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Regulation & Compliance

Special Report

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An Unenviable Position

I don't envy Wall Street technologists—these haven't exactly been boom years of late. The financial crisis ushered in an unprecedented wave of new regulations. As a result, already pared-down IT teams contemplating life with shrinking budgets have been forced to become more focused and efficient.

Some would say that this is for the best. In the Q&A on page nine, our group of industry experts takes a look at the competitive advantages that can be gained from this regulatory overhaul. Turmoil creates opportunity for those intelligent and efficient enough to capitalize on market confusion.

And confusion abounds. Several rules stemming from the Dodd–Frank Act are currently bogged down in litigation, while one—the proxy access rule—has already been shot down. There are numerous definitions pertaining to these new regulations that are yet to be finalized, resulting in regulators pushing back compliance dates on a number of major initiatives.

This is also an election year in the US and there's no guarantee that President Barack Obama will win a second term. However, even if he is victorious, he's likely to have to back off his drive to clean up Wall Street through regulation, and that might just mean the death of the Volcker Rule, which has already been delayed until July 2014.

I recently attended a conference in Houston where the keynote address was delivered by Dan Berkovitz, the Commodity Futures Trading Commission's (CFTC's) general counsel. Berkovitz used the word "hope" no fewer than a dozen times when speaking about meeting deadlines for initiatives such as the definition of a swap—a long-term sticking point for the industry—cross-border implementations of the Dodd–Frank Act, clearing requirements, and what the soon-to-be-introduced swap execution facilities (SEFs) are likely to look like. He also told attendees about several new rules the CFTC is "hoping" to unveil in the coming months. This means that even as regulators fight to finalize rules that were meant to come into effect by the end of 2012, there are still more to come.

An uncertain environment is a dangerous—if opportune—one. And with each answer given, it seems as though a new fight is created in a courtroom. No, I don't envy Wall Street's technologists—but rest assured, the survivors of this current challenge stand to gain a great deal of credibility and goodwill from their CEOs and CFOs … until the next wave of regulation comes along. ■

Anthony Malakian
US Editor

Inside Market Data Inside Reference Data Buy-Side Technology Sell-Side Technology
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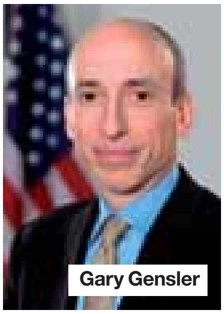
CFTC Extends Deadline for Swaps, SEF Regulation Implementation

In May, the US Commodities Futures Trading Commission (CFTC) announced a series of changes to the dateline for implementation of clearable swaps and swap execution facilities (SEFs).

Crucially, and as many expected, the proposed exemptive order initially stating those changes, has extended the date for implementation of the regulation from July 16, 2011—the default date for implementation of Dodd–Frank Title VII, which has been included in a number of previously agreed rules—to December 31, 2012. The CFTC maintains, however, that should its rules be finished sooner, the regulation will be effective at that time.


Gary Gensler

The order also made a number of additional clarifications: that agricultural swaps can already be cleared through a derivatives clearing organization or traded on a designated contract market (DCM); that as-of-yet unregistered trading facilities required to register as a SEF under the new regulation may use the additional time to complete that transition; and, that regulators' work further defining certain key terms, including "swap dealer" and "securities-based swap dealer," is nearing completion.

"The staffs of the CFTC and Securities and Exchange Commission are making great progress, and I anticipate the Commissions will take up this final definitions rule in the near term. Until that rule is finalized, the proposed exemptive order appropriately provides relief from the effective dates of certain Dodd–Frank provisions," says CFTC chairman Gary Gensler.

Comments on the order will be accepted for 14 days after its publication in the federal register.

SEC Outlines Data-Driven 'Creative Destruction'

The US Securities and Exchange Commission (SEC) has subjected its data infrastructure to a year of "creative destruction" as the regulator enhances its technology to adapt to the growing amount of information it collects as a result of new regulations, according to Thomas Bayer, CIO of the SEC, who delivered the keynote speech at sibling publication *Inside Market Data*'s North American Financial Information Summit in May.

The largest dataset the regulatory body must process is filing forms data for its Edgar database, which is growing further as a result of the reporting requirements in the Dodd–Frank Act, and creates a challenge around how the SEC can make that data more accessible to its own analysts in a more efficient and effective way, as well as to external users, including individual investors and professional analysts, Bayer says.

As a result, the SEC is enhancing its analytic capabilities, building out its data warehouse and leveraging predictive analytics and data visualizations with the goal of "working smarter," Bayer says. "We are taking a forward, proactive view of how the capital markets use information and how information is filed within the SEC," he says. "We have to think differently. We can't use the same old solutions. We have to innovate using predictive analytics. We have to think like a mathematician."

> "This is not the SEC of two years ago. This is one that's very focused from an analytical perspective, and we're leveraging highly capable statistical programs."
> **Thomas Bayer, Securities and Exchange Commission**

For example, the SEC is utilizing more quantitative analysis, most prominently in its "market aberrational analytics" tool, which employs quantitative models to detect unusual investment performance by analyzing fund returns, Bayer says. The Commission is also investing in market data analytics and quant models to support its review of high-frequency trading's impact on the market, he added.

"This is not the SEC of two years ago. This is one that's very focused from an analytical perspective, and we're leveraging highly capable statistical programs, whether it be Matlab, 'R,' and so forth, and we're also leveraging visual analytics and other capabilities," Bayer says.

For public users of its data, the SEC last month began upgrading its SEC.gov website, which serves as its primary means of communication with the public and previously consisted of about 148,000 pages of static content. The SEC is now implementing enhanced search capabilities to enable easier access to Edgar filings data, and has unveiled a dynamic user interface that changes depending on the type of user—such as, an individual investor or professional analyst—to highlight the tools most relevant to that user, Bayer says.

In addition, the Commission is also in the process of overhauling its Edgar system to improve how data is filed in the database and how data is retrieved. "The SEC takes in petabytes of data every month, and it is ever-growing. We try to turn as much of that information back to the public as possible, so that they can mine and use that data, either through the Edgar filing system or SEC.gov," Bayer says. "And in the future, we intend to provide more of this information."

Lone Pine Turns to SS&C for Form PF Support

Lone Pine Capital, a buy-side firm based in Greenwich, Conn., with about $23 billion under management, has selected SS&C for its Form PF reporting solution. Lone Pine is using SS&C's web-enabled Form PF application and expertise to help comply with Form PF, a new reporting requirement applicable to hedge fund investment advisers, private equity funds, and other private funds that meet certain asset thresholds.

Investment advisers subject to these rules will be required to report information on a quarterly or annual basis for use by the Financial Stability Oversight Council (FSOC) in monitoring systemic risk to the US economy.

According to Windsor, Conn.-based SS&C Technologies, the firm's Form PF platform, unveiled in March this year, is cloud-based, offering clients access to every aspect of data collection, workflow management and submission of Form PF online. The product supports complex fund structures, and multiple asset types and data sources; it can be used by current fund administration clients or on a stand-alone basis by funds who use third-party administrators or an in-house process.

FSB Approves ISO Legal Entity Identifier Standard

The Financial Stability Board (FSB) has approved a legal entity identifier (LEI) standard published by the International Organization for Standardization (ISO).

"ISO 17442: 2012, Financial Services–Legal Entity Identifier," contains a 20-character alphanumeric code and additional reference data elements. The standard is intended to identify global entities that require an LEI, it defines open governance for issuance and maintenance of LEIs, and does not embed intelligence about an entity in the LEI. ISO's TC 68 working group developed the standard.

"The proposals do set out a governance framework and promote active coordination between the various regulatory communities and the private sector in implementation of the system," says Alexis Grassie, director, data management group, at CIBC in Toronto.

"The proposals do set out a governance framework and promote active coordination between the various regulatory communities and the private sector in implementation of the system."
Alexis Grassie, CIBC

The FSB has invited the ISO TC 68 group to participate in the FSB Industry Advisory Panel that will prepare its recommendations on a global LEI solution to present to the Group of Twenty (G20) nations at the G20's June meeting in Mexico. The FSB met in Hong Kong on May 29 and 30, and stated then that its reference data and LEI code are compatible with ISO 17442.

Cinnober Debuts Scila Compliance

Cinnober has announced the launch of Scila Compliance, its multi-asset surveillance and monitoring solution for brokers and investment banks.

"A great trade surveillance system should do more than just keep you out of trouble."
Javier Tordable, Cinnober

Scila allows for customized reports and alerts for compliance officers, and includes functionality for performance measurement, position monitoring and analysis of high-frequency trading applications. Other modules factor in anti-money laundering compliance, as well as mandatory reporting requirements.

"We think a great trade surveillance system should do more than just keep you out of trouble," says Javier Tordable, CEO at Cinnober. "You should also be able to leverage the large amount of business data and actually improve your trading operations. Scila Compliance goes beyond enhancing your management of financial and regulatory risks—it also provides a corporate dashboard for benchmarking trading operations and uncovering new business opportunities."

Scila Compliance is part of the same suite of tools as Scila Surveillance, which is used for trade monitoring in nine regulated markets.

SunGard Upgrades Surveillance to Comply with ESMA

SunGard has updated its Protegent market surveillance tool to comply with regulation from the European Securities and Markets Authority (ESMA) regarding tighter monitoring of automated trading.

ESMA's 2012/122 guideline is aimed at tightening the noose around rogue traders using market-manipulating activities such as layering, spoofing and quote-stuffing by keeping tabs on the orders-to-trades ratio and suspending guilty parties.

SunGard has adapted its Protegent surveillance solution with the addition of a new rules library that supports these guidelines.

Magnus Almqvist, senior product specialist for SunGard's capital markets business, says the complexity of the marketplace means that compliance officers require a complete picture of events.

SEC Modifies 'Flash Crash' Circuit Breaker Rules


Mary Schapiro, SEC

The US Securities and Exchange Commission (SEC) has announced two updated initiatives, and corresponding mechanisms, referring to the Flash Crash of May 6, 2010, replacing those initially approved on a pilot basis following the events of that day.

The first establishes parameters around a limit-up–limit-down mechanism preventing trades on individual exchange-listed stocks from occurring outside particular price bands that correspond to preset percentage changes occurring over the previous five minutes. Securities on the S&P 500, Russell 1000 Index, and other certain liquid exchange-traded products will have a level of 5 percent; remaining securities will be limited at 10 percent. Those percentages will double during opening and closing.

The five-minute trading pause included within current circuit breakers will remain to accommodate more fundamental price moves.

Meanwhile, the second initiative addresses market-wide circuit breakers, which had been in place since October 1988, but proved insufficient to trigger a halt to trading during the 2010 Flash Crash.

The new rules will reduce the decline percentage threshold triggers to 7, 13, and 20 percent from the prior day's close, replacing 10, 20, or 30 percent, for initiating a halt in trading. It will also shorten the duration of those halts in trading not causing a close in market to 15 minutes, from 30, 60, or 120 minutes; simplify relevant trigger time periods down to two—before and after 3:25 p.m.; designate the S&P 500 rather than Dow Jones Industrial Average for pricing references; and mandate daily, rather than quarterly, recalculation of trigger thresholds.

Paladyne Adds Hong Kong Regulatory Requirements

Paladyne Systems has announced the extension of its Portfolio Master product to meet incoming regulation from the Hong Kong Securities and Future Commission (HKSFC).

From June 2012, fund managers will be required to disclose their net short positions to the HKSFC. The rules come into force on June 18, with the first reporting day and deadline being June 22 and June 26. Any fund manager taking a short position in Hong Kong stocks will be required to comply. Portfolio Master, Paladyne's combined order and portfolio management system, will automate the process by extracting relevant data on short positions, and generate daily reports as appropriate. The required weekly reports for specified thresholds, as well as daily data, can also be generated.

FPL Updates Execution Venue Reporting Guidelines

FIX Protocol Ltd. (FPL), the organization responsible for the adoption of the FIX protocol, has updated its guidelines on execution venue reporting in an attempt to encourage greater transparency between brokers and buy-side firms.

The new guidelines are geared toward the European market, following on from those produced by FPL's Americas Buy-side Working Group in February 2011.

Taking into account European regulation such as the Markets in Financial Instruments Directive (Mifid), the new guidelines recommend buy-side clients monitor where and in what way their liquidity is used by brokers.

Jim Kaye, product development manager of European execution services at Bank of America Merrill Lynch and co-chair of FPL's EMEA Business Practices Subcommittee, says the guidelines will give buy-side firms greater control over how their capital is used.

Rule Taps Hansen for Data, Regulatory Consulting

UK-based business and technology consulting and services provider Rule Financial has hired Larry Hansen as managing director in New York, responsible for US business development and identifying global consulting assignments focusing on data management and regulatory issues, including the data impact of swap execution facilities (SEFs) and the data quality requirements of risk-related regulation.

"We're working with many of the largest banks on their continuing efforts around delivery of timely and accurate data to support derivatives trading and risk management because quality data is core to good risk management," Hansen says. "Banks are looking at what the state of the world will be when SEFs come into play as they look to comply with Dodd–Frank and the Volcker Rule," which bans proprietary trading.

Hansen will sit within a group formed earlier this year by Rule's March acquisition of Waterline Group, a consultancy based in New York and Toronto, and will report to managing director Chris DeBrusk, one of the founders of Waterline.

Hansen was previously vice president at Sapient Global Markets, prior to which he was director of product management at Lime Brokerage, and held various senior product and content-related roles at data and trading technology provider Townsend Analytics.

ISTIC Regulation Group Focuses on Legal Entity Identifier

The new Regulatory Working Group (RWG) launched by the International Securities Association for Institutional Trade Communication (ISITC) will focus on the legal entity identifier (LEI) standard, but will also leave room for smaller subcommittees to focus on other regulation affecting the financial industry such as the Foreign Account Tax Compliance Act (Fatca), according to Tom Brown, co-executive sponsor of the group, and an associate partner at Brook Path Partners. Karla McKenna, director of market practice and standards at Citi, is the other co-executive sponsor leading the group.

ISITC RWG has been communicating with the Financial Stability Board (FSB), the global organization advising the Group of Twenty (G20) nations on the LEI, and which recently approved the ISO 17442 message format for the standard, according to Brown. The group is waiting for details from the US Commodity Futures Trading Commission on its CFTC Interim Compliant Identifier and preliminary LEIs.


Tom Brown

"We can focus on where some of the data can reside in a message and we can initiate some activity to work on a best practice to support the data, but until such time as we get confirmation from all the parties involved as far as how the exact model, which we expect to be a federated model, will work, we can't really handle the communication points for the data distribution piece of that best practice," says Brown.

The RWG recently held its first meeting at the ISITC Industry Forum in Denver. The group's membership includes investment managers, vendors, custodians and broker-dealers. It aims to form best practices for regulatory compliance. The RWG plans weekly conference call meetings, largely to work on the LEI at first, according to Brown.

Form PF Shines Light on Golden Copies, Mapping Requirements

As the first Form PF deadline is approaching—June 15 for most advisors with $5 billion under management—firms are beginning the process of running mock filings and establishing workflow processes. A new whitepaper by ConvergEx's Eze Castle Software states that, of the many challenges in pulling together 1,500-plus fields of data, buy-side institutions are challenged most by creating a golden copy of normalized data, mapping those data points, and making sure those processes are repeatable and efficient.

Roger Gregory, a product manager for Eze Castle, says there is a lot of data coming from a multitude of different sources: holding files, security master data, risk metrics, investor breakdown, financing information, and fund structure, among numerous others. Some of that information is coming internally, some from a third-party provider.

"To the best of my knowledge there isn't one operational system out there today that can house all of that information," he says. "One of the complexities that we see is that the various systems that are going to be contributing to Form PF need to have the same methodologies for the calculations—the same market data—otherwise, the basis of the reporting is going to be skewed."


Roger Gregory

This means that the data has to be brought in through a common set of normalized terms and the basis of the calculation has to be the same, he says. Basically, firms need to be able to reconcile and audit a golden copy of the data so that when the form is presented to the regulators, it is acceptable and will stand up to a US Securities and Exchange Commission (SEC) audit.

Furthermore, adds Phil Christianson, a product manager for Eze Castle, it's not simply about consolidating the data. "Form PF is all about time series. Every single question is, 'Give me your month one, your month two, month three numbers,'" he says. "So you've got to find and pull that information together for each month."

Another area that is potentially being overlooked is the need to make sure data points are mapped properly. There are numerous mapping activities, each with multiple classifications, the whitepaper notes. For example, funds need to provide investment strategy information, of which there are 22 classifications, such as "equity, long bias," "relative-value, fixed-income asset-backed," or "macro global." These are the SEC's definitions of investment strategies, but they may not match the definitions of the industry at large, notes Christianson.

"Strategies, in general, are not a homogenous term across our client base. Every client has a different definition of what they think strategies are," he says. "So what Form PF is asking you to do is take your strategies, map them to what the SEC thinks are strategies, and come up with normalized data."

The SEC estimates that completing a Form PF filing will take about 53 hours, but Eze Castle says that number is on the low side. Of their clients, many are already beginning to prepare by running through mock filings with a team of six to 10 dedicated, full-time staffers. Not only are firms having to deal with aggregation and normalization issues, they also have to begin to institutionalize workflow processes and figure out who will approve the data to be sent to the regulators.

Comply OR Die

A convergence of factors—increased globalization, the credit crunch and ensuing economic crisis, technology advancements and rogue trading scandals—have led to a veritable tsunami of regulations with which capital markets firms must comply. Those that are unprepared face fines, sanctions, and, perhaps most costly, reputational damage—just to name a few of the consequences of noncompliance.

Q What areas of compliance and regulation are likely to provide organizations with the most acute challenges during 2012?

Lee Cutrone, managing director of industry relations, Omgeo: The financial crisis of 2008 set the wheels in motion for a sea change in regulation in both Europe and the US. However, the implementation of these regulations has proven to be a lot more complicated and time-consuming than I think legislators and regulators thought. As a result, we find ourselves in a period of waiting to see where the regulations will end up and how they will ultimately impact market participants. In my opinion, the biggest challenge in 2012 may actually be inaction as some significant pieces of legislation including Dodd–Frank and some regulations in Europe, such as the European Market Infrastructure Regulation (EMIR), continue the long process of being vetted and implemented.

However, there are a few pieces of regulation that are gaining quite a bit of momentum and should be on firms' radars. First, Europe's recent proposed rules for increasing settlement efficiency across the European Union by recommending a common regulatory framework for central securities depositories (CSD) is gaining speed, and it is expected that the regulation will be enacted next year. This regulation will set the stage to a move to a harmonized

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T+2 settlement cycle in Europe as well as introduce financial penalties for trades that fail to settle on time. This regulation is sure to have an impact on Europe and beyond. Secondly, the global legal entity identifier (LEI) initiative, backed by the Group of Twenty (G20) nations, continues to move forward as the industry seeks to create a common data standard for identifying underlying legal entities for financial transactions worldwide.

Jacob Gertel , SIX Financial Information: From my perspective, I believe the Foreign Account Tax Compliance Act (Fatca), Solvency II, Basel III and the ongoing changes in both the national and international tax regimes that includes the Swiss withholding tax agreements with the UK and Germany, will be extremely challenging.

The implementation of the Fatca regulations will be very challenging to the financial industry due to the complexity of the task, and the fact that the final regulations will not be published until summer 2012. This will leave the financial industry with a very small window of opportunity to both complete development and implement the new regulations.

With regards to other regulations—the financial industry contributes a number of resources in order to comply with these regulations. Due to the complexity of the regulations, together with the tough business environment worldwide, organizations are having to allocate extra resources at a cost to themselves—i.e., extra IT, operational and compliance costs—that could lead to a reduction in profitability and shareholders' value.

Keith Ross Jr., CEO, PDQ ATS: One is that guidelines are more difficult to respond to than actual rules. I think part of the issue is the uncertainty around what the definition of proprietary trading is for banks. What is market-making? In fact, I would argue that some of those questions may not be answerable in a real, reasonable sense. So that uncertainty is always difficult.

In the equity space, determining if orders are manipulative in a real-time fashion is not trivial.

> "The financial crisis of 2008 set the wheels in motion for a sea change in regulation in both Europe and the US. However, the implementation of these regulations has proven to be a lot more complicated and time-consuming than I think legislators and regulators thought. As a result, we find ourselves in a period of waiting to see where the regulations will end up and how they will ultimately impact market participants."
> **Lee Cutrone, Omgeo**

Q From a technology perspective, how well-prepared is your firm to meet these various regulatory demands? What are the specific technology challenges that you believe to be the most difficult to satisfactorily address?

Keith Slattery, senior vice president, State Street's Global Services' fund administration group: We feel very prepared to meet the demands of regulatory changes. We view these changes as a way to add value to our customers and to differentiate ourselves in the marketplace. We have teams of technical and regulatory experts who are continuously monitoring regulatory changes and industry events to identify what will be impactful to State Street and State Street's clients globally.

Stephen Anikewich, head of US compliance, NICE Actimize: Firms are encountering significant technological and infrastructure challenges in meeting the new and evolving regulatory requirements. Specific challenges include upgrading, enhancing and integrating the front, middle and back-end systems to capture and report the new data points and activities covered, including, but not limited to, the new and evolving regulatory framework driven by Dodd–Frank for swaps and over-the-counter (OTC) derivatives, conflicts of interest manual, the expanded Financial Industry Regulatory Authority (Finra) Rule 2090 and 2111, know-your-customer (KYC) and client suitability obligations, and conformance with the expected adoption of the Volcker Rule.

Other issues faced by firms include the implementation of new surveillance systems that provide the necessary pattern-based detection, sophisticated algorithms, case management and on-demand querying capabilities, in order to meet the new requirements and implement a risk-based approach. "Eyes-on" manual processes continue to survive, regrettably, as a component of some organizations' supervisory and compliance risk management practices.

Firms will be hard-pressed to rationalize and argue the efficacy of those manual processes—particularly when their feet are being held to the fire by the regulators. They will need to embrace an alliance with technology to replace, enhance and update their existing compliance risk management controls. Manual processes will need to be quickly abandoned, and first-generation automated systems and reports will need to be replaced by the current generation of technology platforms that have, as their core components, sophisticated analytical rules-based risk controls; ad-hoc query tools with drill-in capabilities—e.g., transactions, positions, risk exposure, market data, and so on—enterprise case management; critical data information; and visualization capabilities, which, in the aggregate, will facilitate the all-too-often daunting challenge of connecting the dots for an holistic view.

The continued adoption of new rules, and the proliferation of regulatory initiatives—e.g., Dodd–Frank—in the areas of swaps and OTC derivatives, suitability, the recommendation of complex products, conflicts of interest, uniform fiduciary standards, high-frequency trading, and of course, the Volcker Rule, present formidable compliance risk management challenges to the financial industry.

To put matters into perspective regarding the tsunami of evolving regulations, only 27 percent of the rule-making requirements of Dodd–Frank have been adopted as of June 2012. These considerations, along with the exponential growth the markets have witnessed in the volume of data and the migration to real-time surveillance, strongly argue for the continued development of technological controls via internal resources and third-party vendor capabilities.

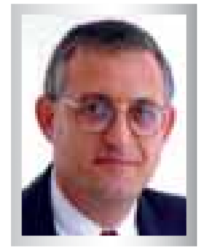
Gertel: In order to comply with the regulatory, compliance and reporting requirements, firms must be prepared to invest in both their IT systems and third-party data suppliers to ensure that they are receiving all the mandatory data attributes they require.

Based on my knowledge, firms are already working on the technology solutions. The main remaining challenge appears to be the understanding of the regulations based on their complexity, data quality, changes in the firms organizational processes, and the reporting processes.

> "The international regulatory standards and frameworks—Basel III, OECD, FATF—are looking to 'close' all these regulatory arbitrages. Together with the international bilateral agreements between jurisdictions, the world is moving toward harmonization in the regulatory environment. Jurisdictions that do not comply with the international regulatory standards might face various restrictions and even sanctions."
> **Jacob Gertel, SIX Financial Information**

Cutrone: I don't think we are as prepared in operations departments as we need to be, especially in the middle office, or the part of the trade lifecycle between trade execution and settlement. Someone once used the analogy that the front office is like riding on the Autobahn and then you come to post-trade processing, or the middle office, and you hit a dirt road. This isn't necessarily surprising as, historically, most IT investments have been focused on the trading areas of the business.

But a lot of the regulation that we are seeing today is calling for increased efficiency, greater transparency and better reporting, including full audit trails, especially around derivatives transactions. The only way to meet these expectations is by having a robust, automated infrastructure. I believe that regulation will ultimately drive a more equal allocation of IT spending beyond the front office and into the middle and back office, where automated processes, greater reporting, and improved transparency is urgently needed. This is where I think firms will need to focus.



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Q Are the regulations specific enough to allow market participants to plan ahead from a technology and operational perspective, or does complying with such a wide variety of regulations mean that you're constantly in reactionary mode?

Gertel: I believe that many firms are finding it difficult to allocate the correct level of resource due to a number of factors. The variety and sometimes lack of information are the primary issues, but the complexity of the regulations may also impact delivery schedules so firms must ensure they have a level of contingency built into their project plans so that they don't find themselves in reactionary mode.

Ross: There is time to react in the equity space. Most significant changes are rolled out on a pilot basis before full implementation. This may not be the issue in the banking space as folks comply with Dodd–Frank.

Slattery: We fully understand that these new regulations get debated and challenged—even legally challenged—and ultimately modified before final implementation, so we plan ahead accordingly. We build our systems with enough flexibility to be able to adjust to whatever the final requirements are. For example, there are proposed Commodity Futures Trading Commission (CFTC) rule changes that will impact the mutual fund landscape. We know what those requirements are—they impact a few areas of our clients' business, but are mainly compliance requirements and financial reporting requirements. We also know that those rule changes are being challenged in the legal system by both the Investment Company Institute (ICI) and the US Chamber of Commerce. So we are planning for those changes as if they will become effective as proposed. We understand that they could change or perhaps even go away entirely. We're working with our clients to update them on the status of those requirements and what we're doing to be ready to meet them.

Anikewich: Firms are already challenged by recent vintage regulatory requirements—as an example, Finra 2090 and 2111, KYC, and suitability requirements. Exacerbating this, they will be even more

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challenged by the anticipated, but yet defined, risk controls that will be indispensable to a credible and effective compliance risk management framework in various areas, in particular, the Volcker Rule and the changes in the organization's model that will be compelled by the promulgation of a uniform fiduciary standard.

Cutrone: The fact is that we are still waiting for regulation to be finalized and implemented. For the majority of Dodd–Frank, the Volker Rule, EMIR and others, we are still in a bit of a holding pattern. However, as I mentioned earlier, there are other pieces of regulation that are gaining speed including the global LEI initiative and the move to T+2 in Europe. I believe firms are starting to assess how these initiatives will impact them. They are asking whether they have systems to be able to handle the new data maintenance and management requirements of the LEI initiative. At the same time they are looking to ensure their trading processes are as efficient as possible to meet accelerated settlement timelines—from the front office straight through to the back office.

Ultimately, regulation may drive IT investments in these areas. However, I don't think firms need to wait. There are absolute gaps in trade-processing capabilities today, and firms can make changes that will have an immediate, positive impact on their risk management capabilities. Investing in improvements now enables firms to enhance their risk management capabilities today, while positioning them to meet future regulations.

> "Firms are encountering significant technological and infrastructure challenges in meeting the new and evolving regulatory requirements. Specific challenges include upgrading, enhancing and integrating the front, middle and back-end systems to capture and report the new data points and activities covered."
> **Stephen Anikewich, NICE Actimize**

Q What are the greatest challenges for banks when it comes to complying with the Volcker Rule? Do you see a scenario where banks will spin off their proprietary trading businesses to comply with the new July 2014 deadline?

Anikewich: The Federal Reserve recently announced a two-year conformance period relating to the Volcker Rule, effective July 21, 2012—i.e., during the "conformance period" organizations will need to conform their activities and business models, investments, relationships and transactions into conformance with the Volcker Rule. Firms that are impacted by the proposed rule have already undertaken to scale back, and in certain instances, eliminate their proprietary risk activities, and will continue to do so during the conformance period. The challenges during this conformance period are most easily evident in the monitoring requirements and pre-trade and execution controls that the organization will need in order to arrest proprietary trading; in identifying and obtaining the data for quantitative metrics reporting; and for incorporating, at a minimum, the prescribed quantitative metrics into the organization's internal risk systems. Also necessary is a post-trade supervisory and compliance surveillance workflow process that will be effective in identifying "risk" trading activities; escalating exceptions involving prohibited activities; supporting the analysis and reporting of quantitative and other metrics; and demonstrating compliance to their Volcker Rule regulator.

Gertel: The greatest challenge of sell-side firms in my opinion is to put in place controls and reporting solutions ensuring compliance with the regulation. Furthermore, the companies will have to re-review and amend their business strategies accordingly.

Ross: If the banks have to do that to keep functioning as banks, I don't think they have any choice; it would make sense. But again, the definitions of those parts are still vague. It's going to be extremely difficult to unwind that ball of string in a way that's not going to be very cumbersome for the marketplace and slow down trading.

Q Can firms use this regulatory overhaul as a source of competitive advantage? In other words, are early movers likely to enjoy an advantage over their competitors?

Slattery: We would say, "Definitely, yes." We think that the firms that are ready to meet the challenges in the changing requirements—the firms that can get out to market with their own product innovations—are the ones that will maintain their market position or enhance it in the process.

Here's another quick example: State Street has spent a lot of time recently in the derivatives area. It has a comprehensive end-to-end derivatives solution that has been created largely out of regulatory reform over the last several years. That solution includes everything from execution and clearing capabilities; daily servicing, accounting and reporting for derivatives positions; collateral management; and exposure monitoring. Those are things that have become common in the vernacular of mutual fund clients that wouldn't have been even five or 10 years ago.

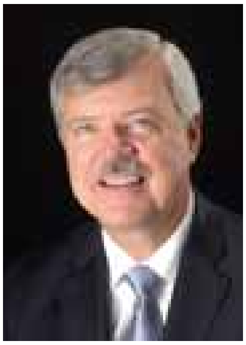
Cutrone: At the end of the day, regulation is going to force firms to become more automated and more efficient. Automation is really the only way to meet the calls for greater transparency across the trade process, accelerate the trade lifecycle and

improve reporting. This is a fact. There is always a question of when to move, the whole risk and reward dichotomy—the question of whether to be a first mover or a laggard. Do firms want to be on the cusp of change and make the necessary IT investments today, or wait? By acting more assertively, I believe first movers will absolutely gain a competitive advantage as they improve efficiency within their firm and improve their overall risk profile.

Underlying investors are not only calling for returns, but they want to ensure they are working with firms with sound operational infrastructures. Moving now can improve a firms' competitiveness while better meeting investor expectations.

Anikewich: We would hesitate to say that compliance provides a "competitive advantage," although there are reputational risks to non-compliance, an important fact to recognize. That said, early movers could perhaps recognize some business advantages. For example, having the right risk controls in place and early conformance with the new regulations, could allow a firm to more easily add new products and activities to its business portfolio with a clear understanding of the risk exposure involved, and offer the ability to mitigate this risk through the benefits of full monitoring and surveillance capabilities, which could detect any ill effects on clients or the business. Competitors who haven't been as proactive may need to limit their business activities or avoid extending them, until they can conform to the new requirements. While difficult, if not impossible, to quantify, reputational risk should not be underestimated from the perspective of approved counterparties, particularly when the buy-side customer owes a fiduciary obligation to its clients and/or investors.

Ross: Yes, anything that can facilitate the customer's needs and make their life easier will be a competitive advantage. At PDQ, we have an extensive routing facility that we use for our clients and there are some nuances in that with regard to the regulations in terms of reporting the trades, printing them, risk reports, and drop copies. We just decided to integrate that into our system so that we handle those things for our clients because we're trying to be a one-stop solution for their trading needs. I think that this has helped us to generate more business and keep our customers happy and sticky.


Keith Ross
PDQ ATS

Gertel: I believe that companies will be able to use the regulatory overhaul as a competitive advantage—especially companies who are in a position to offer global and/or tailor-made solutions to regulatory burdens.

The key point to note is that firms must start the implementation process as early as possible to ensure that they are not left behind.

Q What is the likelihood of a regulatory arbitrage scenario emerging where certain regions attract market participants due to their relatively relaxed approach to compliance and regulations?

Ross: I'm hoping that the regulators are smart enough to see that since people are already talking about regulatory arbitrage as an outcome that they're not going to be fooled by it. And if there is a shift and there's a cause-and-effect result, I'd be surprised if the rules weren't changed rather quickly, or maybe first they'll try it on a pilot program to see if the desired effect failed miserably.

Slattery: We think there is a risk of regulatory arbitrage for market participants to become established in different jurisdictions. We strongly support reaching a global consensus on key regulatory changes to ensure as much consistency as possible. On certain issues like derivatives clearing, we see a reasonably strong global consensus emerging, but on others, there's a little bit less buy-in globally—for example with the Volcker Rule. The Volcker Rule only applies to US banks and will create a competitive disadvantage for US firms, as opposed to the multinational firms. We also see the potential for regulatory arbitrage between more and less regulated sectors within jurisdictions. So there could be growth in peer-to-peer lending versus bank loans. We could see hedge funds and other market participants emerge as alternatives to bank swap dealers. Those are forces in the marketplace today that maybe couldn't have been foreseen only a short time ago.


Kevin Slattery
State Street

Gertel: I believe that the international regulatory standards and frameworks—i.e., Basel III, Organisation for Economic Co-operation and Development (OECD), Financial Action Task Force (FATF)—are looking to "close" all these regulatory arbitrages. Together with the international bilateral agreements between jurisdictions, the world is moving toward harmonization in the regulatory environment. Jurisdictions that do not comply with the international regulatory standards might face various restrictions and even sanctions.

Cutrone: I think regulatory arbitrage is an absolute concern for our clients. We live in an interconnected world and most of our clients are global in nature. Regulatory initiatives that are regionally focused could pose problems for those markets, where clients could possibly look to do business in other markets to avoid the local regulation. One example of this could be the proposed Financial Transaction Tax now in discussions in Europe. While the extraterritoriality of some of the pending regulations might offset arbitrage to some extent, it doesn't completely protect against the risk. The best way to move forward is to ensure all parties are at the table as regulation is being written and implemented—regulators, legislators and market participants alike.

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