

STRAIGHT THROUGH PROCESSING TECHNOLOGY

What firms need to know to stay ahead of an important industry shift

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Introduction

Alternative investments are a multi-trillion dollar industry. According to financial research firm, Preqin, the alternative assets market is expected to reach \$14 trillion by 2023.¹ But currently, a large portion of alternative investment transactions are processed manually, with paper documents mailed or faxed between sponsors, advisors, and their investor clients. While this is how things have been done for decades, alternative investments have fallen far behind other segments of the overall investment industry. Mutual funds, for example, moved away from the check-and-app process in the 80s.

There are a number of problems posed by these manual processes, including high error rates, a slow and expensive investment process, and security issues—all of which creates an unsatisfying user experience and can deter financial professionals and investors from getting involved in alternatives.

Luckily, emerging technology solutions have arrived to pave the way for an improved alternative investment experience, similar to the current process for mutual funds. These tools overcome many of the problems with manual investment processes and benefit sponsors, advisors, their investors, as well as third-party participants such as transfer agents, fund administrators, and custodians.

Manual Processes Can Result in Poor User Experience

Have you ever arrived at a doctor's appointment, only to sit in the waiting room for 20 minutes filling out paperwork before your appointment can even begin? Wouldn't it be nice if instead of filling in your name and birth date on 5 separate pages, you could just write it once and then it would automatically populate everywhere else that it is needed? Or better yet, what if when you arrived, the office had already pulled the necessary information from your records and you received fully completed paperwork when you walked in that you just had to review and sign?

The same principles apply to investments. When prospective investors decide to make an alternative investment, the documentation process is often overwhelming. Paper-based forms require duplicate information in several different places. Financial professionals investing on their clients' behalf must carefully scan dozens of pages of documents to ensure they accurately entered all the required data and fulfilled every information request. This is made more complicated when entire sections of documents may not apply to certain types of investors, and readers are left to decipher the forms on their own. Not only is this process painful, it also results in a high rate of errors on investor documents.

High Error Rates

On average, **30 to 60 percent**² of documents submitted for investments are considered "not-in-good-order" (NIGO), and the sponsor, broker-dealer, or their transfer agent or custodian must reject the application or follow up to correct or clarify errors. This is a tedious and time-consuming process. Once errors are identified, a client services team member reaches out to the investor to correct the documents, and the prospective investor will then have to print, scan, and re-send the documents to the sponsor or to the broker-dealer.

There are two major problems caused by high rates of NIGO documents: *administrative costs and lack of transparency*.

Administrative Costs

Frequently, these submissions and re-submissions still occur through the mail or delivery service. Because of the extra time and manpower required to correct errors, NIGO documents **can cost a company 3-4 times**³ as much to process as a document that is submitted correctly the first time.

This may not seem like much of a problem if your company is only dealing with a few documents submitted with errors, but if 30 percent of your documents are NIGO, those costs can add up quickly.

In addition to the financial costs, the time it takes to process investor documents manually could be better spent doing other things. Advisors or registered representatives could be spending more time on client-facing activities or developing new client relationships to grow their business. Sponsors could be running their day-to-day operations or identifying new distribution partners. Manual investment processes put unnecessary weight on the sales process for sponsors. Sponsors not only have to convince distribution partners that their investments are worthy of inclusion in client portfolios, but also that the value is worth the time and effort it would take an advisor or representative to submit an investment, when they could much more easily invest in something that is automated.

51% of firms are currently implementing automation technology to transform their operations.⁴

Lack of Transparency

Another reason financial professionals may be hesitant to invest in alternatives is the lack of transparency when it comes to investments in progress. Without a meeting or phone call, an advisor or representative cannot quickly check whether an investor has read, signed, or mailed a subscription document. While that may not be much of an issue for a single investment, if there are several investments across multiple clients, checking on their status could eat up a considerable amount of time, while also disrupting clients.

Manual processes don't just create a poor user experience for financial professionals and investors. They also create a bad experience for the sponsor. When sending out paper documents, it is extremely difficult to see how many subscriptions are in progress and how far along they are.

With an obscured view of the investment pipeline, sponsors may have a difficult time assessing how successfully a raise-in-progress is going.

CASE STUDY: A LEADING DST SPONSOR REAPS THE BENEFITS OF STRAIGHT THROUGH PROCESSING⁵

THE CHALLENGE

An experienced tax-advantaged real estate sponsor uses a paper-based investment process that has an extensive cycle-time—over 3 weeks for investments that are submitted correctly the first time. They reject over 30% of subscriptions into their offerings due to NIGO errors, which they then send back to their affiliated brokers for corrections. This correction process doubles the investment time to 6 weeks and costs the sponsor money, as they cover postage for all mailings of the subscription documents. During the lengthy capital raise, they are spending money on marketing and investor communications while the capital is sitting in escrow unable to generate returns until the raise is complete.

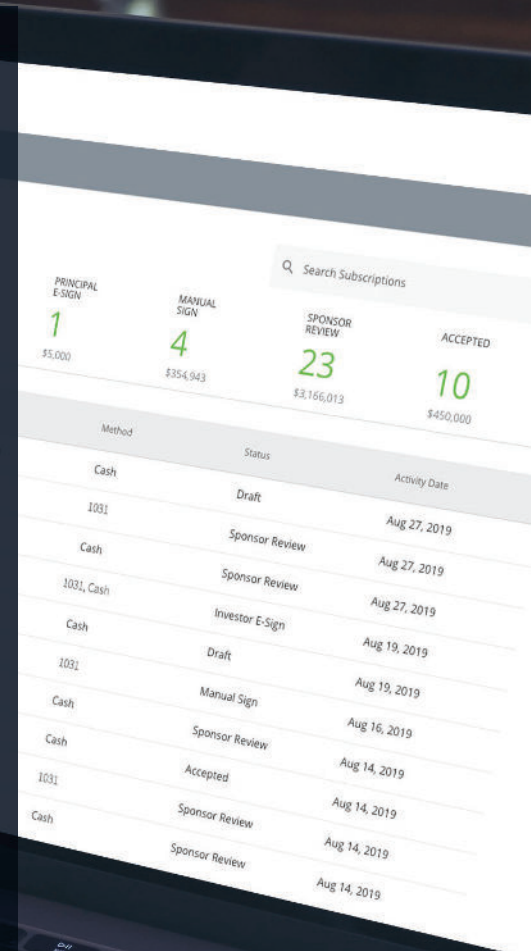
THE SOLUTION

After adopting the Altigo straight through processing platform, the sponsor has been able to reduce their cycle time down to 2 days for digital subscriptions, with one stand-out investment going from the opening of a new purchaser questionnaire to signing and acceptance *in under 40 minutes*. Subscription documents submitted through their platform have a 4% NIGO rate, saving them money on mailings and preventing unnecessary increases in cycle time.

THE RESULT

When comparing an average investment without straight through processing to one using their new technology platform, the sponsor was able to achieve a 90% reduction in cycle time and a 47% reduction in the cost to process an investment. These changes allowed them to speed up their raises and put capital to work more quickly. In addition, their advisors and investors have expressed increased satisfaction with the updated investment process and a desire to use it for other investment products.

⁵This case study is based upon one of our clients and may not be representative of the experience of all customers. It is not a guarantee of performance and they have not been compensated.



Manual Processes Can Result in Poor User Experience

Security

Creating subscription documents involves handling a lot of sensitive information, from social security numbers, to bank account and routing numbers, and more. This information must be handled with the utmost care and security. However, most of these documents are sent between sponsors, advisors or brokers, and investors via mail or fax, both highly unsecure methods.

Information Exposure

When sending documents through the mail, there is always a chance that information will be lost or delivered to the wrong address. With potentially thousands of documents per year being sent, even a 1% misdelivery rate would be unacceptable.

While faxing documents is more direct, it comes with its own host of issues. Unless the recipient is standing at the fax machine when the document comes through, that information may sit out in the open for anyone to see. Many fax machines also store PDF-like copies of incoming faxes, and without the ability to install additional security software, that information is vulnerable.

With both mail and faxing, there is little-to-no visibility into the progress when the documents are out of your hands. There is no way to audit who is looking at or manipulating the documents.

Paper documents also create the problem of multiple copies of the documents floating around in various stages of completeness. This not only increases the chances that the included information will be lost or exposed, but it also makes it harder to keep track of which version is the most recent.

An obvious solution would be to scan documents and send them via email. But standard email is not secure enough to send personally identifiable information. Even with password protections, email accounts are vulnerable to security threats such as data breaches, phishing attempts, and man-in-the-middle attacks.

Storage

Using manual processes, investments can take up to 3 weeks to complete⁶ before signed and executed documents are finally stored for record keeping. The longer a document spends outside of secure storage, the more likely it is to be exposed.

When you do successfully get documents sent back and forth, signed, and executed, you then need to maintain a secure and compliant method of storing these signed documents. The SEC Rule 17a-(4) requires that subscription documents pertaining to investments must be kept on record by a broker-dealer for at least 6 years. FINRA and other regulatory organizations have their own record keeping requirements. Depending on the frequency of your capital raises and the number of investors involved, this could result in the need for a substantial storage solution.

Physical storage solutions pose numerous security problems. Paper files stored in boxes or filing cabinets can be easily accessed and run the risk of being destroyed in a fire, flood, or other natural disaster. There are precautions you can take, such as fire or flood proof storage, but physical storage takes up a significant amount of space, which can be costly and difficult to scale.

Consequences

The loss, destruction, or disclosure of information contained in subscription documents, even if by accident, will lead to consequences for all involved. If you lose or accidentally destroy information, it could result in the investment not being processed or distributions and updates not making their way to investors. On top of unhappy investors, you may also face regulatory penalties since some records are required to be kept for a set period of time.

In the case where an investor's sensitive information is exposed, leaving them vulnerable to identity theft, you may face even more severe consequences. Most states have notification requirements if investor information is compromised. Failure to abide by these requirements may lead to fines. Additionally, you may be required to pay for identity protection for the affected investors, or if their identities are compromised, they may sue.

The Solution: Straight Through Processing

Automating manual processes in investments enables companies to address security concerns, increase transparency, and decrease time-consuming errors.

While NIGO rates often fall within the previously mentioned range of 30 to 60 percent, some industry participants are able to achieve rates as low as 5% or less through the use of straight through processing.⁷ This reduction frees up time and money to be better spent elsewhere, increases the potential throughput of investments, and creates a faster, more efficient investment experience for advisors and brokers.

Straight Through Processing

Straight through processing, which originated in the 1970s for trading public securities through computer networks, is a concept designed to let financial companies automate transaction processing through the use of online workflows.

In the case of an alternative investment offering, straight through processing enables sponsors and advisors to collect investor information, verify their identity, deliver signature-ready subscription documents, and transfer funds. Even back-office compliance, typically a highly manual process, can be partially automated. Each step of the process is designed to be as frictionless as possible, which means a higher throughput of investments, fewer errors, less time spent manually sending documents back and forth, and more time doing the things that really matter, like running the day-to-day business.

By adopting a technology-assisted investment process, sponsors and advisors get the added benefit of greater transparency into their investors' progress. Dashboard features can allow you to see who has opened what emails and how far they are along in the process, enabling companies to better set expectations for how their raise is going.

Using an effective technology-enabled system, a sponsor or financial professional can streamline the process in a legally acceptable manner, provide a more secure and delightful experience for all users, as well as save them time and money.

MARKET TREND

The Opportunity for Technology Disruption in the DST Market⁸

The \$3.5 billion 1031 Exchange DST market is growing quickly, but rife with barriers that may be hindering adoption and holding the market back from even greater potential.

THE CURRENT MANUAL DST INVESTMENT PROCESS



3+

documents mailed for signature



5+

individuals needed to sign



≥30%

NIGO error rate on documents requiring rework



3+

weeks of total time to complete

STRAIGHT THROUGH PROCESSING TECHNOLOGY PROVIDES A BETTER WAY

Technology platforms such as Altigo streamline the investment process creating new opportunity.

- ✕ Allows for attachment of firm documents into a single package and eliminates the need for mail.
- ✕ Provides quick and easy electronic signature options for all signatories.
- ✕ Reduces NIGO error rates to 5% or less, decreasing the amount of required rework.
- ✕ Takes about 1 week to complete an investment from beginning to end.

⁷Based on our internal analysis of clients who use WealthForge technology for the completion of subscription agreements.

4 ESSENTIAL FEATURES OF A STRAIGHT THROUGH PROCESSING TECHNOLOGY SOLUTION

» Information Collection Workflow

Straight through processing technology automatically populates documents, meaning advisors or brokers only need to input their investors' information once, rather than have clients visually scanning documents for blank spaces to fill out. A user-friendly workflow can dynamically adapt the information it requests about investors to gather exactly what is needed for a successful subscription, omitting fields that are irrelevant to that particular investor. Additionally, business rules in the process ensure that the correct type of information is provided in a given field. For example, a rule could ensure that the dollar amount entered corresponds with the number of shares the person wants to purchase or that a mailing address is one recognized by the U.S. Postal Service. This eliminates needless errors that can be expensive and time-consuming to correct, creating a more pleasant experience for both financial professionals and their clients.

» Electronic Signatures

Signing paper subscription documents is rapidly becoming a thing of the past—not just because it takes more time, but because it's a much less investor-friendly process. There are a number of e-signature software providers that map subscription documents for electronic execution and routing. This means that once an advisor or broker fills out the online workflow, that information is digitally transcribed onto the subscription document before being sent via a secure file-share link to the investor's email inbox.

Some securities industry participants are hesitant about the legality of electronically-facilitated transactions. However, The North American Securities Administrators Association (NASAA) has set forth a statement of policy⁸ specifically addressing its suggested requirements to administer securities sales online. The NASAA policy incorporates and supplements federal and uniform acts regarding electronic signatures. While the NASAA policy is not itself binding, states are adopting these standards into their respective securities regulations.⁹ Regulators are accepting that automation is coming and that electronic transactions are allowed if the technology and processes meet basic legal requirements.

The leading electronic signature provider, DocuSign, has bank-grade security features, is certified to work with financial services, and is trusted by some of the largest institutions in the industry. Most subscription automation solutions will have DocuSign or a similar service integrated into their technology offering.¹⁰

» Secure Cloud Storage

Secure file-sharing and data encryption are must-have services when utilizing online means of communication with investors. Cloud-based file sharing software allows users to securely and compliantly store and share sensitive documents. Financial professionals and potential investors can be invited to access files through a secure folder with restricted access.

» API and Integration

If you want to get the most out of your technology solutions, they must be able to integrate with your existing tools, as well as external services and vendors you or your investors utilize. Look for an open architecture platform than can connect with fund administrators, transfer agents, custodians, or other service providers.

The Benefits of Straight Through Processing

Benefits for Investment Firms

By adopting straight through processing for their alternative investments business, investment firms can:

Attract and retain investors and talent

We're in the midst of the largest generational wealth transfer in history.¹¹ Younger generations have grown up in a digital world, and value streamlined user experiences. And millennial investors have higher allocations to alternatives than boomers.¹² By offering the latest in alternative investment processing technology, firms will be able to provide a quick and easy investment experience for their clients, which can differentiate them from firms still using time-consuming, paper-based processes.

And, like investors, young financial professionals are used to technology and take available fintech into account when considering applying to—or leaving—an investment firm.

Save time on administrative tasks

With straight through processing, a digital subscription can be submitted in minutes and investment time can be reduced from 3 weeks on average for a manual process, to a single week or less. The freed up time can be spent on revenue producing activities like client meetings and new business development.

Increase operational efficiency and control

A repeatable process across investment types, digital audit trails for subscription documents, and dashboards that track investments in progress all help provide a way for firms to keep an eye on their alternative investment business, which is significantly more difficult—and risky—with paper-processes. Instead of multiple copies of a subscription document floating around in various stages of completion, straight through processing promises a single source of data for all alternative investments, increasing transparency, visibility, and data security.

Benefits for Sponsors

By adopting straight through processing for their alternative investments transactions, sponsors can:

Attract distribution partners and investors

With the largest generational wealth transfer in history¹³ underway, the way investors want to do business is changing. Similarly, their financial representatives are looking for any reason to choose one sponsor over another, when many of their products have similar appeal. Sponsors who offer a quick and easy investment process make it harder for distribution partners to choose a similar product from a sponsor that still uses paper-based processes.

Achieve Operational Efficiency

With high NIGO error rates, an inability to track investment pipelines, and several sources of physical and digital data, the traditional alternative investment process could hardly be described as efficient. However, straight through processing allows for operational efficiency. Data can be aggregated into a single source, improving data security. Dashboards track investments in progress, allowing for visibility into a sponsor's pipeline. And with low, single-digit NIGO rates, more investments are submitted correctly the first time.

Increase Capital Raising Efficiency

Raising money is expensive, and the longer you spend on the process, the more those costs cut into your raise total. Straight through processing speeds up the process, taking investment time from 3 weeks on average to a single week or less. That means you can complete your raises more quickly, and put that money to use generating returns for your investors.

MARKET TREND: TODAY'S UNCERTAIN ENVIRONMENT CALLS FOR A DIGITAL SOLUTION

In reaction to the recent COVID-19 pandemic, much of America is changing the way they work. Many financial services professionals are turning to remote work. Portfolio management, financial planning, and CRM software were already a part of many financial services practices, and now video conferencing has become a necessity.

However, wealth managers working with high net worth investors that invest in alternative investments may find the transition to work-from-home more difficult than they expected. Many alternative investments still largely rely upon paper documents that must be mailed or faxed between investors and advisors. Unless you have been giving out your home address or have a fax machine in your house, subscribing clients to alternative investments is going to be a hassle without making a trip to the office or having an ill-advised in-person meeting.

Luckily, recent changes to regulation and technology now allow some alternative investments to be accessed and subscribed to digitally. Straight through processing technology creates an opportunity for brokers and advisors to provide their high net worth clients with alternative investments without leaving the comfort and safety of their home. Subscriptions can be input, sent to the client, signed electronically, returned, and approved by the firm's principal, all in a matter of days, without ever needing to schedule a face-to-face meeting or visit the office to pick up a fax or physical mail. Compare that experience to a typical paper process that takes weeks to complete and is nearly impossible to do remotely.

After this pandemic has passed, it's possible that weeks of mandated working from home will change the way many companies choose to operate, with even more remote opportunities available. Remote work can be offered to future employees as an attractive benefit, and having technology that facilitates that work will be essential to remaining competitive in this changed environment.



WHAT MAKES SENSE FOR YOUR BUSINESS?

As more and more of the world turns to digital solutions, alternative investments cannot be left behind. Investors are used to doing their banking, stock trading, and more online, so they have come to expect a certain experience. Placing obstacles in the path to investment, in the form of error prone, unsecure manual processes, will inevitably have negative effects on retention. Firms who adopt technology solutions to automate subscription processing will be ahead of the curve when those services become the new standard.

If you'd like to learn more Altigo, our straight through processing technology platform, please contact us:

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