

Invest in investment compliance

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Gone are the days when [investment compliance](#) was seen as a mundane function of investment management. In the post-financial crisis world, the investment compliance function is considered to be a partner to the frontline business, a partner that needs to be empowered on par with the frontline business to meet investor expectations and regulatory obligations.

Thanks to the ever-evolving regulatory landscape, investor expectations, and product and technological advancements, investment compliance has caught the attention of the c-suite level of decision makers as an investment that can provide benefits, shedding its old image of an ancillary function.

Why invest?

Augmented scrutiny and penal action

Regulatory authorities across the world have intensified their scrutiny of operations and activities of investment companies. They have adopted new regulations and penal policies to safeguard investor interest and avoid inherent systemic risk to the macro economy. Remedial action for misconduct may include penalties or derecognition of a fund's legal statuses. In FY2019, the US Securities and Exchange Commission (SEC) collected USD4.3bn in penalties and disgorgement, up from USD3.9bn in FY2018. The UK's [Financial Conduct Authority](#) (FCA) collected GBP0.39bn in penalties and disgorgement in 2019. An example of penal action other than imposing a fine is that of a regulated investment company (RIC) that can lose its RIC status if it does not meet the US Internal Revenue Service (IRS) asset diversification tests at the end of each quarter. IRS asset diversification tests are essentially two percentage tests: minimum 50% and maximum 25%. At end of each quarter, fund must ensure compliance to both limits with prescribed asset types.

Reputation risk

It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently - Warren Buffett

The above quote is a testament to the importance of reputation to any business, especially those in the investment management space. For an industry that thrives on investors' hard-earned money, trust and integrity are the gold standards to assess competitiveness, and hence, penal action or litigation for not following the mandate could be a watershed moment for an [asset manager](#). Moreover, in a world where both information and misinformation are abundant and hard to differentiate, it is important that a firm leave no stone unturned to guard its goodwill and reputation.

Two pillars of investment

Compliance team: An efficient and empowered compliance team plays a crucial role when it comes to meeting the objectives of a compliance function. A compliance officer's role has changed in many ways owing to the changes in regulation, technology and products. Financial markets are using new datasets like never before for investment performance measurement, and it is imperative that compliance officers stay abreast of these changes.

The most important responsibilities of a compliance officer include the following:

- Meeting regulatory and reporting requirements
- Interpreting policy statements and attaining clarity on the mandate in policy statements
- Coding the mandate into the compliance rule engine to automate monitoring
- Communicating instances of violation to regulators and investors
- Liaising with multiple teams, including front-office, client relationship, legal and operations on matters relating to the compliance function

The number of resources in a compliance team depends on factors such as (a) the number of actively managed funds, (b) the level of automation in terms of guideline monitoring and (c) the level of vendor sourcing used in the compliance function.

Compliance rule engine

A well-built and integrated compliance application is a must for efficiently fulfilling compliance responsibilities. The more automated an application, the more its utility and effectiveness. There are many compliance rule engines provided by multiple vendors that include both standalone applications and those provided as a package with a suite of other fintech applications. The main challenge of a standalone application is the ability to integrate it with other applications. For example, integration with an order management system of another vendor.

The most important capabilities of a compliance application include the following:

- Ability to process real-time data changes and produce key accurate results for pre- and post-trade monitoring
- Ability to avoid creating false positives that consume the precious time of a compliance officer
- Suite of regulatory and commonly used rule templates that help in easy coding and activation of rules
- Easy and simple workflow in terms of breach management
- Robust audit capabilities with the ability to store data for a reasonable period of time
- Dashboard capabilities with visualisation for enhanced user experience

Whether to buy a third-party product or build the compliance application in-house is an important

decision every asset manager has to make. An in-house app could be built, leveraging the asset manager's IT team or in partnership with a capable technology solution company. However, given the complexities of a compliance application, the chances of the attempt to falling short of the objective are high, and the compliance team may be forced to accept the less capable application developed, introducing elements of operational risk and lower efficiency.

Acuity Knowledge Partners' solution:

[We](#) create tailor-made dynamic functions with a robust, responsive proficient control framework and process delivery. We have a highly experienced tool-agnostic team that can provide support in investment compliance, [trade surveillance](#), and [corporate, forensic](#) and crime compliance. We are experienced in providing unique solutions with the help of our state-of-the-art technology.

We also have a pool of subject-matter experts for process delivery, training, projects and automation to mitigate costs. Our established compliance capabilities help clients identify problems and opportunities to navigate through a challenging business environment.

Sources:

<https://www.sec.gov/files/enforcement-annual-report-2019.pdf>

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<https://www.reuters.com/article/us-usa-sec-enforcement-idUSKBN1XG1ZW>

<https://www.irs.gov/instructions/i1120ric>

About Acuity Knowledge Partners

Acuity Knowledge Partners is a leading provider of high-value research, analytics and business intelligence to the financial services sector. The company supports over 350+ financial institutions and consulting companies through a team of over 3,000+ subject matter experts who work as an extension of the clients' teams based out of various global delivery centres.

We empower our clients to drive revenues higher. We innovate using our proprietary technology and automation solutions. We enable our clients to transform their operating model and cost base.