

Client on-boarding, with a White House perspective

Mar 17 2015 Julie DiMauro, Compliance Complete

Many financial services firms are beginning to broaden the scope of their client on-boarding functions, using modern tools to move beyond the checklist of prior years. These enhancements involve implementing or upgrading processes such as account maintenance and data management.



As they upgrade, firms can take a tip from former White House official Doug Graham, who served as President Barack Obama's vetting advisor for presidential personnel.

"Risk is not static. Our vetting procedures at the White House needed to react to a myriad of changes in the political environment, like elections and even scandals. Similarly, trends and events will affect the risk associated with particular customers or groups of customers in the financial services sector and sophisticated risk evaluation has to adjust," said Graham, who is now Managing Director at Investigative Group International.

Vetting the U.S. president's cabinet nominees involve significant due diligence responsibilities. Missing a step here can lead to potential threats of national security on the far end and reputational damage on the other – which is true of financial services firms as well. Compliance should be a key part of the client on-boarding function, working with a dedicated team to collect and analyze all of the data and Know Your Customer (KYC) documentation on customers not only required by U.S. and state regulators, but needed to make their businesses safer and thereby more reputable.

Graham noted that just as the White House wants its cabinet-level nominees to succeed, financial firms are looking for long-term, profitable and headache-free relationships with customers.

"While the on-boarding process can seem adversarial, we find that a focused, professionally conducted vetting of new clients will set the stage for a long-term relationship built on trust while ensuring regulatory compliance," he said.

The process is required by regulations and is necessary to the security, profitability and reputation of firms, but, as Graham mentioned, it also sets the stage for the firm-client relationship.

On-boarding procedures and best practices

A regulatory focus is integral to the client on-boarding process in most financial institutions, driven by rules on KYC and client classification (which is incorporated into newer regulations such as the EU's Markets in Financial Instruments Directive (MiFID II), the U.S. Dodd-Frank Act, and the U.S. Foreign Account Tax Compliance Act (FATCA)) and it should

be a major part of the processes.

Also important, is having accurate client profiles, since protecting the institution from changing client risk exposures also helps to ensure the company's overall risk profile remains accurate.

FINRA Rule 2111 – the client suitability rule -- essentially mandates that broker-dealer firms to obtain and maintain a large amount of information on their clients.

Client suitability comes down to ensuring that the financial products being sold to and on behalf of clients match a client's risk profile and are understood by them. Financial institutions will need to perform the necessary client due diligence that will enable it to match the client to the investment advice and portfolio management services and products that will be offered.

Here, firms should carefully consider what information they need about the client and how to collect it, verify it and use it in making recommendations or executing orders.

Many firms are having supervisors make unscheduled phone calls to new customers to verify suitability information on a new account form, even if an adviser has done so, to validate the client information on record, said Deirdre Patten, CEO and founder of Patten Training & Review LLC.

The suitability review does not stop at initial on-boarding.

"Firms are increasing their diligence by re-interviewing existing clients more frequently than every three years and whenever a new representative is assigned to an account to make sure suitability is consistent with account documentation," she said.

Supervisors will be more involved because of new supervisory rules enacted in December, Patten said. Those rules place more emphasis and scrutiny on supervisory systems, written supervisory procedures, branch-office inspections, testing and other related requirements.

People and tools

The on-boarding review often begins with a tool provided by a vendor – a sleuthing device dedicated to combing through the Office of Foreign Assets Control (OFAC) list of individuals, entities and regions subject to U.S. sanctions as well as an examination of federal and state public criminal records.

These tools vary in price and breadth of searching, so firms with a less robust tool must remember to also do Google searches to call up any news items that could mention the prospective client.

"The on-boarding tools that perform these background checks must be supplemented with human effort and not relied on solely," said Patten. "You can use the system as a base from which to also do your own searches of corporate filings, if it's an institutional client, and get credit reports of individuals. This has to be driven by the firm's trained staff, and the systems they use must be tested at least annually."

Not only should firms not rely too heavily on technology, it is in the financial industry's best interest to advise clients of the regulatory requirements the firm is satisfying in performing the on-boarding process.

"On-boarding disclosure statements could address both on-boarding issues and other issues, such as conflicts of interest disclosures, that should be assessed early," said Dan LeGaye, Esq., of LeGaye Law Firm, PC in The Woodlands, Texas.

LeGaye noted how each new regulation requires time to find and deploy technology-based and manual solutions.

For example, to backstop the new FATCA requirements for off-shore clients regarding beneficial ownership that went into effect January 1, 2015, the Financial Crimes Enforcement Network (FinCEN) is proposing new rules to clarify and strengthen customer due diligence requirements.

"The proposal explains that firms should "verify the identity of beneficial owners of the natural persons who own or control legal entities, understand the nature and purpose of customer relationships, and conduct ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions," LeGaye said.

In addition to creating a program to address the rule, the technology solution to the monitoring requirement will require the aggregation of a substantial database – which takes time and money, LeGaye said.

"As a result, firms will be forced to roll out manual solutions in the short run, and they will be judged in hindsight by the regulators as to whether they adequately addressed the regulatory concerns," he said.

Round-up of action items

The ideal client on-boarding solution will ensure consistent compliance with all and evolving regulations – without causing a large amount of frustration with the process. This can happen with a well-designed program that:

- Is updated to address new and emerging obligations, based on a thorough review of regulatory enactments, proposals and guidance. In addition, a process should be put in place to require and organize the evidence collected regarding each customer renewed on a regular basis.
- Is consistent across the organization, with a dedicated client on-boarding team performing the process and the compliance department overseeing its work. In a small firm, the entire process could be outsourced, but the firm should oversee the vendor's work, including vetting the technology the vendor uses and the scope of its

investigative efforts.

- Is subject to the firm's other client controls, so the system cannot approve a person or entity that has been flagged in another area of the business or make an approval before the entire review has been completed, at least without a supervisor's intervention.
- Is auditable such that the on-boarding team can prove and demonstrate that its technology has operated efficiently, has been tested for accuracy and that the right client determinations ensued. In addition, all KYC records for each client must be preserved for at least six years, according to FINRA rules.
- Is prepared to do client due diligence on a client's (even partly owned) subsidiaries, merger or acquisition targets and other related entities.
- Is ready to show with Rule 506(c) offerings that investors in the offering are all accredited investors; and the company has taken reasonable steps to verify this by reviewing documentation, such as W-2s, tax returns, bank and brokerage statements, credit reports and the like.
- Is equipped to train the dedicated staff on the firm's on-boarding procedures, how to spot red flags and how to elevate concerns to a supervisor.

Julie DiMauro is a regulatory intelligence and e-learning expert in the GRC division of Thomson Reuters Accelus. Follow Julie on Twitter @Julie_DiMauro.

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