Global OTC Derivative Reform in APAC

By Andy Mantzios, VP Client Success, Fenergo
Charles Carter-Richards, FinReg Consulting

fenergo

Global OTC derivative reform is challenging financial institutions across the world to rethink their abilities to achieve compliance in an efficient and coherent manner.

In this paper, Charles Carter-Richards from FinReg and Andy Mantzios from Fenergo outline the enormity of the challenge facing financial institutions striving to comply with a patchwork of OTC derivative regulatory rules within tight regulatory schedules and with little harmonisation between regulatory regimes.

The authors outline the many options and routes being undertaken by financial institutions from complying aggressively with the regulations, to non-compliance (either advertently or inadvertently), to deciding if compliance really is worth the business generated by derivatives.

For institutions that have staked a claim in a global OTC derivatives business, the authors explain that while regulatory reform is the new cost of doing business in the derivatives markets, there are a number of technological, people and process elements that can be undertaken to make regulatory compliance with global frameworks efficient and business generative.

Contents

Glossary

FI	Financial Institution	**CFTC**	Commodity Futures Trading Commission
KYC	Know Your Customer	**EMIR**	European Market Infrastructure Regulation
AML	Anti-Money Laundering	**ASIC**	Australia Securities and Investments Commission
LEI	Legal Entity Identifier	**HKMA**	Hong Kong Monetary Authority
SME	Subject Matter Expert	**MAS**	Monetary Authority of Singapore
DTCC	Depository Trust & Clearing Corporation		

1 Meet the Authors:

Andy Mantzios,
VP Client Success, APAC
Fenergo

As VP Client Success, Andy is responsible for managing Fenergo's client engagements in the Asia Pacific region, with a focus on best practice implementation that exceeds client expectations. Andy joined Fenergo in 2011 and has held a number of senior roles including Principal Consultant and Solution Architect with Fenergo. Over the last decade, Andy has cultivated deep technical, domain and delivery expertise, leading high performing engineering teams in delivering mission critical enterprise software solutions to some of the largest financial services firms in the world. Andy holds an MBA from University College Dublin and a Bachelor of Commerce in Commerce / Law from the University of South Africa.

Charles Carter-Richards,
FinReg Consulting

Charles Carter-Richards is a founder of FinReg Consulting, which specialises in assisting financial institutions with regulatory compliance and implementing solutions for derivative reform. Prior to setting up FinReg, Charles worked in the financial services industry holding a variety of roles across American, British and Australian institutional and investment banks. Developing specialised knowledge in exotic products and derivative regulatory reform, Charles held middle office roles prior to becoming a Project Manager concentrating on the complex front to back office functions of investment banking and leading teams in achieving regulatory reform compliance. Charles is very experienced in rapid development within a complex environment, where tight timelines are frequently imposed by global regulators. His input has been sought at industry forums and panel discussions regarding the roll out of derivative reform.

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The Challenge of Global OTC Derivative Compliance

A little background

The origin of modern OTC derivative regulatory reform can be found in the 2009 Pittsburgh Summit. The G20 group of nation's desire was to implement rules and controls to prevent another "Global Financial Crisis" and to govern the financial services industry. The Lehman's event illustrated the true impact of "too big to fail", which was not only about systemic risk across the financial services industry, but the lack of visibility governments and regulators had regarding the inter-relations between financial institutions and their counterparts.

The commoditisation of financial assets and their associated "derivatives" were seen as a key risk due to the Over The Counter (OTC) nature of their transactions. Unlike financial instruments traded through an exchange, OTC derivatives presented a key threat to understanding how exposed one counterparty (or ultimately an economy) is to the credit risk of another counterparty.

Lack of harmonisation in a global regulatory rollout

Meeting the G20 commitment has been a complicated and costly experience. International regulators are tasked with executing the behest of politicians, while navigating a legal minefield that is further complicated due to the cross-border nature of the industry they are tasked to regulate. The US Commodity Futures Trading Commission (CFTC) was the first regulator to address the G20 commitment in earnest, implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act. This constituted a vast regulatory framework and included Title VII, which defined OTC derivative reform rules.

Other regulators around the world have felt the pressure to deliver their own rules and keep their part of the G20 pact. It was hoped that Dodd-Frank would set the framework that all other regulators would follow to ensure rule harmonisation, however, this has not been the case and each regulator has laid emphasis on specific rules due to their own interpretation of the G20 intent. The result is a lack of standardisation across regulatory borders, which is most evident across trade reporting requirements.

"The result of conforming to multiple and sometimes conflicting rules for both buy-side and sell-side participants is an increased cost of participating in the OTC derivative market."

The result of conforming to multiple and sometimes conflicting rules for both buy-side and sell-side participants is an increased cost of participating in the OTC derivative market, which has increased to the extent that some products and sub-markets have reduced significantly in both volume and value. Financial institutions (FIs) are the most exposed because, in many cases, they have the obligation to meet the regulatory requirements while their non-financial counterparties do not.

Compounding this problem, the rollout of regulation to satisfy global regulators has been far from seamless. A good example is witnessed in how the definition of a US person took several attempts to finalise under Dodd-Frank. Moreover, with continued cross-border uncertainties and last minute rule delays and amendments, it has been very difficult for sell-side FIs to implement the technology solutions required to meet the regulatory demands.

In APAC, the situation is further exacerbated due to the number of regulatory regimes that exist in the region compared to Europe and America, where derivative regulation is mostly consolidated under European Market Infrastructure Regulation (EMIR) and the CFTC. It could be argued that the revenue split across regulatory jurisdictions is more evenly weighted for APAC FIs than their European and American cousins, where customer revenue is skewed in favour of the European and American markets.

> "The situation in APAC is further exacerbated due to the number of regulatory regimes that exist in the region compared to Europe and America."

Short timeframes, piecemeal solutions

As a result of the short timeframes regulators allowed participants to comply with rules, as well as the uncertainty in the interpretation of those rules, most participants took a pragmatic approach and have implemented tactical solutions with the intent of replacing them once the regulatory environment stabilises. As with many projects where 'tactical solutions' are implemented, the business case for a more robust strategic solution may prove difficult but is self-evident in terms of both regulatory compliance and the wider business efficiency benefits to be achieved.

Those industry participants that have taken a more laissez-faire approach to regulatory compliance are ultimately likely to incur much higher costs, not only in terms of potential fines from regulators, but in having to review all of their existing data and processes, engaging clients and implementing new controls under the spotlight of one or more regulators.

3 To Comply or Not To Comply

Although no FI would deliberately choose to ignore regulatory reform, the first question is whether the income generated through derivative trading in a certain market warrants the cost of compliance with the regulatory regime of that jurisdiction. In some cases, the first consequence of regulatory reform may be a simple decision to cease trading and exit relationships with clients in those jurisdictions. For example, if an Asian regulator was to implement dual-sided reporting rules that facilitated a delegated reporting agreement, a financial institution might fairly weigh up the income generated from the client base of that jurisdiction against the cost of providing a delegated reporting service. If the cost outweighed the income, it could be a feasible decision to cease derivative trading with counterparts in that jurisdiction.

Regulatory penalties

For the CFTC, key executives (principals) within a Swap Dealer FI have been required to provide a personal level of accountability for their firm's compliance with the Dodd-Frank regulation. Subsequently, a number of non-US citizens working in executive positions in FIs have been fingerprinted with the understanding that criminal charges may be brought against them as individuals should the CFTC discover non-compliance with its rules. Of course, the practical application of holding individuals accountable is yet to be witnessed within the context of OTC reform, however, the recent trial and conviction of Tom Hayes for manipulating LIBOR definitely shows a willingness of governments and regulators to identify and prosecute any individual believed to be knowingly involved with market manipulation and regulatory infringement.

> "US and European FIs may anticipate the threat of regulatory action greater than FIs in APAC."

While other regimes may not threaten personal accountability, the punishments are no less severe at the corporate level with significant fines and loss of licenses being the main deterrents.

US and European FIs may anticipate the threat of regulatory action greater than FIs in APAC. This would be natural given the provisioning that large FIs in the US and Europe have undertaken since the start of the global financial crisis. Libor, FX rigging and misselling scandals have had significant financial implications as a result of the regulatory actions taken over the past few years. It is, therefore, understandable that FIs in Europe and the US (where the majority of these scandals are focused) understand the value in allocating capital to meet their regulatory obligations better than their APAC peers, which are yet to feel a similar force of regulatory penalties.

Although APAC FIs may be impacted to a lesser extent by the big scandals besieging the European and US FIs, there is a risk that once the bodies governing derivative reform increase their efficiency in data monitoring and policing of rules, there will commence a torrent of regulatory fines. Although likely to be smaller in magnitude compared to the punishments levied for the news-hitting scandals, the volume of the infringements are likely to be far greater, resulting in a continued financial drain until FIs have their regulatory compliance in order in accordance with the written rules.

Inadvertent non-compliance

Inadvertent non-compliance due to the complexity and cross-border nature of some rules is a significant risk. FIs may not be fully aware that they are in breach of regulations that impact counterparties and, as such, may not expect to be governed by overseas regulation. Under the CFTC's Large Trader rules, an Australian-registered farmer may find him / herself accountable to the CFTC, due to participation in a derivative of one of the 46 covered futures contracts believed to have a significant impact on the US economy. This would result in the FI having a reporting obligation to the CFTC on behalf of its client. Of course, explaining to an Australian farmer why they need to disclose information in order for you to report their activities to a US regulator can be a protracted conversation, in some cases requiring legal advice to both parties.

“Inadvertent non-compliance due to the complexity and cross-border nature of some rules is a significant risk.”

“My other bank isn't asking for this”

For FIs willing to take the lead in implementing solutions to regulatory compliance ahead of the rule compliance deadline, the outcome may not be as one would imagine. Instead of being commended for implementing early measures to meet the requirements, all too often there is a client backlash to be handled. While regulators look to impose regulations on the sell-side participants, few look to educate buy-side clients with respect to their responsibilities or the responsibilities of their bank counterparts.

This leaves FIs with the difficult task of requesting action or data from their clients without the client truly understanding why the bank requires it. Unfortunately, clients often approach such requests with either confusion, suspicion or, in some cases, anger.

FIs that have implemented solutions to meet upcoming (and, in some cases, already live) rules may be met with a client's response that other banks are not requesting the same information. Subsequently, the client could perceive that it is easier to trade with the other bank. The reality is that the other bank is trading outside of the regulatory rules (most likely unknowingly) and will eventually find itself facing regulatory punishment. However, that does not overcome the immediate concern of losing a client for complying with the rules. The key to overcoming this obstacle is creating a solution that makes the client journey as seamless as possible with the minimal level of inconvenience.

Banks are not incentivised to provide leadership in regulatory compliance and risk becoming the ‘bearer of bad news'. As such, they need to tread a fine line between achieving readiness for regulatory compliance, whilst assessing the regulatory landscape for ‘industry standard' solutions. This compromise must be reconciled with management that may have little tolerance for uncertainty around compliance.

“Banks are not incentivised to provide leadership in regulatory compliance and risk becoming the ‘bearer of bad news'.”

To trade or not to trade

Given the depth and breadth of the rules, there are a multitude of reasons why FIs could seriously consider not executing a deal and err on the side of regulatory caution. Data management and governance is the key to complying with regulatory requirements without inconveniencing the client.

The effect of not capturing or managing regulatory data accurately will be profound on the client and could be the source of competitive disadvantage in the future for FIs. All too often, buy-side counterparties are being asked to provide data that should have been captured by the FI at the point of client onboarding or - worse still - are being asked to provide the same piece of data for the 10th time to the 6th different business unit in the bank that has requested it. This is often due to the disparate systems employed within FIs across their global branches and subsidiaries. The final straw in the relationship is when the same client is advised that their trade cannot be executed because regulatory data is still missing. It doesn't take too many experienes of this nature for clients to lose confidence in their FIs ability to meet their trading requirements.

> “Given the depth and breadth of the rules, there are a multitude of reasons why FIs could seriously consider not executing a deal and err on the side of regulatory caution.”

4 Considerations for Effective, Efficient Compliance

The reaction of FIs to regulatory reform has been varied. Some have acted aggressively forming large teams of legal counsel, project specialists and operational staff to interpret the regulation and embed controls within existing infrastructure or custom built solutions. Others have taken an arguably more commercial route in attempting to comply with regulations, by implementing manual workarounds within business as usual operations and waiting for the industry to reach consensus on how to enforce the rules before investing too heavily.

Both positions are equally justifiable given the perplexing rollout of regulatory reform, thus far, which has introduced market participants to the difficulties of conveying vague rules into tangible solutions. However, the latter run the risk of regulatory non-compliance and potential penalties.

Overall most FIs have spent a significant amount of money and effort to date in their regulatory reform activities. With in-house solution building and legal interpretations comes the risk of being an outlier to the industry norm. Few of the regulatory rules have been written in a clear coherent fashion, designed for financial professionals to read and immediately understand the requirements needed for solution implementation.

Regulatory reform compliance is the new cost of doing business in the derivatives market and has moved beyond rudimentary Excel-based workarounds loosely integrated with existing IT solutions.

To get it right, firm foundations are required in: data governance, regulatory rules management, system integration (both internal and external), workflow / business process management and organisational ownership.

Below are a number of considerations that must be factored into the equation to enable financial institutions to ensure robust regulatory reform compliance.

Where does regulatory reform sit?

Large investment banks, with the benefit of strategic committees to identify the best organisational structure to meet regulatory reform requirements, have identified how to comply with new rules and where the new systems and processes should sit in a "business as usual" (BAU) environment. Conversely, retail-focused FIs (where institutional banking products are not the core offering) have found it harder to identify an ownership structure across Risk, Financial Markets, Compliance and Operations divisions. From the authors' experience, FIs who can move regulatory reform activities from Project to BAU cost centres will witness a competitive advantage, not only through the reduction of expensive project overheads, but also in delivering a more structured approach to meeting new requirements and servicing clients' needs.

> "Unless solutions are built with future scalability and adaptability in mind, FIs run the risk of creating multiple workflows and system touch points bespoke to each rule for every regulator. The financial and operational overhead of this approach is significant."

Moving from piecemeal to scalable approaches and solutions

As already discussed in this paper, OTC derivative reform has rolled out across multiple regulators following common principals related to transaction reporting, clearing, execution platforms, margin provisioning, business conduct standards, portfolio reconciliations, confirmations, trade compressions and a host of other subjects. Most FIs have reacted piecemeal to these principals as each regulator has released their rules for consultation. Many have realised the disadvantages of such an approach and the subsequent benefits of creating regulatory reform solutions that are scalable across regulators. This is no mean feat. Although transaction reporting rules follow the same general theme, actual requirements and definitions differ between regulators ensuring that a solution created to facilitate EMIR reporting requirements will not directly correlate with similar reporting rules mandated under ASIC. Unless solutions are built with future scalability and adaptability in mind, FIs run the risk of creating multiple workflows and system touch points bespoke to each rule for every regulator. The financial and operational overhead of this approach is significant.

> “FIs realising the significance of effective data governance have built their client data model with the legal entity at the core.”

Towards an integrated client data model

With a lot of thought given to the data model and common requirements anticipated under each rule, it is possible to build a regulatory data framework common across all regulators, that can be tweaked rule-by-rule to facilitate adherence to the nuances instructed by an individual regulator. Although labour intensive to establish a foundation framework that is scalable, FIs building solutions in this manner will experience reduced project overheads and the benefit of speed and ease of delivery in future builds.

FIs realising the significance of effective data governance have built their client data model with the legal entity at the core. Not only is this the logical basis to manage all client data attributes and relationships, it also resonates with the importance that regulators place on the same model, for instance Legal Entity Identifiers (LEIs) being elevated to a common reference point. In addition, it provides a framework where related party associations (such as custodians and guarantors) can be adequately managed and linked to the 3rd party data required to meet the regulatory reform obligations.

Most FIs have grown through acquisition and, as a result, technology solutions are inherited and amalgamated with varying degrees of success. Often tactical solutions have been built on infrastructure not specifically suited to meet the needs of the business it supports. The result is a hotchpotch of legacy systems with nonsensical integration points and a duplication of data records across them. To overcome the issue, a robust data governance structure is required with systems identified as the golden source for every data attribute. It is common that a client’s data attributes (such as legal entity) need to be recorded in multiple data systems but it is a recipe for disaster when different systems hold a variation of the same data attribute.

Difficulties assimilating regulatory information with client records vary across institutions based on their existing data model and the hierarchies they use for data management. In organisations where AML and KYC are less integrated with the data repositories that control day-to-day transaction management, identifying the legal entity of a given client record may be very difficult.

Today, to achieve the reporting requirements under derivative regulation, FIs need the ability to identify the true legal entity against which the transaction is executed and integrate the same data with 3rd party providers (such as ISDA Amend) to import a vast array of regulatory information now required from the counterparty.

Reporting rules and jurisdictional data consent

A key issue facing APAC FIs is the number of regulators spread across the region. A significant degree of focus has been placed on transaction reporting rules in APAC, but, to date, there has been little harmonisation of rules across borders. This lack of harmonisation makes compliance with reporting requirements across different regulators very complicated and technologically challenging.

"This lack of harmonisation makes compliance with reporting requirements across different regulators very complicated and technologically challenging."

Each jurisdiction has its own set of privacy laws and punishments for breaching them. While infringing privacy law in some jurisdictions may result in minor fines, some jurisdictions are far harsher, placing company representatives working in those jurisdictions at risk of criminal charges in some circumstances. FIs have tackled the issue of abiding by regulatory rules whilst managing privacy law, by requesting consent to report their clients' identification to regulators. In addition to whether the counterparty has provided their consent, FIs need to ensure that the form of consent requested is legally appropriate.

There are many potential sources and formats of consent that need to be taken into account, which collectively require a complex business rules engine to determine whether consent has, in fact, been obtained in a given jurisdiction. This determination must ultimately be reconciled with core client data and existing consent representations (i.e. ISDA Amend Protocol 1, ISDA Reporting Protocol) to determine if trades with a client are compliant under all regulators. The reporting rules provide a good illustration of how the new financial markets rules sometimes conflict with existing regulations.

Pre-trade control and post-trade reporting

A robust workflow is required as part of the client onboarding process to ensure that new clients have provided all the necessary regulatory representations before the client is established in product systems. A similar workflow is required to ensure that legacy clients have provided the same representations. These processes are intended to ensure that a client is not enabled to transact a derivative unless all of their regulatory obligations have been met. The robustness of this practice will dictate whether a point of execution control is required and what form it should take.

"A hard or soft barrier to trading in the form of an inability to quote prices or a message alert on the Trader's screen respectively are both forms of pre-trade control that FIs have implemented to enforce regulatory reform."

Where representations are missing or don't satisfy the regulator's requirements to trade, a Trader should not be allowed to execute a trade until the obligations are met. Failing to meet this level of control constitutes a regulatory breach. A hard or soft barrier to trading in the form of an inability to quote prices or a message alert on the Trader's screen respectively are both forms of pre-trade control that FIs have implemented to enforce regulatory reform.

With the implementation of Pre-Trade Control there is a requirement for a Post-Trade Report. A framework needs to be embedded to ensure that the Pre-Trade Controls work and, more importantly, ensure that no regulatory breaches have slipped through the gaps. Such a control allows an organisation to quickly identify the problem and learn from its mistakes.

Both Pre- and Post-Trade Controls require: a robust data model; a means of managing the workflow from the point of client onboarding through to post-trade reporting; integration between existing IT systems housing client data attributes and 3rd party providers like ISDA Amend; and a rules engine to transform the gathered data into meaningful attributes and commands to control the workflow.

Document and legal agreement management

There is a transparent need to store trade agreements, ISDA Amend submissions and bilateral agreements against legal entities and link them back to individual client records that traditionally exist at an account - instead of legal entity level. It is better to have access to all regulatory documentation through a single user interface than rely on the 'belief' that they are being stored elsewhere (invisible to the user). Documents may well be stored in legacy data repositories that act as a golden source, but there is a need to take a consolidated view of these different systems for regulatory reform and make them accessible. Market participants that have already invested in robust document management solutions, including integration with core business systems, will have the advantage of being able to leverage those solutions. However, too many participants in the APAC region have, in the authors' experience, not invested in these systems and, as a result, they become a necessary prerequisite to providing a robust solution for regulatory compliance.

> "It is better to have access to all regulatory documentation through a single user interface than rely on the 'belief' that they are being stored elsewhere (invisible to the user)."

Workflow management

In evaluating client representations against regulatory rules, subsequent workflows become apparent depending on the client's responses. These can be as basic as a need to follow up with the client to clarify a representtion to complicated solutions to facilitate delegated reporting agreements. All workflows carry a cost to deliver for the FI, which will vary dependant on resource requirements and complexity. If the FI has not developed the system solutions to support the client in question, there is a need to determine whether it is economically viable to continue trading with the counterparty if the cost of the solution outweighs the total relationship income for that client. Depending on the answer to that question, an FI may decide to implement a manual workaround to overcome the issue. Either way, an efficient monitoring and workflow management tool is required to meet both the regulator's and client's demands.

5 Adopting a System-Thinking Approach to Regulatory Compliance

Most FIs have adopted a fragmented approach to dealing - not only with derivative reform but - with global regulatory compliance in general. The consequences of such thinking is manifested in the number of point solutions that have been developed to meet the plethora of regulations with which the industry has had to contend. Each new wave of regulation sees FIs scrambling to solve that - and only that - regulation. The response to new regulations is reactionary and often the approach has been to tag-on regulatory data and processes to existing in-house systems – systems, it must be said, that were designed and built to solve fundamentally different problems.

The concomitant waste is astonishing, not only in terms of the ever escalating costs of dealing with the regulation du jour, but also in terms of the very palpable strain it puts on the client experience. Recently one of the authors had the opportunity to visit a major asset manager in the UK. Although anecdotally aware that FIs are seriously coming up short in terms of the client experience, we were not prepared for the level of frustration that the asset manager's client onboarding teams experienced.

A fractured and inconsistent process in onboarding clients, by its very nature, will lead to a fractured an inconsistent client experience.

The enforcement of existing regulations and the promulgation of new legislation is not an aberration or a blip. Rather it represents the new normal in the industry. Regulatory flux, penalties and cross-jurisdictional complexities are now the costs of doing business in global banking. To answer the question on how to deal with global derivative reform, one must first answer another question; how do we deal with regulation, client onboarding and KYC challenges – both globally and in general? This approach is predicated on adopting a problem–solution framework such as systems thinking i.e. not viewing the problem in isolation but viewing the problem in context of an entire system. We will refer to the system-thinking approach or methodology as we analyse the best practice approaches to solving for global regulatory reform.

Ultimately, the solution revolves around what might be considered an overly pithy axiom - consolidate the onboarding process and work towards a strategic approach to client onboarding and client lifecycle management that deals - not only with derivative reform – but becomes the linchpin in dealing with current and future regulations. If you are a compliance or onboarding professional, then this is the point at which you quite rightly roll your eyes and implore me to spare you the platitudes and consultant-speak and get to the point – How?

Unfortunately, there really is no silver bullet, magic formula or a one-size-fits-all solution to this challenge. Having said that, we can give you markers, sign posts and principles to guide you when navigating the complexity.

Let's start. Whenever faced with solving what may seem to be an intractable problem, especially in a system-thinking methodology, a good place to start is at first principles:

1. Ownership

Find a strategic home for onboarding and solving cross-jurisdictional regulatory challenges. If the problem is a fragmented process, then the solution needs to be solved from a single nexus, a single team. If there is a natural home for this within your organisation - such as a Compliance and Group Regulator Affairs team - then ensure that it is empowered to lay out a global vision and enforce it. If, like most FIs, there are a number of departments in the organisation that are responsible for and have a stake in the client onboarding outcomes, create a focused vagaries of yearly budget reviews.

2. Policy

A unified global policy for client onboarding that encompasses not only derivative reform but global regulation and cross-jurisdictional KYC issues is fundamental. The policy should allow for a degree of local variance but it should be globally consistent, understandable and knowable by the teams tasked with its execution, irrespective of whether this 'team' is a global shared services team or a number of local jurisdictional teams. The aim should be the same proverbial hymn sheet, albeit with local variations and modulations.

> "If you are setting policy for a particular regulation or for a particular jurisdiction, you are setting the wrong policy!"

If you are setting policy for a particular regulation or for a particular jurisdiction, you are setting the wrong policy! As stated, solving regulation-by-regulation is a fraught path, beset by waste, frustration, complexity and failure. A common policy, global in scope but adaptable for local nuance, is the primary aim. Once again, a systems-thinking approach.

3. Lifecycle

Flowing from our systems-thinking methodology mentioned above, we need to consider the totality of the client lifecycle. Client onboarding is a misnomer as it denotes a single event in the client lifecycle and disregards the totality of activities that go into ensuring the client is onboarded, passed through a myriad of compliance checks and reviewed on a regular basis throughout its lifetime with the bank. A robust and future-proofed system needs to account for many diverse factors that drive compliance - even after the client has been onboarded. For instance, many documents that are required for onboarding will need to be refreshed when they expire, so too for documents required for particular regulations. Therefore, you need to ask the following questions of your client lifecycle capability:

> "Client onboarding is a misnomer as it denotes a single event in the client lifecycle and disregards the totality of activities that go into ensuring the client is onboarded, passed through a myriad of compliance checks and reviewed on a regular basis throughout its lifetime with the bank."

- Does the system account for these refreshes?
- Are there automated flows that are initiated when a document refresh is required?
- Does the policy and business process account for these refreshes?

Many departments within the FI need to co-operate in order to manage the client lifecycle. So the question here is:

- Do the processes seamlessly bind the department's specific tasks into a logical and transparent workflow?

The data used for KYC purposes can be leveraged for other regulatory and, in fact, most OTC derivative regulation compliance (we estimate that up to 80% of data and documentation collected for a previous regulatory purpose can be re-used to satisfy other regulatory requirements). Therefore:

- Does a change in the KYC data and documents flow through and update Dodd-Frank / OTC derivative regulation compliance.
- If a client has been onboarded in New York, can a branch interacting with that client seamlessly onboard it in Singapore?
- How much of the process is duplicated when onboarding the same client from a "new to bank" vs "new to product" or "new to jurisdiction" perspective?
- Are the internal policies in place to accommodate this?

The key is to view all the activities as components of the same system. Hence, the reason client lifecycle management is the more appropriate term than mere Client Onboarding. It describes the related activities and prompts a pattern of thinking. In fact, complete client lifecycle management and system-thinking is starting to make its way into regulation. For instance, the basic tenets of BCBS 239 are aimed at viewing risk in totality and across a number of different dimensions.

4. Data

Data is the lifeblood of regulatory onboarding and client lifecycle management. The failures in data management are well-known, have been described above and should, not be repeated here. Data strategy is out-of-scope for this paper, but suffice to say that a single view of the counterparty and regulatory data should be the aim. Data becomes actionable and valuable if it is viewed in context and holistically for that context. For example, viewing the investment manager/ fund relationships is important in understanding whether a legal entity is compliant from a Dodd-Frank standpoint; similarly, viewing the controlling party hierarchy (i.e. the shareholding structure) when analysing tax residency for CRS classifications is crucial. Presenting the right data at the right time within the right context is the ultimate goal. A system that allows data to be consolidated from multiple sources and viewed - even if the data viewed is transitory - within that system should be the aim.

"Data is the lifeblood of regulatory onboarding and client lifecycle management."

5. Client-Centricity

We live in the age of the client, therefore, FIs should actively ensure that defunct, contradictory and messy internal processes do not permeate to the client. Dealing with global regulatory change and ensuring a good client experience do not have to be mutually exclusive. The canonical example here is the FI that keeps asking for the same information and documents over and over from the same client. The client onboarding policy and the systems implemented to give it efficacy should form an abstraction between the client and the FI's onboarding complexity.

"FIs should actively ensure that defunct, contradictory and messy internal processes do not permeate to the client."

6. Collaboration

A greater degree of collaboration is required amongst FIs in the industry. This is especially true when it comes to interpretation of regulation. There is zero benefit in being an outlier when it comes to interpreting regulations.

Sell-side participants have a limited opportunity to gain competitive advantage by providing leadership in the interpretation of rules and dissemination across other market participants who are unable to ignore requirments once a certain view becomes 'market practice'. Once such a view is formed, the ability to determine the impact on existing clients and to expedite information required from them, and to amend processes and systems to incorporate new data requirements on any new clients provides a significant operational advantage.

7. Implementation

Having made the point that a global policy and strategy should be adopted, the impression should not be created that implementation should ipso facto follow a big bang approach. It is imperative that any project team tasked with executing a Client Lifecycle Management (CLM) project deliver tangible value to the business across the life of the project. Delivery cadence is a key component in the success of any major strategic rollout. There are natural delineations in a strategic CLM rollout that can be carved off and implemented which will deliver business value. Other factors play a part in successful implementation; these are true for any project and, as such, will only be mentioned here in passing. They include skillset of the project team, experience in global rollout etc.

> "Regulatory reform is the new normal."

Since the focus of this paper is OTC derivative reform, a natural starting point in addressing the challenges should be a regulatory onboarding as a subset of client lifecycle management.

8. Technology

As mentioned already, regulatory reform is the new normal. FIs should be circumspect in assuming that we are going to turn a corner, that regulators are going to ease up or that the level of regulatory change is going to abate. Dealing with this regulatory change and the ramifications of enforcement will become more costly. Given that new regulations are the norm and given that the regulators are becoming more vigilant in enforcing the regulations, there are essentially two possible ways of dealing with the problem. The first is to throw more people at it. The mathematics of this approach are obvious and dire; a linear relationship exists between the cost of onboarding and regulatory pressure. Throwing more people at the problem in the face of greater regulatory flux will automatically lead to an increase in costs. The economics of this approach are prohibitive. The only way to flatten the cost curve is to employ leverage. This leverage is quite simply technology, but herein lies the rub: technology can quite easily exacerbate the cost implications if it is not designed, built and implemented from the ground-up as a global, multi-jurisdictional client lifecycle platform. The next question is then what are the basic tenets of such a technology platform? The checklist matrix on page 15 is designed at a high-level to give guidance of the inherent capabilities that a solution should provide and give some practical implementation considerations.

> "The first is to throw more people at it. The mathematics of this approach are obvious and dire."

6

Client Lifecycle Management Capabilities Checklist

Regulatory Framework	
Is there a common regulatory framework designed to leverage existing document, data and rules?	A strategic client lifecycle management solution should leverage a common extensible regulatory framework that seamlessly allows for the re-use of existing documents, data and rules. This will obviate expensive non-flexible point solutions.
Does the FI use an externally configurable rules engine to drive process steps within the workflow?	The global client lifecycle policy should be implemented on a platform that will ensure that users of the system are guided in a dynamic manner to ensure compliance with that policy. The ability for the workflow to dynamically update based on input factors is crucial, as process steps may be required as new data becomes available.
Does the FI use an externally configurable rules engine to drive compliance determinations for regulations?	The rules and the interpretation of the rules as they relate to KYC, AML, Tax and Trading regulations need to be encapsulated in a rules engine that is centrally managed, thereby, obviating non-compliance and user interpretation.
Are the rules encapsulated by the rules engine peer-reviewed?	The rules set driving local as well as global compliance should be based on industry consensus and should be in line with peer practices. It is vital from a compliance standpoint that the FI has interpreted and implemented regulatory obligations according to the general industry standard. There is no benefit in being an outlier in the interpretation of regulations.
Are the rules encapsulated by the rules engine updated periodically to reflect new regulations, amendments to existing regulations and new geographies?	The solution should allow for regular and seamless updates to the existing rule set. The current regulatory environment is beset by change and flux. The rules need to be updated on a continuous basis. The platform should allow for updates to occur seamlessly without the need for full IT release cycles.
Is the rules engine configured to drive delta document and data requirements for new to jurisdiction, new to product and/ or new to bank client requests?	A delta-based approach to new client requests vastly improves efficiencies and improves the client experience.
Is the rules engine configurable by non-IT staff?	Allowing analysts to change rules promotes a more flexible release schedule.
Does the framework allow for retroactively remediating legal entities based on existing and future regulations?	Worldwide regulators are enforcing both new and existing regulations. FIs in the industry need a means of ensuring that existing and onboarded legal entities have complied with all relevant regulations. A means of retroactively classifying legal entities forms a crucial part of a robust client lifecycle management system.

Document Management	
Are the documents centrally viewable and rolled-up to provide a 360-degree view of the documents captured as part of a client request?	Cuts down on the non-value add contact with the client and significantly improves the client experience. The ability to process new requests is enhanced and, hence, time to revenue is shortened.
Is it possible to add metadata to the documents to reflect document context, document category and types?	The ability to re-use data is predicated on the system's ability to tag documents in such a way that these documents can be re-used in new requests.
Is it possible to index document contents allowing for searchable content?	The ability to index the contents of the documents allows for the documents to be searchable and, thereby, allow easier analysis of existing documents.
Does the document management system track expiry dates and react accordingly with automated workflows and tasks to refresh required data?	A client lifecycle management solution should ensure manage-by-exception and have the intelligence to ensure compliance and efficiencies in terms of reviews. Tracking expiry dates will drive this to allow for process efficiencies. Client experience is enhanced since the document refreshes are requested only when required.

Personnel and Implementation	
Does your organisation have access to specialists / Subject Matter Experts (SMEs) that understand the industry perspective and are well versed in best practice approach to regulatory, KYC and AML practices?	Complex multi-jurisdictional onboarding requires specialists in a number of key areas including regulations, data management etc.
Does the implementation team have experience in implementing regulatory solutions that are bank-wide and span multiple divisions within the institutions?	The team that leads the implementation needs to have experience in the industry and specifically understand the pitfalls of implementing a client lifecycle management system.
Does the project team have experience with complex multi-jurisdictional onboarding and client lifecycle implementation approaches?	Although strong implementation experience both in terms of IT and the project management is crucial for all successful project implementations, it is vital that the SME's on the project have been exposed to cross- jurisdictional projects. Not necessarily specifically in the CLM space (although obviously this is a bonus), but projects that span geographies, cultures, time-zones and regulatory regimes. Such projects give rise to complexity in implementation, and communication. For example, SME's that have been involved in the roll out of a bank wide MDM solution would be ideal candidates for a CLM project.
Is there a modular framework capable of delivering both tactical and strategic benefits on the same platform?	A client lifecycle management solution should be implemented in a modular fashion. This will allow for a delivery of value to the business on a regular basis whilst the ultimate strategic objectives are being met.

Lifecycle and Workflow	
Does the workflow engine reflect the global policy and facilitate (rather than hinder) the execution of the global policy?	Flexible policy-based processes lie at the core of a robust client lifecycle management solution. The policy and the underlying framework should guide the user down a path of predictable and governed compliance processes.
Does the lifecycle process provide an auditable history for the event at that point in time?	The system should have the capability of providing a point in time view of all actions taken against the legal entity. This includes all approvals, all updates to data, whether these are from internal, user or 3rd party data sources. The fact that a legal entity was compliant this year, does not mean that it will be ipso facto compliant next year, as such compliance teams should have the capability of viewing the legal entity at a point in time.
Does the workflow engine enable dynamic tasks and steps based on rule engine driven output?	This will ensure that a common policy is executed.
Is the workflow configurable by non-IT staff?	This allows for updates to the policy and the framework without the need for lengthy and expensive release cycles.
Is it possible to initiate the correct processes based on point-in-time data?	The system should dynamically guide the user through the lifecycle event based on the most current and up-to-date data available to the FI.
Are processes defined for the totality of client lifecycle management including the maintenance, remediation and control models?	A successful client lifecycle management solution / implementation should account for the totality of the client lifecycle events.

Data Model and Data Management	
Is there a centrally managed integration platform that will allow data sources to be integrated into the onboarding platform?	New internal and third party data sources and downstream systems should be integrated using a common platform and, thus, reduce implementation costs. Allowing downstream systems such as account systems to be integrated into the onboarding process cuts down on swivel chair integration and the time it takes to onboard.
Are there third party data provider licenses across the full spectrum of onboarding (e.g. static data, KYC data, PEPs and sanctions, data hierarchies etc.)?	Not all data is available to the FI from the client. There are third party data sources that run the gamut from client static data to PEP (Politically Exposed Person) and sanction list monitoring that can be integrated into the client lifecycle management solution that provide value and ensure compliance.
Are there existing third party integration points for external services?	Implementation time will be significantly reduced if the client lifecycle management solution provides pre-configured adaptors for third party data providers and downstream systems.

Is the data model flexible enough to allow for configuration? Is it future-proofed to cope with inevitable regulatory and process changes?	The data model should be flexible enough to allow for the inevitable change that is wrought by industry and regulatory imperatives.
Does the data model follow a legal entity-centric approach?	Ultimately, the client lifecycle management solution needs to determine the regulatory standing and compliance profile of the legal entity. Adopting a legal entity-centric approach to the data model ensures that this principle is upheld.
Does the system allow for assessment of the data quality (in terms of completeness, accuracy, currency, level of duplication, external references etc.)?	The framework should provide the means to ensure good data quality by automating duplication checks and augmenting of existing datasets from third party data sources. It should facilitate this process by allowing for a flexible UI (User Interface)-driven mechanism at critical points in the lifecycle event.

Case Management	
Are the lifecycle events / requests encapsulated within a case so that the workflow steps, documents and data are logically related and are viewable by event or case?	Different lifecycle events will necessitate different data capture, document and process requirements. These should be encapsulated in cases and should roll-up into the legal entity so the entity tracks all the events that make up the history of compliance for that legal entity.

7 About Fenergo (www.fenergo.com):

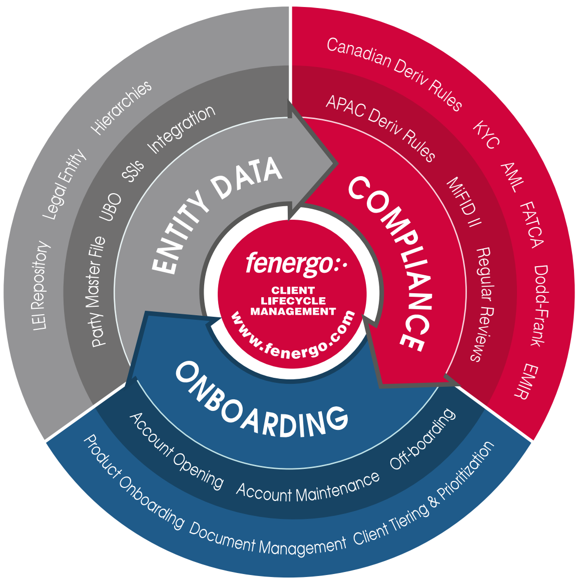
Fenergo is a global leader in Client Lifecycle Management software solutions for capital market firms and investment banks. Its world-class client onboarding workflow technology streamlines onboarding, account opening and client maintenance processes, while delivering regulatory onboarding processes that ensure compliance with global and local regulations based on clean, golden source entity data. These regulations span Anti-Money Laundering (AML), Know Your Customer (KYC), FATCA and OTC Derivative Reform regulations such as Dodd-Frank, EMIR, MiFID, Canadian and APAC derivative rules).

Fenergo takes a unique approach to regulatory onboarding and entity data management. Built upon three core product pillars (Client & Counterparty Data Management, Regulatory Compliance Management and Client Onboarding Lifecycle Management), Fenergo's enterprise-wide Client Lifecycle Management platform is designed to help financial institutions manage client and counterparty data, comply with new and emerging regulations and onboard clients and products quickly and efficiently – all on a single platform solution.

Comprised of three core software solutions, Fenergo's Client Lifecycle Management platform includes:

Client & Counterparty Data Management

Fenergo's Client & Counterparty Data Management solution is a centralized master data system designed to help financial institutions to acquire, validate, store and distribute legal entity data across product lines, business lines and jurisdictions. It allows tracking, merging and grouping legal entity identifiers to create a holistic single view of the client and all its associations.



Regulatory Compliance Platform

Fenergo's Regulatory Compliance Management solution ensures compliance for the financial institution throughout the entire lifecycle of the customer and across global compliance and regulatory directives, such as: Jurisdictional KYC (Know Your Customer), Client Due Diligence Checks, Anti-Money Laundering Checks, Ultimate Beneficial Ownership Checks, FATCA, MiFID, Dodd-Frank and EMIR Classifications, as well as compliance with the Patriot Act and the 3rd and 4th EU Money Laundering Directives.

Client Onboarding Lifecycle Management

Fenergo's Client Onboarding Lifecycle Tool enables financial institutions to improve time to revenue and provide a quick and efficient onboarding process for new and existing clients, whilst ensuring the highest level of compliance with ever-evolving regulations all the way through the client lifecycle (at client take-on and ongoing due diligence stages).

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More Fenergo Publications:

Check out the Industry Knowledge section of www.fenergo.com for more industry publications such as:

- Consistent Technology Infrastructure for Global Regulation, Entity Data & Client Lifecycle Events
- KYC & AML Client Reviews
- Managing the Delta of Regulatory Data
- Research – Total Economic Impact of Client Lifecycle Management Solutions
- Regulatory Landscape for Capital Markets in 2015 (see also special APAC edition)
- Surviving the Perfect Storm: Making the Case for Client Lifecycle Management
- Riding the Wave of Utilities in a Tsunami of Regulation
- Implementing Rules-Driven, Risk-Based Regulatory Onboarding and KYC Processes
- Managing Client & Counterparty Documentation in a Regulatory World
- Regulatory Onboarding – The Fenergo Way
- AITE Research - Keeping Calm and Under Control: Legal Entity Data Support in a Regulatory Age
- Getting to Grips with Client & Counterparty Data Management
- Client Onboarding: Solving the Challenges, Maximizing the Opportunities