The Future of Compliance:

The Technology Behind the Brokerage of Tomorrow

Finalto Broker Series

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Third party vendors, including key liquidity and technology providers, play a vital role in supporting retail brokers with a variety of regulatory and compliance obligations. This applies not just to meeting specific requirements but also to managing change effectively and efficiently, as well as managing controls across different regulatory jurisdictions.

In this paper we will discuss, from a regulatory and compliance perspective, the advantages of automation in compliance procedures; simplifying the complexities of operating across different regulatory regimes, and the importance of change management.

Many of the examples and descriptions of regulations and compliance requirements will be based on a European/UK point of view; however, the principles outlined can easily be exported to non-EU countries and jurisdictions. In fact, as we explain, one of the characteristics of good regulatory alignment is being able to have systems in place to adapt to different regulatory regimes in which a broker operates or onboards clients.

Best execution

The principle of best execution when executing client trades is a cornerstone of trading regulations in a number of jurisdictions. Failure to meet the best execution criteria can result in significant fines and reputational damage.

The Committee of European Securities Regulators explains: “The overarching MiFID best execution obligation requires investment firms to take all reasonable steps to obtain, when executing orders

on behalf of clients, the best possible result for their clients, taking into account the execution factors – price, costs, speed, likelihood of execution and settlement, size and nature of the order or any other consideration relevant to the execution of the order."

Following from this, brokers have a requirement to seek out the best liquidity profile for their clients and deliver pricing that meets the best execution requirements.

Finalto curates pricing from a range of Tier 1 banks and other non-bank liquidity providers to create a liquidity pool from which clients can derive pricing.

The advantage of this is a more bespoke and sustainable liquidity that can assist brokers and other investment firms to adhere to certain elements of their best execution policy requirements.

At Finalto we have developed systems to empower clients with greater access to additional pools of liquidity.

The approach involves a focus on connectivity to multiple electronic trading venues; the aggregation of multiple sources of liquidity from different venues; streamlining trade workflow, such as the number of steps required to execute a trade; and creating analytical tools to proactively manage and improve end-client experience.

It is important to remember that best execution does not just pertain to price, but other factors such as speed of execution and costs applied by retail brokers.

Post trade monitoring

Operating the execution policy is ongoing and relies on regular post-trade monitoring to ensure the effectiveness of the policy and to adjust any problems identified. Brokers should look to automate their post-trade monitoring to check if the price given was available in the market and assess the reasons for any discrepancies.

Risk management

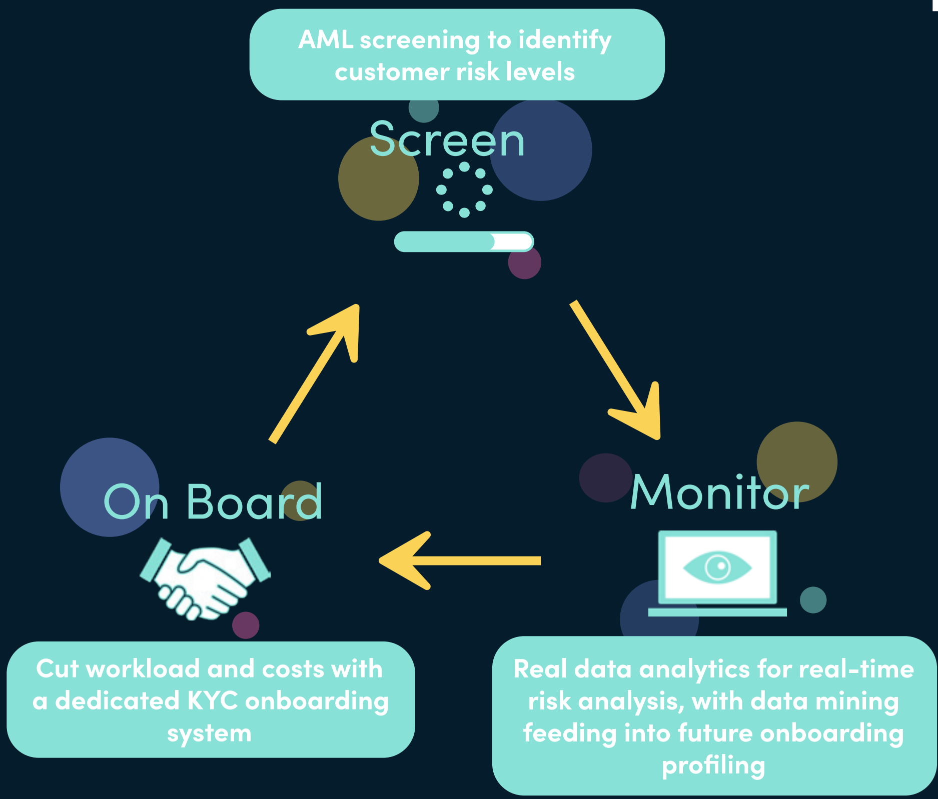
Regular reporting requirements for areas such as capital requirements and client money are an important part of a broker's obligations. It's incumbent on firms to identify risks, assess risks and mitigate risks relating to the proper segregation of client money. Technology providers may assist brokers with automating exposure reports to provide real-time analysis of equity, client balances etc. It's also important to monitor transactions from an anti-money laundering (AML) perspective, with tech stacks that can integrate customisable alerts and red flags to maintain control.

Transaction reporting

Fulfilling transaction reporting obligations such as MIFIR and EMIR can be onerous for smaller brokers with small teams. Third party technology providers play an important role in delivering ready-made reporting templates for this task that help brokers comply with all technical considerations, as well as offering guides for best practices to remain compliant in multiple jurisdictions to ensure data accuracy and timely submission. Liquidity providers may also offer delegated reporting possibilities for EMIR.

Onboarding and CRM

Onboarding processes, including Know Your Customer (KYC) checks, can lead to friction between



business and compliance teams. Most brokers would recognise the potential for bottlenecks in the process.

Streamlining and automating onboarding processes with a dedicated CRM system can lower costs, improve efficiency and ensure consistent regulatory compliance.

For example, appropriateness assessments requirements vary from jurisdiction to jurisdiction and may be open to a degree of flexibility. Therefore, brokers within a group need automated solutions allowing them to apply different methodologies per jurisdiction/regulation. The controls and technology arrangements in place should be dynamic to allow for swift changes and tweaks of the assessment methodology. It is important that the assessments consider the economic profile of clients, and are flexibly designed so that brokers can add or reduce questions depending on their risk profile and the jurisdiction in which the client is onboarding. Onboarding and compliance teams should be aware that they are not operating within a silo. Other business functions rely on their efficiency. Automation of the assessments ensure accuracy, consistency and avoid potential human error.

Ongoing good broker-client communication is also an important component of conforming to regulatory requirements. Ensuring clients are properly informed about changes to account terms and conditions, trading conditions – such as spreads or commissions and charges; and updating clients about market-moving events that might affect their PnL are all considered not just good practice but also an essential part of adhering to local regulatory considerations. Good communication and customer support are becoming focus not only in the UK, with the new Consumer Duty requirements, but also globally. Therefore, a strong, adaptable CRM function that can be embedded as part of the entire broker solution is a very useful tool.

The changing regulatory landscape

Increasingly, brokers are not only needing to think about financial industry regulations, but are also meeting with stricter consumer duty requirements that impact businesses of all kinds. These relate to the concepts of transparency, fair value, customer support and consumer understanding.

A good example of this is the Consumer Duty rules in the UK, a new framework setting out a list of obligations and requirements for financial services firms taking effect in 2023 aiming to govern the way firms communicate and offer their products and services to retail consumers.

- **A new Consumer Principle that requires firms to act to deliver good outcomes for retail customers.**
- **Cross-cutting rules requiring firms to act in good faith, avoid causing foreseeable harm, and enable and support customers to pursue their financial objectives**
- **Four Outcomes rules requiring firms to ensure consumers receive communications they can understand, products and services meet their needs and offer fair value, and the support they need.**

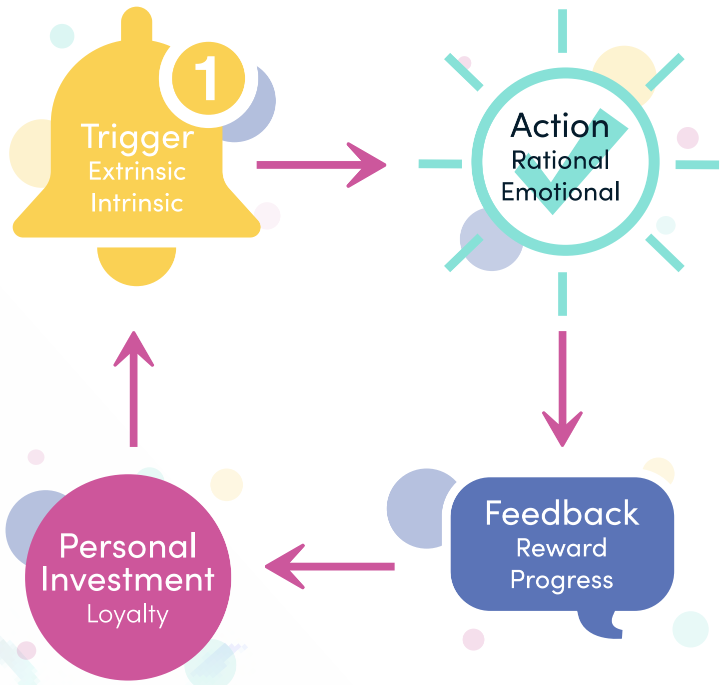
Delivering 'good outcomes' for retail traders is not a straightforward concept, therefore having the right technology in place to deliver the best experience to clients is an important step to take.

Retail brokers have a number of tools at their disposal to help deliver 'good outcomes' for their customers. For example, charting packages and other analytics provided to the retail trader by the broker could be considered as part of the set of measures the broker is using to ensure 'good outcomes'.

Going back to the thinking around CRM, it could also be said that the delivery of reliable, timely and relevant market and account information to clients that can be customisable and in simple language would assist in brokers meeting some of the requirements that require firms to ensure consumers "receive communications they can understand, products and services meet their needs and offer fair value, and the support they need".

The Consumer Duty framework places particular emphasis on vulnerability and customers exhibiting vulnerable characteristics. Brokers are expected to have a set of policies and procedures in place to address elements of vulnerability and provide better support and assistance to vulnerable customers. As such automated tools, such as speech analytics, may be key to assist firms identify customers with vulnerability characteristics and provide them the help they need.

Product change management



Alongside meeting changing regulatory requirements, be that from country to country, or adapting to changes to a particular regulatory regime, brokers should be mindful of product development and how this can play with regulators. Products in this sense can mean both asset classes or platform technology.

For instance, the UK's Financial Conduct Authority (FCA) recently issued a direct warning about the problem behaviours linked to trading app design. It warned stock trading app operators to review design features, including those with game-like elements, which risk prompting consumers to take actions against their own interest.

Features that the FCA flagged as being potentially harmful include sending frequent notifications with the latest market news and providing consumers with in-app points, badges and celebratory messages for making trades. The FCA found that consumers using apps with these kind of features were more likely to invest in products beyond their risk appetite.

This is where end-to-end management of the entire product and client ecosystem is important. Designing an app with the 'best' UX to generate engagement and trading activity is not necessarily best practice from a client protection perspective, and could ultimately see a broker run foul of regulators, with potentially damaging reputational and financial consequences. It can be easy to look at competitors and feel like a trading app could be 'improved' to generate more returns without considering the regulatory aspect of this. Whilst compliance teams would catch this, it can be a costly enterprise in design and building before this occurs.

Technology partners can aid in this respect by providing technology stacks, white label applications and other systems that have been developed with the full end-to-end business needs in mind, by a company with huge depth and breadth of expertise in ensuring products are relevant and appropriate for clients and meet the demands of regulators.

White label tech providers delivering end-to-end platform and CRM systems can also enable brokers to adapt their product to different jurisdictions – running different campaigns and even offering a different in-app experience depending on where the client resides. This means that products can be optimised based on the regulatory situation of the client, rather than a one-size-fits-all approach that would default to the lowest common denominator, which in this case would be to comply with the strictest regulatory regime.

In summary, there are all kinds of different considerations for brokers from a compliance and regulatory perspective. In many cases, they may find that third party vendors, including their liquidity providers and tech partners will be able to play an active role in supporting their efforts.

We encourage all partners to get in touch with us at Finalto to discuss how we can support brokers across all their various business functions, including from a regulatory and compliance perspective.

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From

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