Meeting the Regulatory Challenge:

How a digital approach can deliver market-leading cross-border compliance
Executive Summary

Private Banks and Wealth Management Companies that provide cross-border investment advice and services to wealthy clients face an expanding maze of regulation. The surge in regulatory activity over the past seven years has led to a greatly increased volume of rules that are extremely complex and constantly evolving, that vary from one jurisdiction to another, and that must be understood and complied with equally both in the country where the intermediary is based and where the client is domiciled.

The natural response has been to invest heavily in hiring skilled compliance staff to manage these operational and conduct risks. However, compliance solutions based on human expertise and manual processes are costly and inefficient. They leave the organization too dependent on the individual skills and experience of particularly staff who can leave at any time, taking their expertise with them, and they do not enable Private Banks and Wealth Management Companies to scale their operations at acceptable levels of cost and risk.

A different approach is needed that will deliver greater efficiency, more consistent and auditable oversight, a way to embed compliance expertise and best practices within the institution’s business processes, and a much more scalable operating framework.

The Indigita Framework that we set out in this White Paper answers those needs. This technology-based solution falls into two parts that together provide up to date, comprehensive compliance information that integrates seamlessly into the organization’s workflows.

• The first element, inData, is a constantly updated digital version of the country manuals published by leading international compliance consultancy BRP. This delivers an enterprise-wide, instantly searchable compliance resource that empowers front-line staff to operate much more effectively and efficiently.
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- The second element, inRules, turns that regulatory knowledge-base into a structured framework of rules that can be tailored to each institution’s needs and integrated into its core banking system. This extends the benefits of technology automation into an area of activity that to date remains excessively dependent on expensive human resources and inefficient processes.

The result is an automated, real-time “first line of defence” against compliance risks. The Indigita Framework therefore offers the potential for Private Banks and Wealth Management Companies to achieve major efficiency gains, more consistent application of their compliance policies across the organization, and to reduce the risk from non-compliant activity.

A technology-based first line of defence, reduces the need to call on specialist compliance staff for routine matters and frees them to concentrate on more complex cases that require specialist expertise. Equally, integration of checks and rules into the organization’s work-flows ensures they are applied consistently – particularly in relation to “Grey Zone” issues where rules are not clear-cut and the institution must decide its own approach – and that cases are fully documented and auditable.

This approach delivers an effective, workable response to the extremely complex web of regulation that now impacts on cross-border Private Banking and Wealth Management services. By increasing technology automation, institutions can manage risks, increase efficiency, improve performance and ensure a more solid platform for growth.

Ultimately, the Indigita Framework enables Private Banks and Wealth Management Companies to strike a proper balance between three key strategic goals:
- To ensure enterprise-wide compliance
- To provide excellent customer service
- To create an operating framework that can scale with the organization
Introduction

Over the past decade private banks and asset managers – in common with all other financial services providers – have faced a very large volume of new regulation and laws from authorities all over the world. This surge in regulatory activity has forced companies to invest heavily in expanding their compliance functions in order to reduce exposure to the risks of regulatory sanction, litigation from unhappy clients and even in extreme cases criminal prosecution. In the Euromoney Private Banking and Wealth Management Survey 2016, 41% of banks said their biggest challenge during the year would be regulatory changes.

For companies providing investment advice and services to wealthy individuals, the environment has become especially challenging: not only are these clients often classified in regulatory terms as private customers – who therefore qualify for a high level of investor and consumer protection – but they are also frequently domiciled in different jurisdictions from those where their private bank or wealth manager is based.

This exposes private banks and wealth managers involved in providing cross-border services to a particularly complex regulatory situation, in which they must ensure they can demonstrate compliance both with the regulations and laws in their territory where they are based, and with the rules and laws that apply in the country where their client is domiciled. Each country differs in the criteria they use to decide whether local regulation applies and the level of activity that triggers compliance issues. The need to take account of cross-border regulation is just as vital when communication between the bank representative and the client is by remote means as it is when the two parties meet in either jurisdiction.

For front-line staff, and the compliance experts they rely on for advice, this creates a very challenging environment in which the company’s ability to serve clients and expand its business depends above all on the individual knowledge and experience of a relatively small number of key compliance staff.
Introduction

In this paper, we propose an alternative, technology-based approach to managing the compliance risks of conducting cross-border business with private banking and wealth management clients. It is an approach that offers benefits both in terms of improved risk management and by increasing operational efficiency, productivity and scalability.
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The Strategic Imperative

Ensuring compliance with a rapidly growing body of regulation and law has undoubtedly become a critical strategic imperative for financial services companies. International rules that have already come into force or are planned, including MiFID II, UCITS, AIFMD, MAD; PRIIPS, Basel III, FATCA, enhanced Know Your Customer and Anti-Money Laundering rules, have imposed major additional compliance burdens on firms, obliging them to reinforce their internal controls and invest heavily in expanding their compliance teams.

However, ensuring regulatory compliance is just one of many strategic imperatives that firms must pursue. Equally important is the need to provide the highest possible levels of service to their private banking and wealth management clients wherever they are domiciled, and to enable private banking activities to expand geographically and grow in scale.

Balancing these regulatory and commercial goals is now more challenging than ever. Firms that provide financial services across international borders are subject to a steady flow of new sector-specific regulation that can vary widely between different countries, as well as to the general laws in areas such as consumer protection that apply in each country where they do business. In addition, existing regulations are amended frequently and new rulings periodically change their interpretation. In order to operate safely companies must understand not only the detail of the regulations that will apply to their activities in any foreign jurisdiction, but also the way in which that territory's supervisory authorities will tend to apply them in practice – how they will interpret the spirit of the regulations as well as the letter.

The result is a complex and shifting international web of rules that differ depending, for example, on where and how →

Range of types of regulations and laws that can apply to cross-border financial services providers
contact between the bank’s staff and the clients takes place and on the “thresholds of tolerance” that apply to foreign financial intermediaries in different jurisdictions.

At the same time firms are under growing pressure to ensure their processes are fully documented and auditable so that they can demonstrate their control systems are operating properly and their processes are compliant. As a result, their overhead for expert compliance staff continues to grow and the difficulty of ensuring compliance in all circumstances inevitably increases the risk of exposure to non-compliant activity when staff are prospecting, promoting services and serving foreign-domiciled clients. This can lead to regulatory sanction, as well as invalidating contracts between the bank and its clients.

Firms therefore face a pressing strategic challenge. They must reinforce their compliance functions in order to be able to pursue objectives for growth and service quality. But unless they can also achieve productivity gains and economies of scale in their compliance activities, they may fall short of optimum profitability and find they are still exposed to continuing compliance risks.
The Limitations of the Current Approach

The approach that private banks and wealth managers typically take to ensuring compliance in serving international private clients relies overwhelmingly on manual, paper-based processes and on the experience and knowledge of key individuals. This leaves banks exposed to a significant business risk: a vital part of their risk management and mitigation depends on the expertise of individual members of staff. They therefore lack an embedded, institutional knowledge-base that exists independently of their key personnel.

The weaknesses of this approach are obvious. Manual processes that are paper-based or involve direct contact between front-line staff and compliance specialists in order to resolve the majority of issues are an inefficient use of expensive and expert compliance professionals’ time. In organisations that serve thousands of clients, the aim should be to apply compliance expertise where it is most needed and can therefore add most value for the organisation.

Relying on human expertise as the ultimate compliance resource makes this much more difficult to achieve. It also leaves the firm vulnerable. Skilled compliance staff are in high demand and banks are therefore constantly at risk of losing vital people to rival organisations, thereby weakening a critical function. They are also exposed to the inevitable risk of human error as the demands on compliance staff increase. Finally, this model of compliance monitoring is too expensive to scale in line with the bank’s growth objectives. A fresh approach is needed.
The Indigita Framework – Digitally Optimised Cross-Border Compliance

Private banks and wealth managers face a considerable challenge to scale their cross-border operations while at the same time reducing the risks of non-compliant activity:

| The framework of regulation is extremely complex | The skilled resources are ineffectively deployed | The processes they currently use are inefficient |

The central problem with the situation today is a lack of technology automation, which significantly reduces the productivity of expensive compliance resources. The technology-based solution that Indigita proposes is built on comprehensive, detailed regulatory information compiled by BRP, the leading cross-border regulatory consultancy that is one of Indigita’s two co-founders. This information is then digitised, structured and integrated into the bank’s core IT systems using the software implementation expertise of BRP’s partner, the technology consultancy Orbium.
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The Indigita Framework consists of two major elements:

**inData**

is at the heart of the Indigita offering. This is a complete, digitised version of the market-leading country manuals published by BRP. These represent the world’s most comprehensive body of regulatory information and guidance for private banks, wealth managers and financial advisers serving cross-border private clients. The country manuals include summaries of the cross-border regime for each territory, detailed analysis of the specific regulations, and definitions of key legal concepts. The regulatory information compiled in inData is constantly updated to incorporate new regulations, rulings and interpretations of the rules as they appear, and these changes are sent out as alerts to ensure compliance staff remain abreast of the latest changes. This rich digital resource, which integrates readily with third-party IT systems, therefore provides the vital attribute that current compliance functions lack: an embedded, institutional knowledge-base that is structured, detailed and instantly searchable. inData therefore underpins compliance activities right across the company and enables users to operate much more efficiently and effectively.

**inRules**

complements the inData regulatory knowledge base and delivers the second major benefit of the Indigita Framework: automated integration of cross-border compliance checks and recommendations into the organization’s routine workflows. To achieve this, inRules turns the regulatory information and interpretations contained in inData into a structured framework of rules that can be tailored to the individual bank’s needs and integrated into the core banking system. This enables the bank’s IT system to deliver real-time, automated and context-specific checks, advice and compliance alerts each time staff deal with a client based in a foreign jurisdiction. The result is a big reduction in calls from front-office staff to consult compliance specialists on everyday matters.
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Efficiency Gains through Cross-Border Robo-Compliance

The comprehensive, digital knowledge-base provided by inData, coupled with the structured framework that inRules creates around it, enables private banks and wealth managers to achieve major efficiency gains in their compliance operations at the same time as reducing the risk of non-compliant activities.

There are three major elements to the proposition.

1st the system provides an automated, real-time “first line of defence” for front-office staff against non-compliant activity. Once integrated into the bank’s core systems, Indigita’s tools allow the system to check interactions with clients as they take place against the embedded digital rules for all relevant jurisdictions, generating alerts when potentially non-compliant transactions or activities are detected and blocking any associated orders from being executed. This system-based “first line of defence” greatly reduces the need for client-facing staff such as Relationship Managers to consult compliance teams on everyday issues, allowing the company’s regulatory experts to concentrate on more complex issues where they can add more value. The result is a compliance system that not only makes more efficient use of expensive compliance staff’s time, but also delivers a consistent, company-wide system of checks and safeguards, greatly reducing potential exposure to non-compliant activities.
2nd as well as the vital front-line function of integrating “road-blocks” into the organisation’s workflows to prevent non-compliant transactions from going undetected, the Indigita Framework also offers a comprehensive regulatory reference tool that staff who are not compliance specialists can consult as a first source of information and guidance on conducting cross-border business, including for example behaviour guides for Relationship Managers with “Do and Don’t” lists. Relationship Managers who need to deal with a client based in a foreign jurisdiction can consult the inData knowledge base in advance to check rules on conduct of business, financial regulation, investor protection, consumer protection, foreign exchange controls and the need for a locally-established branch. This therefore enables staff to gain a rapid understanding of key issues such as which activities they are permitted to carry out in different jurisdictions, whether a particular product needs to be registered with local regulators and whether they require a local licence in order to operate.

3rd the Indigita system can be customized to create an e-learning and testing tool to deliver in-house compliance training. Private banks and wealth managers can adapt the tool to reflect the needs and characteristics of their business, and can therefore tailor the training the system delivers to meet their knowledge requirements of their staff.
Delivering Strategic Flexibility in The Grey Zone

Private banks and wealth managers face a particular challenge in implementing their policy on regulatory issues that fall into the "grey zone", where the rules are not clear cut and the organisation must develop its own strategy for activities that fall into this area of uncertainty.

Example:

In Italy local laws do not make clear whether or not a Relationship Manager working for a foreign intermediary is legally permitted to provide a personal investment recommendation to an Italian-domiciled client. As EU citizens, however, Italian clients have the right under Article 42 of MiFID II to approach foreign financial intermediaries to establish a financial relationship with them.

In this case, each institution operating cross-border will have to decide its policy in relation to Italian clients and how it will ensure that any relationship results from reverse solicitation, rather than a direct solicitation of the client by the bank.

Because the Indigita Framework can be customized so that its system-based rules and checks reflect the bank’s individual policy on regulatory issues that fall into the "grey zone", it enables companies to handle these effectively and consistently. The customized rules are integrated into the daily workflows, allowing the bank to implement its “grey zone” strategy consistently each time an instance arises. As a result, the bank can significantly reduce the risk that its Relationship Managers and Back Office staff will take an inconsistent approach to compliance between clients in less clear-cut areas of regulation.
Conclusion

Indigita’s automated technology offers an effective way for private banks and wealth managers to manage the compliance risks that they face in serving private clients based in foreign jurisdictions.

Its rich, digital knowledge-base is a dynamic resource that evolves to reflect the changing and highly complex web of laws and regulations that govern cross-border financial activities. This makes the relevant rules and guidance instantly accessible to all staff carrying out regulated activities.

The overlay of structured rules and alerts turns this knowledge-base into an automated, real-time “first line of defence” that is embedded in the company’s routine workflows. This highlights compliance risks as they occur and can therefore help to prevent banks from leaving themselves exposed to the risk of regulatory sanction.

This ultimately helps to deliver major benefits for the institutions that implement the Indigita Framework:

- Reduced risk of non-compliance leading to regulatory sanctions or litigation
- Reduced reliance on manual and in-person compliance processes, and on the knowledge and experience of individual compliance staff
- More efficient use of expensive and skilled compliance resources
- Greater opportunity to expand private banking operations, thanks to more effective company-wide management of cross-border compliance risks and a more efficient and therefore scalable compliance function.
About the Authors

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