Global regulatory compliance

RegTech isn't a panacea but provides critical tools in the right hands.

Global regulation has developed like a slow growing but increasingly powerful storm system over the last five years. And whereas big wave surfers welcome such conditions thanks to the epic waves it produces, there are, it could be argued, precious few C-suite executives relishing the equivalent regulatory waves being cast ashore.

Philip Masterson, Senior VP and Managing Director at SEI's Investment Manager Services

Asset managers today must contend with complex data aggregation tasks due to reliance on multiple data sets often operated and managed on multiple systems. But whilst this is putting great pressure on internal resources, creating a tug-of-war between compliance departments and the front-office as they compete for additional dollars, there is a way forward; one that uses both top-down and bottom-up approaches to create a more cost-effective, automated regulatory compliance programme.

Philip Masterson is Senior VP and Managing Director at SEI's Investment Manager Services division. He sets the scene by noting several questions the C-suite asks: "How do we effectively track all of our compliance obligations? Do we have the requisite expertise? Can our systems handle this? How do we ensure consistent regulatory reporting across jurisdictions? And, of critical importance, how much is this going to cost?

"C-suite executives have become more focused on compliance due to the increasing costs of complying as well as the significant reputation risks associated with non-compliance – the often punitive impact to client relationships and the negative effects to financial results," says Masterson.

"The core context here is that compliance is competing for revenue-generating functions across regulated firms. Compliance is non-optional but there is a natural tension because as more dollars are spent on this task, fewer strategic dollars are available to spend on front office initiatives including portfolio management, business development and investor servicing.

"In speaking with one of our clients recently, she mentioned needing to increase regulatory and compliance resources yet simultaneously also needing more investment analyst resources. This anecdote highlights the difficult resource allocation decisions firms must make.

As a result, the key question facing any group CCO is: "How can I maximise or optimise the firm's compliance spend?" And while leveraging technology is critical, technology alone is not the solution.

As mentioned, complex data aggregation is at the heart of the challenge for any buyside firm as they strive to cope with reporting deadlines and regulatory commitments across different regulatory regimes and global jurisdictions. Europe alone has become an alphabet soup of regulation, with MiFID II and PRIIPs the latest to join a long list of regulations including EMIR reporting, annual KIID updates and filings and Annex IV reporting under AIFMD.

In the US, registered investment advisors are preparing for the upcoming Investment Company Liquidity Risk Management Programs rule, known as SEC rule 22e-4, adding to Form PF and CPO-PQR reporting requirements that alternative fund managers face under the Dodd-Frank Act.

For those operating regulated and unregulated funds, it has, in short, led to an explosion in the volume of data to be managed as firms vie to stay on the right side of their compliance obligations. The usual response to this challenge is to extend one's IT infrastructure, adding new systems to respond to the changing regulatory winds. While it may work in the short term not only is this costly, but it invariably creates an environment in which different teams are drawing on multiple sources of data, multiple types of data, and using multiple repositories for that data.

The bottom line, says Masterson, is regardless of the solution, firms need timely, cost-effective access to that data.

"Also, because of the breadth of regulatory obligations facing investment managers, you have several application providers who have built cottage businesses around niche compliance obligations. Consequently, when you look at it from a firm-wide perspective, those firms are forced to integrate multiple application providers to form a complete solution.

"However, the questions are, do they want to be in the business of identifying that universe of potential application providers, vetting them, integrating them and monitoring them on an ongoing basis? It's not what investors are paying them for.

"From a CCO's perspective, and that of a CEO as well – the latter who needs to look at the performance of the firm as a whole – it is a complex regulatory landscape; multiple policies and procedures, annual testing requirements, ongoing reporting obligations and the like. How do they manage that? Typically it's been through the use of SharePoint and Microsoft Outlook," explains Kevin Byrne, Managing Director of Global Regulatory Risk and Compliance at SEI's Investment Manager Services.

Firms need timely, cost-effective access to comprehensive, aggregated data that has been normalised. Whether that is achievable in-house for those other than the largest global asset managers is debatable. SEI believes that there is a way forward to alleviate the fears and concerns of fund managers, combining technology with human expertise in the form of a top-down, bottom-up solution.

Kevin Byrne, Managing Director of Global Regulatory Risk and Compliance at SEI's Investment Manager Services

The top down approach

Prior to joining SEI, Byrne was a Chief Compliance Officer at a large registered investment advisor. During his tenure there, he lamented the fact that there was no centralised system for compliance, equivalent to an Order Management System or a Customer Relationship Management system used in the front-office.

He explains that by using a platform that is able to centralise and digitise all compliance activities, it is possible to achieve a firm-wide view of one's compliance programme that is accurate, scalable and able to provide enhanced transparency.

"Compliance today does not have a management tool. Firms often have policies and procedures in Word, testing schedules in Excel, and use SharePoint for some of their reporting. Finding an equivalent "Compliance Management System" is going to be key for successful managers going forward. It will take time to adopt, as compliance is historically very slow to change, but a centralised compliance system will allow firms to keep track of everything within their compliance programme and reduce key person risk," explains Byrne.

Currently, there are two ways for a CEO to determine whether the CCO and their team are on top of everything. The first is the old fashioned approach of asking. The second is to wait and find out the result of an SEC exam.

But as Masterson says, both options are suboptimal and risky given the dangers associated with non-compliance. "With a digitised platform, you can periodically log on, see status reports and get questions answered right away. Are all compliance tasks completed and up-to-date? If not, what are the outstanding issues to address? Have any deadlines been missed?

"This gives the C-suite the ability to take a more proactive approach to compliance, one that not only saves them time and money but provides more accuracy and the ability to get in front of potential issues," remarks Masterson.

Byrne refers to this top-down solution as 'Firm Compliance', allowing a CCO to manage their day-to-day compliance programme with a level of confidence that just isn't achievable using disparate systems and compliance tools.

"A Compliance Management System allows firms to digitise their compliance programme. Every day when the compliance team comes into the office, they log onto the platform and they know what the day's tasks are, they know where all the data is located, where the testing results are housed in advance of an examination and so on. It's truly digitising compliance at a firm-wide level. That's what we mean by adopting a top-down solution," explains Byrne. ■