Compliance and the case for agility

FUNDSTECH TALKS TO JANUSZ LORENC, CEO OF METROSOFT, ABOUT ASSET MANAGERS' APPROACH TO COMPLIANCE RISK AND THE CASE FOR AGILE SOFTWARE DEVELOPMENT.

ACCORDING TO JANUSZ LORENC, chief executive of Metrosoft, some asset managers are leaving money on the table due to a lack of properly integrated technology.

More specifically, they are choosing to walk away from some riskier clients, not because the risk is too great but because they don't have the right systems and set-up to properly manage that risk.

This process of restricting access to a product or service for a particular category of investors that financial institutions associate with a higher risk of money laundering or terrorist financing, is called 'de-risking' and is often a sign of ineffective risk management

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The onboarding process has become markedly more complex in recent years thanks to an ever-growing list of compliance checks. These include sanctions lists screening, politically exposed persons identification, counter-terrorist financing measures, anti-money laundering rules and Know Your Customer (KYC) checks.

Asset managers must ensure any new client passes these checks when onboarding but now, in addition to that, they are also responsible for ongoing and effective monitoring of their transactions.

"Most regulatory bodies promote a risk-based approach and you need to understand the risk you are assuming when you take on a new client," says Lorenc. "But understanding the risk is one thing and actively monitoring that client is another. These are typically two different processes run in silos."

Sometimes, the group that looks at the risk decides the risk is too great and the relationship is not entered into. Rather than use technology to manage their compliance risks efficiently, firms are instead avoiding the risk altogether. But with proper monitoring and mitigation, this need not be the case, says Lorenc.

"It is not just a technology issue. It is also the mindset. Some firms have a tick-box approach to their processes."

There are typically three components to onboarding and compliance. The first is to know whether the potential client is or appears later on sanctions or similar lists. Then, you have to really know the counterparty and lastly, you need the right tools to monitor their transactions. This is typically done in three different silos that are loosely tied together.

"The list-screening and KYC process is typically done in one silo and the transaction monitoring is done in another silo," says Lorenc. "But if you had these joined up, you would get a better picture of the client and be able to better understand the risk."

There are reasons for these silos. Some of it is historic. The different rules were formulated at different times and the solutions were developed in different times by different vendors. Some of it is operational. These are very different processes and there are also often different teams performing the functions.

Another complication is the fact that compliance is also still paper-based in many instances. Digital identity has not been widely adopted, yet in Europe and elsewhere, many asset managers insist on paper copies of key documents like passports.

Agile methodology

In Lorenc's view, the compliance process is a perfect use-case for agile methodology. In software development, agile refers to collaborative effort, self-organising and cross-functional teams and iterative and incremental development. Working in partnership with the client and having open conversations that are built on trust is key.

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It is in contrast to the 'waterfall' practices of traditional project management based on linear and sequential practices and a clearly defined separation between vendor and client. "Agility as a concept exists in life – it is the ability to get the desired outcome in changing conditions with the least effort," says Lorenc. "Agile software development is not new either. But in order to be able to use this methodology, you need to have trust and transparency between vendors and clients. It involves a change of mindset, away from just fulfilling contractual agreements and towards common objectives."

This change of mindset is happening and it is helping, says Lorenc. "Working together on a project rather than on opposite sides of the table helps you move much faster. We have been lucky enough to work with clients where that trust exists and the only objective is to achieve common goals instead of protecting your territory and creating a paper trail of all things you've done."

Another change of mindset that is integral to agile development is the ability to have more direct communication, not just internally but between vendor and client, says Lorenc. "In our firm, we are promoting direct communication; radical candour and radical transparency. If you believe something is wrong, just say it. And say why. For some people that is a problem and a barrier. But we have interacted with Silicon Valley firms where that approach is common. It is a different mindset. So, we are also learning and evolving."

One benefit of the pandemic and the forced move to remote working is that it has helped to promote the case for more digital processes, says Lorenc. "It has simply not been possible to provide some of the authorised documents that are often requested."

By taking a more agile and digital approach to compliance and transaction monitoring, firms will end up with benefits beyond a more efficient onboarding process, says Lorenc. "With larger service providers and large asset managers, data is very often segmented and duplicated. Investors are often featured in many different systems and that data is not always in sync.

"So having a core digital onboarding process gives you a digital footprint for every investor," adds Lorenc. "And by monitoring their transactions, you get to understand your investors' behaviour. You can build a knowledge base that allows you to better service your investor."