Applying a bottom-up approach

Applying a bottom-up approach to regulatory compliance will help firms achieve consistency in reporting.

In mid-March, we published the first of a two-part article series with SEI Investment Manager Services on how a top-down, bottom-up solution can go some way towards helping fund managers grapple with regulatory compliance demands as efficiently as possible.

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

As was highlighted in the previous article, 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.

The top-down element of the solution involves using a platform that is able to centralise and digitise all compliance activities, making it possible to achieve a firm-wide view of one's compliance programme that is accurate, scalable and able to provide enhanced transparency. This can best be thought of as the compliance equivalent of a CRM system for the front office or an OMS (Order Management System) for trading in that all compliance activities are housed in a central system.

This comprehensive overall 'Firm Compliance' view allows 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.

What then, should one think about from a bottom-up perspective?

The bottom-up solution

When talking about regulatory compliance, one cannot divorce it from the data management challenge. It is critical and indeed necessary to address.

Even if one integrates best-of-breed regulatory applications, applications alone are not sufficient. Having a sound, reliable, regulatory data management platform is a prerequisite.

Of critical import is being certain that the data being fed into such a platform is scrubbed, cleaned, normalised and consistently of a high quality. Also, the process should be scalable.

"If the process is extremely manual and the firm has any level of complexity, the risk of omitting required data or including inaccurate or incomplete data is high," says Philip Masterson, Senior VP and Managing Director at SEI's Investment Manager Services division. "At a minimum, the risk of inconsistency across regulatory filings and a cumbersome, unscalable process is nearly certain."

The regulatory data management piece is, therefore, the bottom-up foundational piece.

"From our experience, it is a combination of data warehousing technology and data mapping technology," says Masterson, "but you can't underestimate the importance of gritty practical knowledge. The best firms know not just what's required from a regulatory perspective. Their people are also experienced and know where the data is located, where it needs to go, and in what format."

Regulatory and operational expertise, in addition to flexible, scalable technology, is the trick to making a bottom-up solution as efficient and operationally effective as possible.

The last thing any investment management group wants is for the middle- and back-office teams to use a data warehouse and regulatory data management programme separate and disconnected with the firm's strategic initiative from the front-office perspective; it really needs to be an integrated solution.

"Fundamentally, a firm's overall data management strategy needs to encompass regulatory data. And because of the importance of regulatory reporting compliance, regulatory data management can serve as the catalyst for a firm to commit and accelerate their overall data management strategy," says Masterson.

"This is something where regulatory compliance can drive a forward-looking perspective in the firm," comments Kevin Byrne, Managing Director of Global Regulatory Risk and Compliance at SEI's Investment Manager Services.

As fund managers are all too aware, compliance is not optional, it is mandatory. The financial and reputational consequences to falling foul of the regulators are significant. Many asset managers are struggling with data management in general, across the firm, regardless of function or need. But Byrne observes that the regulatory data management component can act as a catalyst for a firm to get their entire data management strategy in order.

The data one collects for regulatory reporting purposes can then, potentially or even, ideally, be used in other parts of the firm – from an analytics perspective, for example, in the front-office, or as a way for product specialists to help innovate new fund offerings.

To achieve this bottom-up solution using regulatory data management as the cornerstone, fund managers can go down one of two paths: firstly, they choose to own it themselves and come up with an in-house proprietary solution. Whilst this would allow managers to keep all the expertise internally, with staff collecting and analysing the data, building data mapping tools and so on, the question is: Is that why investors allocate to a fund manager in the first place? In addition, in the face of fee pressure, are managers prepared to make the necessary financial commitment to build a scalable, sustainable regulatory data management programme?

At the end of the day, they are investment specialists not data scientists or technology specialists.

The second option is to leverage an outsourced solution where, one could argue, an outsourced partner can handle the data management challenge in a more focused way.

"Increasingly, we have seen managers wanting to outsource. They see the benefits. They appreciate it's extremely important and they understand that data management isn't their core competence," says Masterson. "Plus, they don't want to be in the business of identifying, selecting, implementing and monitoring disparate regulatory application providers."

"Regulatory data management is an aspiration for a lot of firms," adds Byrne. "With the best intentions, many firms are cobbling systems together and there isn't much of a holistic approach. Only the largest firms are really pursuing data warehouses and data models on their own and keeping things in-house. Most are muddling through, and not in a scalable way."

Future proofing

One of the clear advantages to creating a top-down, bottom-up solution to overcome the complexities of regulatory compliance is that it will allow firms to future-proof their operations.

As Masterson says: "At the Firm Compliance level, it's a very flexible platform. As a new governance requirement comes on stream, you can manage and monitor that requirement through this type of platform. A lot of firms using our solution also really like the workflow document management and tracking component.

"On the data management side, when you are collecting data and realise you're subject to a new reporting requirement, if the platform is designed appropriately, integration of the new regulatory reporting application and the requisite clean, accurate, timely data can be leveraged accordingly.

"You might need to include some additional data fields but with the core functionality already in place, it makes it infinitely easier to comply with that new regulatory requirement."

The key point to make here is that as fund managers grapple with things from a regulatory compliance and a regulatory data management perspective, are there better ways of doing things? When firms are facing fee compression and there's serious competition for resources, what is the most cost-effective way of achieving long-term, scalable compliance? And can firms continuously evolve and innovate in a silo?

Take SEI for an example. "One of the value-adds of our platform is the analytics component," says Byrne. "That is, because of the volume of data flowing through our platform, we now have enough of a database where we can provide best practices to clients and say, 'For this question, 60 per cent of managers answered it this particular way'.

"And importantly, we also have functionality where we can cross-reference things such as regulatory AUM; in one form, a client might have answered it like this and in another form they answered it like that, so let's do some reconciliation work to make sure everything stays consistent. The data validation protocols are important.

Adds Masterson: "The SEC, for example, is looking closely at firms' Form ADV and other regulatory reports to ensure consistent information and if there are inconsistencies, that quickly becomes an unwanted conversation during an exam that can lead to potential problems."

With these two ends of the spectrum locked down, in terms of regulatory data management and having the ability to centralise and digitise all compliance activities, fund managers will be in a better position to meet the ongoing regulatory compliance demands as cost-effectively as possible. And better utilise new regulatory applications that come on stream.

By doing so, they will be able to present themselves in the best possible light to global regulators and investors. ■