

[<Back](#) [Print](#)**April 2009**

Gleanings . . .



The Perfect Storm

Cost cutting, profitability and meeting regulatory demands are terms that are hourly reminders of the dynamics affecting broker dealers today. These terms come from boardrooms, advertising campaigns and nightly news programs. To me they are the signs that the financial service business, like many others, is under attack. And perhaps that battering is a little more severe given the perceptions that the financial service industry is at fault for the current crisis. The result is that the environment that the majority of broker dealers are finding themselves in demands infrastructure spending in the face of a dramatically contracted revenue base. My observations coupled with new Beacon Strategies research leads me to believe broker dealers are in the midst of a "perfect storm".

Today broker dealers are being pushed to enhance infrastructure at the same time that revenues are down over 30% from only twelve months ago. Firms that have traditionally had margins in the 4-9% area are now bleeding capital resources. The challenge is that at the same time firms are being asked, or pushed, into adding infrastructure elements like rules based account on-boarding software, document imaging and workflow capabilities, and rules based compliance software. And as many of you know these are items at first blush can be perceived as costly. But on digging further the underlying cost, efficiencies and improvements to data quality gained by adding automation can benefit firms in the middle and long term. In a recent Beacon Strategies survey of 100 firms we found that the majority of firms had greater than 15% Not-In-Good-Order (NIGO) rates. Add to that our research found the traditional "fully loaded" client on-boarding costs could be as high as \$200 per event. This is the reason that a number of the larger broker dealers have, or are, biting the proverbial bullet and are evolving, though slowly, in the contemporary direction of automation.

The firms that are really under attack are the small and middle-sized broker dealers. These are the firms that have always processed applications and data manually into the systems they needed to process commissions. The challenge is that today the firms that followed this path are finding that their data is lacking integrity and depth. Their management of books and records information in paper is causing oversight challenges. And their manual processes are causing increased scrutiny from the regulators. The reality is that when there is challenge, opportunity is present. For some broker dealers' reality will come in the choice of whether to stay in business. For others broker dealers the choice will be to purchase or merge. For other broker dealers the choice is to hold close their independence and embrace automation and work with their own capital and flexible vendors to push their infrastructure into this century. But at the end of the day each broker dealer has a choice. The only choice broker dealers do not have is not to make a choice.

In this edition we will be highlighting Rules Based Compliance Systems. We will be including Actimize / Pershing, Broadridge / Mantas, Fetter Logic E*Assist & SunGard.

Our objective is that we help you gain some insight into what these firms are thinking and what differentiates them in helping broker dealers like yourselves.

As always call or email us so we can help provide richer intelligence.

Have a great month!

All the best,

Chip Kispert, *Editor*

[Learn about The Leading Industry Strategy Group for Broker-Dealers](#)

Compliance Challenges and Restoring Investor Confidence

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Actimize is Offered Through Pershing's iNautix Unit

A top theme in 2009, and likely to be for the coming years, is around maintaining a comprehensive compliance oversight program. It is hard to open the paper these days without reading a story about a new Ponzi scheme or investors getting bilked. Leaders of the industry regulatory bodies have warned firms against decreasing their investment in compliance; and, in December the SEC even went so far as to issue an open letter to financial company executives reminding them that "while many firms are considering reductions and cost-cutting measures," they have a legal obligation "to maintain an adequate compliance program."

Unfortunately, investor trust is clearly at risk; and some industry professionals are now talking about whether an entire generation of investors has become disenfranchised due to recent market events, similar to what occurred with the generation of the Great Depression. Given all of this, are broker-dealers prepared to fully oversee their compliance activities and help restore investor confidence?

In a recent series of webcasts iNautix hosted, entitled "Monitor, Manage and Mitigate Risk" less than 20% of the responding broker-dealers currently have an automated process to manage their sales practice oversight. Additionally, the majority of these same participants cited a "strain on resources" as their top compliance challenge. Given the regulatory environment and the inefficiency of manual solutions, the time is now for firms to take action and automate their compliance oversight.

To help firms overcome these compliance challenges, last year, iNautix entered into an exclusive partnership agreement with Actimize to offer their sales practices platform to Pershing's customers. We offer a hosted solution integrated into our brokerage platform for as little as \$26,000 annually, which would otherwise be a six- or seven-figure solution for firms choosing to go it alone. The following are some of the advantages of the iNautix compliance solution:

- Provides a State-of-the-Art Solution
 - Actimize is deployed at 6 of the top 10 global banks and 8 of top the 10 US brokerages
 - In a 2008 Celent study, Actimize was named as one of the clear leaders in the compliance monitoring space
- Drives Efficiency and Reduces Risk
 - Captures multi-custodial and direct business for broad range of products
 - Scores trades based on 24+ business rules and the tolerances you set
 - Routes issues to field and home office compliance based on defined roles

- Enables detailed research, tracking and resolution of issues
 - Provides audit trails and standard and custom management reports
- Helps Your Firm Stay Focused and Uncover Cost Savings
- Enables firms to support more business with the same compliance staff
 - Allows principals to focus on growing the business instead of keeping up with regulatory requirements and managing manual compliance solutions
 - Saves money on infrastructure by no longer having to support an in-house product

[Link to iNautix](#)

Compliance for Broker Dealers

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Broadridge™

What's Keeping You Up at Night?

Ask broker dealers what keeps them up at night and you more than likely hear about the difficulties they have faced bringing their firms into compliance.

Broker dealers who currently are experiencing unprecedented strain on their revenues and margins are understandably reluctant to spend money on compliance management software. Yet the reality is that regulatory enforcement has increased significantly in the last few years, and this trend is expected to continue into the future. Failure of non-compliance with the industry related directives can result in serious consequences for a firm. Executives must ensure they can respond quickly and confidently to the information demands of the regulatory authorities. They can no longer rely on manual compliance processes, duplicating tasks and efforts across departments, or wasted time searching in multiple repositories for appropriate records.

These coming changes will make it even more difficult to be a profitable firm, so choosing the right solution is important. Firms whose compliance resources are already strained have three options:

- hire additional compliance professionals
- retain additional services from compliance consultants
- adopt new technology to increase the efficiency of the existing compliance staff

The argument for automation

Back office operations prior to technology solutions were notoriously inefficient: repetitive, paper driven, suffering from disparate systems that were irreconcilable, arcane filing and retrieval, and very prone to human error and loss of important information. Financial services firms now take for granted the need for automation in most back office operations: technology solutions are now considered to be necessities for operating and growing your business.

What principals of financial services firms must realize is that, with the right software solution, a compliance department may maximize its value to the firm by reducing the time spent on collecting and organizing information - so that they have more time to keep current on regulatory changes, update policies and procedures accordingly, and test the compliance controls to mitigate the risks of violations. This is true for firms of every size, whether they have a dedicated CCO or rely on consultants.

Examiners and auditors are increasingly focused on proof of ongoing testing of policies and procedures. No longer is it acceptable merely to have in place the right policies and procedures; rather, it is incumbent upon the firm to demonstrate that they are actively

administering these rules and processes by routinely identify infractions as soon as they occur. Lacking automation this task may be insurmountable.

Principals also have to resist the temptation of denying the compliance department's request for technology support because the firm survived past audits unscathed. However, other things ought to be considered. Since your last audit:

- Has your firm expanded disproportionately to your compliance staff and budget?
- Has your firm altered its risk profile?
- Has your firm's reputation become more important to your advisors and their customers?
- Have your peer firms experienced an increase in enforcement scope or level of scrutiny?

If the answer is affirmative for at least one of these questions, it would be prudent to explore a compliance solution.

The Solution

Firms of all sizes need to have access to proven compliance and supervisory tools to help them assess risk quickly, increase productivity, and keep up with the regulatory landscape. The Broadridge Compliance Service Bureau is a comprehensive, web-based solution designed to provide financial services firms with:

- **Comprehensive Instrument Coverage:** unmatched coverage of all financial instruments. It is used to monitor a wide array of instruments including equities, fixed income, options and other derivatives (listed and OTC), foreign exchange, money markets, mutual funds, trusts and derivative deals.
- **Breakpoints Compliance and Mutual Fund Activities:** Firms can realize a reduction in false positives and an overall improvement in breakpoints compliance.
- **Customer Suitability:** Leveraging the solution's analytic capabilities, firms can gain a better understanding of how account activity relates to established client investment objectives, risk/return appetite and profiles.
- **Heightened Supervision of Brokers, Reps and IAs:** Firms can avoid potential violations by monitoring higher risk brokers with more restrictive compliance parameters.
- **Insider Activities and Customer Exploitation:** Churn, commission malfeasance and multiple other behaviors around how the customer is treated are all identified and analyzed.

Compliance is not new to financial institutions, but the increasing reputational and financial risk of ineffective or unproductive compliance solutions is causing institutions to look at risk and compliance in a new light. Broadridge can provide clients a clear choice to assist with managing the compliance of their firm. Our comprehensive web-based service will offer our clients unprecedented transparency and visibility across both their data and process activities on a cost-efficient basis.

[More on Broadridge](#)

Right-Side-Up Supervision and Surveillance in an Upside-Down World

By: Scott
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The securities industry is always turbulent but is now completely upside-down. The SEC implores us to fulfill the promise of a culture of compliance and to vigilantly test and re-test all activities of the firm, while we also deal with reduced revenues and tight budgets. At the same time, we're trying to keep up with business models that are evolving from

transaction-based service delivery to fiduciary based advisory services.

These conditions accentuate the need and challenge to do things right. So, how do you make sure you're doing things right?

Think "System"

Your business needs a comprehensive system of compliance including thorough supervision and surveillance. Gone are the days of reviewing a trade blotter as your primary means of exercising supervision. The world is much more complex now. FINRA (NASD) Rules 3010, 3012 and 3013 have codified the requirement to think "system".

Many firms have installed rules-based software to identify pockets of exposure and we applaud this. But is this enough? The term "system" implies an automated set of processes covering all business requirements. Does your system meet this definition? Ask these questions:

- Do you currently use rules-based software to detect exposures in trades and investor accounts?
 - Have you recently evaluated the effectiveness of the rules to identify evolving concerns?
 - Do the rules test for account-level conditions as well as trade conditions?
 - Can you customize the rule parameters to target accounts with defined risk characteristics?
 - Do the rules produce an excessive volume of noise exceptions?
- Does your system cover all accounts and activity across all custodians and products used by your firm, including insurance and directly held mutual funds?
 - Are there blocks of accounts or investment products not covered by your system?
 - Have you recently tested the data inputs to assure the software is properly reacting to all data elements from all data sources?
- Does the software package include adequate supporting reports and tools to assure your staff is covering the bases?

Drive for results

If you've automated surveillance, are desired results being achieved? Is your supervision and compliance staff efficient, thorough and productive? Ask these additional questions:

- Is your staff spending too much time compiling information rather than performing value-added activities and uncovering exposures?
- Does your system include labor saving productivity tools or does it take more energy to use than time saved?
- Can you quickly and confidently respond to regulatory requests?
- Can supervisors and compliance staff efficiently document their reviews?
- Are you achieving a highly favorable ROI on your technology investment after considering the human factors and costs?

Stay out front by aiming at where the industry is headed

The industry is in a rapid state of flux, and compliance systems installed several years ago no longer meet the business requirements. Significant upgrades are required in many instances, involving considerable time and expense. Further, most solutions are administered internally placing that upgrade burden squarely on the shoulders of your

staff. Consider using providers delivering their software, (with processed output), as a service, ("SaaS" providers), and enjoy the following benefits:

- There is currently a plethora of hot topics including senior suitability, AML, VA's, customer privacy and Rule 3012, among others. SaaS providers will upgrade functionality and underlying data schemas seamlessly as part of their service keeping you ahead of industry standards.
- Our firm believes that in the near future firms will need to automate the surveillance of their advisory business in a similar manner to brokerage. SaaS providers are already preparing for the converging transaction and fiduciary based delivery models.
- Top tier SaaS providers will assure client privacy and data security. In addition, they will make required security enhancements as conditions dictate fulfilling your compliance obligations with minimal internal disruption or expense.
- Foster a culture of continuous improvement by leaning on your SaaS provider to deliver frequent enhancements rather than endure periodic, disruptive big-bang changes.

In conclusion, there are three key ways to turn your upside-down world right-side-up. Think "system"; drive efficient results; and/or depend on your SaaS provider to do that for you while relying on them to anticipate trends and provide products created to address them.

[More on Quadron Data Solutions](#)

Compliance - Solutions through Automation and Outsourcing

By Dan
Young -
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Consultant to
E*Assist



For years, margins at broker-dealers have been thinning. Reps demand higher payouts, and yet expect better technology and more services. Now, in the aftermath of the recent financial meltdown, we will almost surely have more burdensome and complex compliance responsibilities, at exactly the same time that broker-dealers have been forced to cut staff. So what is a broker-dealer to do?

Two related solutions are emerging to this conundrum: automation and outsourcing. Forced to do more with less staff and more demands from regulators and reps, they must become more efficient. Fortunately, technologies have been developed that will increase the speed and efficiency of compliance review and decrease staffing needs. In addition, a revolutionary outsourcing model is emerging that goes well beyond the typical consulting relationship and creates further efficiencies. Best of all, both the technology and outsourcing can actually IMPROVE the level of compliance review and thereby protect the customer.

Automation

Technology is now able to oversee many compliance related tasks. For example, supervision can now be done through a quarterly automated questionnaire. The questions are sent electronically out to the Reps. Certain answers cause further, more detailed questions to automatically populate. In addition, supervisors are notified of responses that are of concern. Tracking of completion is also done automatically, and an automatic block on commissions remains in place until the Rep completes the exercise. In this way, supervisors obtain information about Reps, offices, trends, outside business activities and changes to U4s with very little manual effort.

Another example of efficient automated compliance stems from suitability. An embedded rules engine allows the firm to develop the needed parameters. These would be based on client information reported by the rep, such as age, net worth, income, and risk tolerance. The product sale could fall into one of three categories. If it meets the

parameters, then the sale would pass suitability and be automatically signed off. If the rules detected a situation that was outside the bounds of acceptable parameters, the task could be automatically marked as a fail. The third option would be one that falls into an area that allows discretion. Here the firm would look at the transaction, gather more information from the rep, and determine if the sale can go through.

Once again, using technology and automation saves bodies. The firm would not have to staff up a supervision department to review all transactions. It also takes away friction between producers and the broker-dealer or OSJ for rejected transactions. What's more, the rules are applied uniformly and fairly, thereby protecting the interest of clients.

Outsourcing

To be sure, there are some tasks that require human discretion. A firm cannot entirely delegate its supervisory responsibilities to machines. Staff must exercise judgement in gray areas, set policy, determine exceptions, interact with regulators and mete out discipline.

But the typical model of hiring compliance and support staff is changing too, through outsourcing of compliance and legal functions. Services can range from the typical consulting services such as audit support and project work, as well as going well beyond the model normally employed by consulting firms.

A firm can pay a monthly fee and be provided with an outsourced CCO. Full oversight responsibility can include:

- Establishing policies and procedures;
- Monitoring those policies and procedures under rule 3012;
- Complaint handling and reporting;
- Branch inspections;
- Surveillance of sales practices;
- Regulatory inquiries and examinations; and
- Anti-money laundering monitoring.

Because outsourcing has scale, the compliance effort is cutting edge. The outsourcing service provider can hire top level talent, and send them to every industry conference and seminar. By outsourcing this function, firms obtain this high level compliance effort without the expense of senior level hires. Outsourcing could even include General Counsel allowing run-of-the-mill legal questions, contracts and other routine questions to be outsourced for a monthly fee.

As for suitability, all transactions can be run through the rules engine for review and approval. This is especially valuable for more complicated products, such as variable annuities, where certain riders and features are not easily compared. Once again technology and its rules engine can efficiently opine on the transactions and take responsibility for approving them. If regulators question those judgments, the technology, rules and outsourced oversight are easily available for review and inspection. Conflicts of interest are virtually eliminated, as the party responsible for supervision does not participate in commissions or overrides on the sale.

Conclusion

Broker dealers need to step up the compliance effort - but they need to work smarter, not harder. Technology can automate functions, reduce infrastructure costs and improve protections for the clients. In addition, outsourcing functions such as CCO or General Counsel allows firms to reap the benefits of cutting edge, high level effort without expensive employees.

Dan Young is ex-CEO of NYLIFE securities and NFP and has managed some of the world's largest independent broker/dealers.

[More on E*Assist](#)

Additional Notation

SUNGARD Due to an error in communication on the part of the Editor, SunGard was not able to provide an article this month. We will include the SunGard article in next months edition.

Editorial Calendar

Our monthly calendar and the subject matter we will cover in 2009:

- **February** - Forms Management & Account On-Boarding
- **March** - Imaging Systems
- **April** - Compliance
- **May** - Data Aggregation
- **June** - Marketing Tools
- **July** - Client Relationship Management
- **August** - Commission Processing
- **September** - Email Surveillance
- **October** - Financial Planning
- **November** - RIA Reporting
- **December** - Training
- **December II** - Best of . . .



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