Technology Solutions to Address Compliance in Advisory and Execution

Colin Anthony, Managing Partner of 42 Consulting, represented LexiFi, a provider of software solutions for the management of cross-asset products, at the Hubbis Compliance in Asian Wealth Management Forum 2020. He gave the audience valuable insights into solutions around pre-trade disclosure, explaining that the process must evolve from a static approach to a dynamic approach, with wealth management firms assessing risk at the portfolio level to be fully effective. An effective post-trade information flow on products and portfolios is also essential. Importantly, investment in the right technology to address these matters can yield returns, in terms of enhanced transparency and engagement between the wealth management firm and their clients.

"MY MISSION TODAY IN THIS TALK IS THE EVOLUTION OF COMPLIANCE AND ADVISORY AND EXECUTION," Anthony began. "The topic is, therefore, pre trade documentation and post trade documentation, and how we are now moving from static documentation to dynamic documentation. I will also cover the technology that is required to have standard documentation in place."

After the GFC, there was an increased focus on pre-trade/pre-sales documentation, the idea being to make sure that clients had enough information before they actually executed a trade or made an investment. Producing pre-trade documentation with relevant data for each trade a client could potentially execute was not realistic as at that time, most of the work on this was manual. Factsheets with static data, updated once a quarter or once a year at that time, therefore, served as the solution to fulfil regulatory requirements.

From static to dynamic

"And ten years later," Anthony observed, "the speed of change is remarkable, so where are the regulations heading today, and how is this affecting this kind of trade documentation? The

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answer is a movement nowadays from static documentation like fact sheets, to actually more dynamic documentation."

He explained that dynamic documentation is driven by certain factors such as the type of client, the jurisdiction, the instrument, the investment product and also the lifecycle. In Europe, he reported, the Packaged Retail and Insurance-Based Investment Products Regulation (PRIIPs Regulation) came into force in January 2018. PRIIPs aims to increase the transparency and comparability of investment products through the issue of a standardised short-form disclosure document – the PRIIPs Key Information Document (KID). Anthony explained that for clients in the EU, it is now compulsory for them to receive a KID before they proceed with making any investment decisions.

With that, Anthony delved into more detail on the different categories of KID. He explained there are standardised requirements for every KID, so it covers risk indicators and scenario analysis, in other words, the product and what happens if the issuer is unable to pay, what are the costs related to the product, how long does the client have to hold the product and can money be taken out early, as well as the process for lodging a complaint. All this, he reported, makes things easier for clients to actually make a comparison between financial institutions before they make the decision to transact in the product.

"All this," he said, "is moving further to dynamic documentation, and it has already been in place for nearly two years in Europe, and we see it coming to our shores in Asia before long."

The Post-trade protocol

KID, he added, is pre trade and the next step is for KID post-trade updates to then be done every 12 months or when a trigger event happens. Performance reports then give clients a snapshot of an investment performance mid-tenor.

"You need to refresh the data, make sure the data is current and if there is a trigger event, in fact, you also need to do ad hoc updates for the KID," Anthony explained. "For example, if you have a barrier event on an auction, a knock-in, you will have to then regenerate the KID to make sure that it remains relevant, so you can see that there is a sync required with the lifecycle of the product and with the document lifecycle as well. That is what we mean by dynamic - there is regular monitoring and updating."

Moving further into the trends and requirements for the post-trade documentation, he noted that in the past this covered things like term sheets, long-term confirmations, but those are again static documents that are usually generated once and not again through the lifecycle of the product.

Leveraging data

"But today," he said, "dynamic documents being generated for things like product performance reports, to provide a snapshot of the investment performance mid-tenure for any product. It can give the client a snapshot at any point of time about the past performance of the product, past and future lifecycle events that are going to happen or have happened, and also, of course, the P&L breakdown. The clients can get hold of this information online, thereby obtaining insight after the trade."

Besides having performance reports on an individual product, there are also portfolio performance reports being generated by some financial institutions on a periodic basis to allow clients to have a view of the snapshot of the entire portfolio. Here they can see the contribution of different investments in the portfolio, and they can also look at risk indicators, how risky their portfolio is, they can assess concentration, and overall it gives them a good view of whether their portfolio is streamlined with their investment thesis.

"Very positively for the financial institutions," Anthony remarked, "besides giving insights to clients there is actually a benefit for financial institutions, as what you gather for your clients helps you engage better with them, in other words, the RMs and investment advisers can leverage all this for more fruitful discussions and to thereby better serve those clients."

The right ingredients

Anthony said that with such reports and insights, they are only as good as the data input. "The challenge for the financial institutions is, therefore, to generate the current data and also generate the current documentation in a timely fashion," he observed. "This means you must have the right technology in place that allows you to generate the data and documents fast, seamlessly, accurately, with almost no manual intervention and in a cost-effective manner."

He added that the technology in place should be able to handle what he termed a variety of payoffs. "You might have acquired technology that handles all your current payoffs," he elucidated, "but when you have a new payoff you need to handle that with only minor tweaks, you certainly don't want to spend too much time or money on that, or you will slow down your time-to-market, and moreover it costs."

Investing in technology

He closed his talk by concluding that the shift from static documents to dynamic ones is continuing and financial institutions cannot ignore the implications and the need for technology solutions that address these needs. But with costs associated, there is an upside - besides regulatory compliance, documents with the most up to date data provide clients with increased clarity and transparency, and these documents will help FIs serve their clients better and improve revenues and profitability.

His final word was that LexiFi has worked with multiple clients globally to implement the PRIIPs regulation and continuously works with them to improve those documents. Moreover, LexiFi is also part of many projects that are implementing portfolio and product reports. ■