

# Death of the Portfolio Accounting System

## Regulatory Changes

On November 22, 2010, the IRS enacted Rule TD 9504, which governs "Basis Reporting by Securities Brokers and Basis Determination for Stock"<sup>1</sup>. The rule stipulates that cost basis at the tax lot level and the calculation of short and long term capital gain calculations be performed by the broker. The law also governs nuances surrounding the cost basis tax oriented issues such as wash sales, dividend reinvestment, automated lot closing and specific lot closing, and other tax oriented events surrounding cost basis.

Soon after TD 9504 for stock was enacted, similar rulings were put in place for cost basis issues for bonds, adjusting cost basis for amortization of premiums and accretion of discounts, adjusting cost basis for pay downs and pay ups using factors for asset backed securities, exercise of options, options expiry, fixed income maturities, OID accretions and derivatives closing transactions. These landmark laws triggered shock waves across Wall Street as brokers clamored to implement the systems to perform these complex accounting calculations.

Now five years have passed and we have seen the systems put into place at brokers and custodians; some good, some not so good and none perfect. The common fact is that the broker is the book of record, and the responsibility for keeping and reporting cost basis for tax purposes has shifted from the investor to the broker.

How has TD 9504 affected investment advisors? For now, most advisors are continuing to manage portfolio accounting systems such as

Axys, APX or Schwab Portfolio Center and other in-house systems; or they have implemented cloud portfolio accounting systems such as Black Diamond, Orion or AssetBook. Either way, the advisor is paying for the systems and operational costs of running those systems to calculate much of which is now, by the law the obligation of the broker.

## Is This the Death of the Portfolio Accounting System?

In this new environment, do advisors need portfolio accounting systems (PAS)? Is this the death of the PAS?

We believe that there is still sufficient need in the short term, for three reasons.

1. **Timeliness of Data** – Position, tax lot and cash realized and unrealized gain data is not readily available in time for start of day trading across the board at all brokers for now.
2. **Aggregation** – Most advisors use their PAS as their aggregation systems. A new breed of systems that store data, not calculate data, would need to be developed. The emergence of the IBOR (Investment Book of Record) is a possible solution to the aggregation of broker data.
3. **Performance** – Most advisors use their PAS to calculate and report performance. A select few brokers do not calculate performance. However, most do not, and most importantly, brokers are not required to do so by law.

However, as these issues are solved, we believe that in the near future, advisors will be able to operate their firms in a different manner.

<sup>1</sup>[https://www.irs.gov/irb/2010-47\\_IRB/ar08.html#d0e220](https://www.irs.gov/irb/2010-47_IRB/ar08.html#d0e220)

## ***What is an IBOR?***

*IBOR, or Investment Book of Record, refers to portfolio data used in support of an investment management process.*

## **Opportunity for Advisors**

TD 9504 represents an opportunity for advisors to save an enormous amount of time and money by eliminating the cost basis and realized gain calculation process and the resulting custodian reconciliation process from their operations. This can, and most likely will happen with increased competition in the broker field, which will solve issue 1 above. Issues 2 & 3 can be solved now with IBOR and performance measurement systems.

With the large amount of money being invested by private equity in the FinTech space, we are sure to see existing and new technology providers fill this gap of IBOR + Performance Measurement. If performance reporting continues to be an enforcement issue by the SEC, the U.S. Government may mandate that brokers calculate performance for investors. If we look north, Canada has done this, making brokers legally responsible for calculating performance.

Going forward, advisors can benefit from these changes. New entrants who provide innovative access to accounting quality custodian data aggregation and normalization vendors will become increasingly valuable assets to the advisor. IBOR systems, performance measurement systems, billing, trading and other systems will increasingly rely on these

new broker data aggregation vendors as the reliance on portfolio accounting data migrates from the in-house or cloud SaaS to the broker provided data directly. Each and every broker formats their data differently and in different formats, thus necessitating for the vendor to be accurate, reliable and have accounting quality data.

The good news for advisors is these innovative data technology platforms, firms will be able to dramatically lower their data costs, while improving accuracy and timeliness in reporting.

## ***Schwab Advisor Services Cost Basis Field Examples***

*Amortized and unamortized  
cost basis, original face,  
wash sale, disallowed loss,  
original purchase price.*