WHITEPAPER

WEALTH MANAGEMENT & THE CASE FOR eDM[1]

The role of Document Solutions in the Finance sector

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1. electronic Document Management

In this paper we examine a number of issues faced by businesses in the finance sector, in particular the broking and wealth management communities. We'll also identify the role of technology in mitigating them, most notably via document based solutions.

The burden of compliance

Regulatory burdens have always been in evidence. However, the landscape has changed greatly over the years. The banking crisis, Enron et al and increasingly sophisticated, technically savvy and organised fraudsters are all high profile wake-up calls demanding a support network. That network comes in the shape of legislation, regulation from professional and overseeing bodies and peer pressure for better practice. These change working practices and, more often than not, generate increased operational workload. As the burden compounds then so do the potential penalties for exceptions. Likewise, the numbers of compliance-facing staff continue to rise. Against an economic backdrop where efficiency and cost savings are more important than ever this is a recipe for greater overheads with no appreciable return.

Anti- Money Laundering (AML)

HMRC defines money laundering as *"exchanging money or assets that were obtained criminally for money or other assets that are 'clean'. The clean money or assets don't have an obvious link with any criminal activity. Money laundering also includes money that's used to fund terrorism, however it's obtained."* All financial institutions are obliged to put controls in place under the Money Laundering Regulations 2007 and there is no escaping the impact of AML.

Firms must ensure that all necessary management control systems are in place and all staff are AML trained. Additionally, the records needed to prove that AML checks have been fully carried out must be preserved. These include all documents relating to any financial transactions, client ID information, risk assessment information and records of management procedures and processes.

Any financial institution and a number of other organisations too are required to validate their clients and transactions to ensure that they are not facilitating transactions from the proceeds. In the first instance this requires that client on-boarding is a more thorough affair.

AML checks will involve proof of identity. These proofs must be retained for future reference. The ID must also be validated via a third party source. In each case the validation must also be retained.

These are potentially onerous tasks and, if nothing else, will serve to put a pause on client transactions and therefore the quality of service that your firm can provide.

These are not one off checks either – periodically these same checks should be repeated with updated evidence whilst there may also be repeat visits based on transaction frequency and size of transaction.

Systemising these checks is an important step in improving service levels whilst also reducing costs. Introducing clear processes and automating them where at all possible also achieves the number one aim which is compliance and peace of mind for all concerned. The likes of Experian, CreditSafe and GB Group have high quality databases which can give you ID validation, background checking, Sanction, Watch and Black List checks, Politically Exposed Persons (PEP) List checks, credit checks and more. Reconciling this data with the information provided is at the heart of AML checking. Fortunately, most of these offerings are Cloud based services which can be tapped into directly. So, the validation itself can be an automated function.

However, the processes around this activity are administrative and prone to potential error. The process is simple in principle:

- Request / collate the physical evidence
- Run AML checks
    - The scope of this will vary based on the service used
- Review results and
    - Open the gate for new or continuing trading or
    - Refuse/halt trading
- File AML results
- Update back office systems with status
- If checks are failed then report the activity
- Notify the client of the success as appropriate/ file correspondence
- Return documentation if necessary

The number of checks to be undertaken will vary daily. At peak times of year (notably towards the end of the financial year) the volumes involved are likely to cause an administrative bottleneck and therefore service deterioration. In a worst case scenario there is a hold up in trading and a potential loss of financial opportunity.

Joining up these steps is a clear win, especially if they can be automated. This is where eDM and other document based solutions step in. IT systems are based on data level integrations and processes. System to system tie-ins can be complex but are almost always viable.

AML is inherently manual in part – the client must provide physical evidence of identity. Automating these stages and joining them to the electronic world overcomes the manual limitations whilst ensuring that the process is seamless and efficient.

Data extraction from physical documents is proven technology. Using passport numbers, addresses and other key pieces of data enables the client to be identified and then hooked into on-line data providers to perform the AML checks. Scanning the initial documents means that records can be retained in the document repository, whilst reports back from the AML check also form part of a client's record. The AML results can be fed into back office systems in line with your own policies. Emails or physical letters can also be generated automatically to notify the client of their status and again filed.

The process is joined up and a job which could take hours or days has become a background task measured in minutes from start to finish.

Know Your Customer (KYC)

Extending the AML concept is the wider KYC principle. Establishing that the (potential) client is who they say they are and has no evidence of skeletons in the cupboard must also be supported by transaction monitoring to ensure there is no suspicious activity. Once over the initial barrier criminals may then embark on money laundering and so institutions need to look out for unusual transactions or patterns. This is AML on a day-to-day basis and requires the same evidential checks to keep its knowledge of the client whilst there is still a relationship. This enables changes in activity to be assessed with unusual behaviour triggering alarms and escalation measures.

The important element to this is having sufficient information to enable a risk based assessment to take place. As well as the on-boarding stage, this can also be at an annual review or based on trading volumes, patterns or transaction value. Potentially, this could be a frequent event in some cases. The joined up processes outlined in the AML section above therefore continue to be relevant.

Getting these checks right and in timely fashion not only enables good operational capability, it also minimises risk to the business. Where there is cause for initial concern suitable due diligence will need to be carried out and undertaken quickly with all information to hand. Joined up systems will be key to providing good quality KYC information.

Suitability

As a natural adjunct to KYC the FSA's Suitability initiative relates to a detailed knowledge of a client's profile. This is a risk based approach to investment, covering appetite for risk, ethics based preferences and geographical wishes. Assessing the client's risk appetite naturally forms an important cornerstone for investment decision-making and therefore the basis for the ongoing customer relationship. The firm should marry up the clients' profile when making trades and will need to be able to prove the fit at a later date. This means recording:

- Information about the service(s) provided
- Judgments made in reviewing the service
- The basis on which recommendations or decisions have been made

Whether this relates to an individual or group investment, Suitability for the individual investor will need to be met. However, collating some of this information may be difficult, especially as a compliance and FSA driven agenda may conflict with a client's desire for privacy.

Where firms do not use a bespoke or tailored service, model portfolios may not necessarily always match up with a client's wishes. Establishing the client's capacity for loss should be captured as should the appropriateness of investments made on behalf of the client.

Where there is specific deviation from standard terms and conditions and services then these must also be documented. Controls and processes must be in place together with exception reporting. This may include rejection criteria and also suitability based on an "averaging out" basis. In each case, this should all be documented and available.

This is not a one-off event – circumstances will change, propensity to take risk will vary over time, as may definitions of ethical or environmental restrictions for example. Profiling needs to be regular, presumably at least in line with your typical review period and should be pro-active. Diarising this as a regular event is an obvious admin task here.

Investment restrictions must be made clear to all involved in client affairs and investment decisions. This means quick and ready access to the information. If the data is not stored directly in a back office system this can be via the baseline document, say a questionnaire. These documents can also be used as a review trigger as part of a formal records management process.

According to APCIMS[2] "The failure to maintain complete and accurate records is one of the main reasons why firms are unable to demonstrate they are meeting their suitability obligations."

The APCIMS Paper on Suitability checklist sets out a list of documentary activities to be undertaken from service descriptions, exceptions, client identification, investment restrictions and client data forms. Notably, it also includes recommendations that information should be recorded and its format clearly identifiable (whether electronically or hard copy) together with a defined filing structure and minimum content. These are all in the ambit of a well-defined and structured document solution.

FATCA

The U.S Foreign Account Tax Compliance Act (FATCA) came into effect at the start of 2013 to combat offshore tax abuse. Those caught by FATCA may be swiped with a 30% withholding tax on U.S investment income. For understatements on undisclosed foreign (i.e non US) assets there's a further 10% to add to this.

Foreign entities can avoid FATCA's swingeing withholding tax as they enter the FATCA regime – after entering into a binding agreement with the IRS to identify U.S persons and to report certain information about them to the IRS. This information is then used to identify potential instances of under-reporting as well as fraud.

But how is such information collected? FFIs must retain all paper and electronic documentary evidence establishing the identity of account holders for 10 years. As is to be expected records must be accurate, up to date, consistent, retained for specific periods of time, and readily available for certification and auditing purposes. And this latter point is the key – all documents must be electronically searchable. The IRS aims to run sophisticated data collection, recognition and analysis tools over high volumes of data. No more hefty physical files of information or, if you do persist with these, then they must be digitised.

2. Association of Private Client Investment Managers & Stockbrokers

FATCA continued

Because of these requirements firms have had to adapt their systems and operational processes – this is a significant undertaking for many organisations, least of all those with multiple customer platforms. FATCA will be applicable for all types of financial institutions – the operational system needs to be in a position to detect U.S clients when an account is opened, as well as the entire lifecycle of a client through monitoring.

The efforts needed to fulfil these obligations can be substantial for a financial institution and can require specialist knowledge and assistance – knowledge which can be aided by a supplier of such a system with an understanding of the Act itself.

It is essential that organisations caught by FATCA review all their internal systems. Much of this should be in train already, but the disclosure elements and, in particular, electronic searchability/ discovery means that how firms handle, store and retrieve documents will be at the heart of this.

Discussions with a document or content management provider should be high on the immediate agenda. A good provider will be able to call on a strong understanding of the act, and be able to guide the organisation through the requirements and suggest any changes which may be needed to current systems in order to meet FATCA and other compliance requirements.

Risk

Compliance inevitably brings significant penalties. Good practice should mitigate the risk but comes with its own costs. Likewise, appropriate systems and quick processes will enable day to day bumps in the road to be missed, such as ensuring that trades and settlements are not interrupted. (No firm wants to pay out back value because of delays, especially when they are caused by externally-driven constraints).

However, irrespective of the pecuniary loss, maybe even irrespective of the threat of loss of personal liberties it is the reputational risk to the firm that is potentially most expensive. Strong systems and processes enable this to be mitigated. Document and records management are two such weapons which are proven to be effective in this defence. Where systems and processes are joined up and automated the mitigation can be all the more effective.

Summary

GRC – Governance, Risk & Compliance. These buttress the finance sector's operations. They may at times appear like so much unnecessary burden but the lessons of recent history show that there will be more red tape and best practice in the future. Firms with good quality systems, training and processes will feel the burdens of this triple strikeforce less than those without and they will also gain competitive advantage.

With some of the key GRC demands requiring manual process and documentation, whilst also requiring ready and complete access to information, document based solutions can play an important role. If joined up with existing systems and processes and, especially, where these can be automated the impact can be significant. However, the peace of mind created by mitigating the wider risks will be more important and significant still.