Compliance at Scale: An Overlooked Enabler for Growth

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At any point along an RIA's growth curve, a culture of compliance offers conviction that translates into speed and foresight.

There is a plateau that confronts every small business, and assuming the organization can get past it, these low-growth, high-peril periods generally re-occur throughout the lifecycle of any growing organization. This is just as true in investment management as it is in a corporate setting.

Growth generally entails expansion into new verticals or service offerings. Organizations require both the bandwidth and skillset to accommodate and process new demands and complexities. At a certain point, one or multiple functions become stretched beyond their capacity or facility, creating bottlenecks that either slow growth or, worse, break the organization—client and employee turnover being the most obvious red flags.

Among RIAs, these bottlenecks tend to be most common in the compliance function. This is also where bottlenecks do not just impede growth but create systemic risks with more acute consequences. But like every other cost center, the compliance role usually takes a backseat to investment operations, distribution or other front-office, client-facing roles. Making matters worse—and it is a dangerous misconception—it does not help that compliance is often viewed as an inhibitor that poses obstacles for new initiatives. This false impression, ironically, stems from the fact many compliance departments are under-resourced and under-appreciated until the lack of attention does indeed become a growth governor.

There is an answer, it is just that most business leaders do not recognize how a culture of compliance, supported through outsourced specialists, enhances scalability until they have reached a certain scale. It is an epiphany most arrive at only after multiple false starts and having built out the function piecemeal through plugging compliance (and other) holes only after they have become too glaring to ignore. But those who recognize the extent to which a dynamic and scalable compliance function can streamline product innovation, are able to grow with confidence and absent the regulatory snags that stall or kill new initiatives.

A Solution That Grows with You

To be sure, RIAs are familiar with the value proposition of outsourced solutions. Most, for instance, do not think twice about bringing in third-party legal counsel, accounting resources or even fund administration. When it comes to growth, many will even bring in outsourced marketing and public relations specialists before they consider augmenting the office of the chief compliance officer. They may not realize it, but it is not uncommon that internal compliance teams, if they're new to media outreach, will either undermine these efforts because they're too risk averse or attract unwanted regulatory attention because they don't know where the boundaries lie.

What most organizations fail to realize is that outsourced compliance is typically appropriate at any stage of a RIA's lifecycle. This is partly due to the fact just filling compliance roles can be a challenge in and of itself, as battle-worn professionals are hard to find and can be costly compared to other middle-office professionals.

Mid-size shops, meanwhile, will often hit regulatory roadblocks when their path to growth takes them into new segments or asset classes. It may be a fund manager expanding its investor base from institutional to retail investors or a sub-advisor looking to launch their own fund -- whatever the case, even seasoned compliance professionals are often ill-equipped to understand the nuanced differences across each asset class or sub sector.

With good reason, the very largest fund managers are the best equipped to grow. This is because many have already resolved the growing pains that accompany initial expansion efforts and in developing their "innovation muscle," have paired internal resources with outsourced specialists who bring a dynamic and deep bench. The payoff is that they will also gain requisite agility and deep experience on demand to capitalize on opportunities as they emerge.

It is not without reason that the compliance function tends to be overlooked as a growth enabler. The front office initially has little visibility into the work and responsibilities that can pile on exponentially with even straight-forward firm growth. Consider the organizational demands around Personal Account Monitoring. It is not just about accessing and tracking the financial accounts of employees, but also their spouses, kids, and immediate family members. When a firm has three or four employees, nobody thinks about outsourcing these functions; when two RIAs merge or staff-up to pursue a new strategy—and suddenly five employees become 50—Personal Account Monitoring becomes a full-time role.

Beyond just eliminating capacity constraints, outsourced expertise provides clarity in a vacuum.

According to Morningstar, for instance, the number of sustainable mutual funds and ETFs available to U.S. investors surged by 30% in 2020, while fund flows more than doubled the previous record set in 2019. It is clear fund managers see ESG as an opportunity. What is less clear is how regulators will monitor these products. The SEC emphasized as part of its 2021 examination priorities it will indeed be scrutinizing these areas.

Tech Isn't the Answer; Tech-Enabled Should Be

Increasingly, the conventional wisdom points to software as the answer to all scalability questions. Technology can be a red herring. Inadequately researched and resourced software solutions rarely provide a seamless fit to a given organization's profile, while customized solutions, themselves, create scalability hurdles down the road when upgrades or new software require extensive workarounds. In some cases, software can automate discrete manual tasks; but it will not provide a growing organization with the capacity to change—with the markets, regulators or evolving business demands. Moreover, tech solutions can be costly.

However, technology should be a consideration in assessing the universe of prospective outsourcing partners. Expertise and specialized skillsets are still prerequisites, but vendors should stand out with the appropriate partnership between operations and software to create a technology backbone that can be right sized for today's organization or tomorrow's envisioned enterprise. Investment managers gain the same benefits and efficiencies from automation, albeit without the implementation and maintenance costs and absent the integration risks as the technology stack grows.

At the highest level, the value proposition of tapping outsourced compliance resources comes down to cost-efficiencies and on-demand expertise. But if growth is a priority, decision makers should be preparing now for needs that will emerge when the organization is three times as large or for growth goals that may be five or ten years down the road.

A culture of compliance does not merely give investment managers peace of mind; it facilitates growth with conviction—and this accelerates expansion activities and allows asset managers to easily navigate the latent risks across a regulated landscape.

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