financial reporting automation. In 2005, they implemented Unity™ Holdings and later the same year adopted Unity Financial Statements to automate print-ready financial statements.

Prior to deploying Unity Holdings and Unity Financial Statements and, creating holdings and financial reports involved mainly manual and labor-intensive processes, including extensive use of error-prone spreadsheets and requiring lengthy cycle times to complete during peak quarter-end periods.

By 2007, the compliance department was demanding more frequent post-trade compliance testing from the financial reporting group. That demand, coupled with the growth in the number of portfolios and dependence on manual processes, left the financial reporting group with two options: add staff or automate. The Principal initiated their search for an automated solution. In 2007 they partnered with Confluence to develop Unity Post-Trade Compliance and, in 2008, became the first to realize the benefits of the product.

## Synergies of a Unified Platform

The Principal has adopted five products on the Unity Platform – Unity Pricing, Unity Performance, Unity Holdings, Unity Financial Statements and Unity Post-Trade Compliance. While each product is designed to work alone, the products on the Unity platform work together to help back-office administrators achieve even greater efficiencies and business results. That's because Unity is built on a single data hub which enables fund administrators to reuse data which has been validated once and then stored in a single data hub across multiple Unity products.

For example, the portfolio holdings data that has been collected and validated daily by Unity Post-Trade Compliance is used by Unity Holdings to create holdings reports and 'top ten' holdings lists. Reusing previously validated holdings data creates time efficiencies for both the fund accounting and fund reporting teams, since fund reporting no longer needs to request portfolio holdings information from fund accounting. It also eliminates the risk of error and gives the fund accounting team peace of mind knowing that the holdings data is in the right format for financial reporting purposes.

In addition, The Principal is gaining efficiencies in holdings reporting by leveraging their investment in Unity Post-Trade Compliance to check for missing daily income factors and anticipate footnote needs. Prior to producing their Statement of Investments (SOIs) in Unity Holdings, they run a test in Unity Post-Trade Compliance to see if any daily factors are missing. They also run a test to determine if they own more than five percent of a security so that they could anticipate the need to include relevant footnotes.

## Conclusion

As a proponent of best practice processes and automation, The Principal is paving the way for the industry's next-generation fund administration back office. They have embraced a platform approach to automated fund administration and are leveraging multiple products on the Unity platform – Unity Pricing, Unity Performance, Unity Holdings, Unity Financial Statements, and their newest addition, Unity Post-Trade Compliance. Featuring a centralized data hub, the Unity platform lets them validate data once and store it to be reused for multiple purposes, thereby ensuring data integrity and providing peace of mind.

Today, The Principal has eliminated manual processes and error-prone spreadsheets across many areas of their back-office operation. As a result, they are eliminating risk through process automation, realizing the scalability to add new funds without impacting staff levels, delivering elevated service to their stakeholders and achieving cost savings.

In their most recent endeavor The Principal partnered with Confluence to develop Unity Post-Trade Compliance, enabling them to conduct daily testing for many compliance tests, while keeping post-trade compliance monitoring and testing separate from the pre-trade compliance environment for greater independence and control. And they have replaced labor-intensive manual processes with automated compliance testing to achieve bottom-line cost savings and scalability.

## About Confluence

Founded in 1991, Confluence is a global leader in fund administration automation. Confluence helps investment management companies gain unprecedented control by automating every step of the fund administration process—including the collection, creation, confirmation and delivery of investment product data—while maintaining control of the process. Results are lower costs, reduced risk, decreased reporting turnaround times and the scalability to automate more processes without additional resources. Confluence solutions are used by 40 percent of the leading global investment managers, and more than 60 percent of U.S. mutual funds.

The Unity™ platform from Confluence addresses a wide range of problems from performance measurement to customized reporting for a full array of domestic and international managed investment products, including mutual funds, funds of funds, collective funds, separate accounts and variable products, as well as hedge funds and other alternative investments. Major fund companies such as T. Rowe Price and Russell Investments, and service providers such as The Bank of New York rely on Confluence. Headquartered in Pittsburgh, PA, Confluence serves the international fund industry with key locations in London and Luxembourg. For more information, visit [www.confluence.com](http://www.confluence.com) or e-mail [info@confluence.com](mailto:info@confluence.com).

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