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New Software Bolsters Pre-Trade Compliance Capability

by Peter Ortiz

While post-trade compliance has been the norm in the advisor-subadvisor relationship, a new software compliance product is being rolled out that is designed to give fund advisors the ability to conduct pre-trade compliance.

Denver-based technology and consulting firm UAT is introducing a series of integrated software that allows fund advisors to monitor their subadvisors' trading activity in real time, says firm president Tom Warren. The Unified Compliance and Control System provides reporting of portfolio positions and trading activity as they occur.

Fund advisors rely on their subadvisors to monitor trading activity and ensure that compliance policies and procedures are not violated. And while a fund advisor is not required to conduct pre-trade compliance reviews, it is considered a best practice and one that is likely to gain greater interest among funds that have primarily monitored their subadvisors on a post-trade basis, sources say.

Pre-trade compliance involves things like assessing the trade prior to execution to determine that it meets the fund's investment mandate. It can also include a determination of where the trade is directed and whether it's an automated trading platform or through a broker.

"Imagine...if you don't have to go back the next day and review trades," says Mike Brophy, a senior consultant with SEC Compliance Consultants. "It is time better spent by the compliance officer if you can have real-time access to the subadvisors' trading."

UAT's new system will also provide real-time control over brokerage costs. The system creates savings by deciding what trades could be handled by a computer (at lower cost) versus a broker and also runs a pre-trade compliance check and stops violations before they happen, Warren says. Money managers would execute trades they deem need more attention.

The savings of a few cents per share from low-cost trade execution may amount to tens of millions of dollars in annual savings for large multi-manager platforms that execute thousands of orders involving billions of shares, according to the company. The system also allows money managers to create transparency with data that helps their clients with hedging programs, Warren says.

UAT is working in partnership with Amy Lynch, president of Frontline Compliance.

"Basically we built a conduit through which all orders pass and, as a result, advisors gain the ability to run one, consistent, pre-trade compliance check from the viewpoint of the [fund]," Warren says.

The system also allows funds to stop and flag subadvisors' trade orders "that represent potential violations," according to the company. In addition, it aids other entities that use external asset managers, such as insurance companies, pension plans, bank trust groups, 401(k) providers, foundations and endowments.

“In today’s environment, it is especially important because trading is the backbone of what a mutual fund is about, and being able to monitor that trading and having compliance oversight on a real-time basis could prevent violations from ever happening,” Lynch says.

Today, fund advisors have limited ability to conduct reviews on a pre-trade basis because their subadvisors are typically operating on their own accounting and portfolio systems, says Jeff Squires, founding principal of Vista360. While the ability to review on pre-trade would represent a significant advancement in compliance, funds and their advisors would have to conduct a cost-benefit analysis, he says. This especially will be top of mind for funds that have had to reduce compliance staff and resources due to depleted assets.

“The reality now is that compliance still comes with a price tag, and with the economy the way it is, mutual fund companies and advisors are looking for ways to reduce costs,” Squires says. “The technology is only as good as the [firm’s] ability to properly implement it.”

Gene Gohlke, associate director of the SEC Office of Compliance Inspections and Examinations, says examiners expect both the fund and their advisors to enact an effective process to identify compliance risks that are associated with investment decisions and how best to manage those risks. There is no rule mandating pre-trade or post-trade compliance.

Gohlke acknowledges that pre-trade compliance may be very prudent in some circumstances, such as when a firm begins investing in a new type of instrument, working with a new issuer or approaching a hedging strategy in a different way. Pre-trade analysis may shed light on the liquidity risks, the ability to clear, settle and account for a trade, or tax implications. He also says that volatility in the current market environment may have heightened the importance of pre-trade analysis.

“It may make a lot of sense for that firm to take a very robust look at all the implications of those new things in regard to the investment, credit and market risks that they will be taking,” he says.

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