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"The right change, the right way, with the right people"

RegTech is here: Time to turn Regulatory Compliance into a Competitive Advantage

Key Perspective Takeaways

- **Investment** in RegTech companies has more than **tripled in the last 5 years** and the outlook looks very positive for increased investment and scale.
- Regulatory compliance remains a **key cost** and **challenge** for all financial institutions over the coming years.
- **RegTech** brings new advancements in technology which **can address** key cost / effort areas such as **data management, identity control, transactions monitoring and regulatory monitoring / reporting.**
- The **future acceleration and adoption** of RegTech is dependent on **overcoming** several obstacles such as navigating **regulatory complexity**, enhancing ways to integrate into fragmented legacy infrastructures and carefully managing the will of the workforce.
- Financial Institutions should start considering to **invest now** in a strategic RegTech agenda which places regulatory compliance as a **competitive advantage** rather than purely as cost.
- **421** has built a highly skilled team of industry focused project managers with the ability to **lead complex regulatory change agendas** and who can support you in initiating and leading your regulatory compliance projects

421 was founded based on a core understanding of regulatory compliance, IT and project management and has since grown to build a strong team of highly skilled industry focused change managers. We are **the right people** who can support you in initiating and leading your regulatory compliance projects in **the right way**.

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RegTech is here: Time to turn Regulatory Compliance into a Competitive Advantage

About this article

This article aims to introduce Regulatory Technology (RegTech), highlight the significance of increasing RegTech investments, underline some of the obstacles and provide a point of view on how each of the three key parties; financial institutions, regulatory authorities and RegTech players, can each contribute to re-shape the regulatory compliance ecosystem.

RegTech Background

It has been almost impossible to miss the 'FinTech' (Financial Technology) wave as it continues to digitally transform the financial industry. From payments systems to funding platforms, digital currencies to lending advisors; technological start-ups and partnerships have formed to introduce exciting new technological developments which aim to re-define both the customer and institutional experience. Look no further than Sweden and companies such as Klarna, Tink, iZettle and Trustly are just some of the new players to establish themselves as major financial industry players.

Amidst such dynamic times, financial institutions continue to face significant headwinds primarily in the regulatory compliance space. Between 2008 – 2015, the volumes of regulation publications and announcements increased by 492% . In 2015 alone, one new regulatory alert was made every 12 minutes. In the US, the implementation of Dodd-Frank between 2010 - 2016, generated $36bn in costs and 73m hours in paperwork . Such a demanding environment has significantly impacted the financial institutions trying to keep up. Research from Spanish bank BBVA revealed that financial firms are allocating on average 10-15% of their resources

on compliance, with three of the largest banks in the US spending over $1 billion a year. Smaller financial institutions face even further challenges, whereby just employing a handful of compliance resources can lurch the banks into the red. Herein lies the potential for RegTech which continues to emerge as another major technological opportunity with the potential to re-shape regulatory compliance.

What is RegTech?

RegTech is a technologically driven transformation addressing the major regulatory and compliance pain points being faced by the financial institutions. Manual tasks traditionally related to data management, back office processes and regulatory monitoring, are all significant drivers of cost and effort; each of which are now being challenged by new advancements in areas such as machine learning, algorithms and real time monitoring capabilities.

Whilst investors' focus has primarily been towards FinTech, there is a notable increase in attention on the RegTech space which has evolved especially over the last few years. According to figures by FinTech Global, investments in RegTech companies have more than tripled in the last 5 years. In 2015 a record $678m was invested in 70 companies compared to just £185m in 32 companies during 2012. Supported by favourable regulatory policies from the UK's Financial Conduct Authority, London has established itself as the global hub, followed primarily by North American cities such as New York and San Francisco.

How can one categorise such a dynamic and evolving landscape? There are several ways to group the various companies into core capabilities. Deloitte's evolving RegTech Universe provides a useful breakdown into five key areas below:

As the investments into the RegTech space increases, there is currently a clear concentration of focus towards the Anti-Fraud and Compliance spaces which covered 49,6% and 46,4% of investments respectively during 2016 . One example is Onfido, which focuses on automating Know Your Customer (KYC) / Anti-Money Laundering processes. Given that most bank customers access their accounts via computers / smartphones, the challenge of verifying customer's identities is becoming increasing challenging. Onfido's machine-learning software uses the cameras in the devices to combine facial recognition with captured identity documents. This technology is already being taken up by leading FinTech adopters such as Monzo Bank and JustGiving.

RegTech Area	Description	Key Players
Regulatory Reporting	Enabling automated data handling and regulatory reporting through technologies such as the cloud and data analytics	VIZOR, CAPPITECH, HEXANIKA
Identity Management & Control	Supporting customer procedures such as KYC (Know Your Customer) and Anti-Money Laundering / Fraud monitoring	onfido, Trulioo, Comply Advantage, trunomi
Compliance	Real time monitoring of current and upcoming regulatory regulations	Suade, Behavox, CUBE
Transaction Monitoring	Real time monitoring of transactions, exploring the potential of BlockChain distrusted ledger technology	IdentityMind Global, Skry, ELLIPTIC
Risk Management	Monitor / assess current regulatory risks and anticipate future events	OpenGamma, SYBENETIX, PROVENIR

Fig.1 Overview of RegTech focus areas adapted from Deloitte's RegTech Universe.

Behavox has developed a holistic employee monitoring and risk scoring platform based on big data, machine learning and voice recognition technologies. This offering enables financial institutions to take internal surveillance to a new level using behavioural analysis to ultimately prevent rogue trades. Suade is another leading start-up which has developed a BCBS239 platform keeping banks up to date and in line with the latest regulatory requirements.

All three are excellent examples of how such firms can provide tangible options for financial institutions to reduce regulatory compliance cost and effort through the application of technology.

Outlook

It's certainly difficult to argue against a bright future for RegTech. As many of the RegTech companies are still in an early stage of development, this leaves room for each to mature and ultimately scale up. This provides huge incentives to the investment community, who are slowly turning their focus to the specific business opportunities. Likewise, the banks' need for improved data management, process or solution stability, transparency and cost efficiency will continue to grow, providing the demand for such products and their capabilities. It's easy to reach the conclusion that it's only a matter of time before landmark deals are made, acting as accelerators for wider adoption in the industry. However, whilst there have been undeniable increases in investment over the past 12-18 months, one must also acknowledge several obstacles that lay in the path for broader adoption. Some key topics are outlined below:

> Regulatory Complexity

As the regulatory agenda continues to intensify, so does the complexity of geographical differentiations, in effect meaning there can be no one-size fits all approach at this stage. This limits the initial scalability of the solutions and generates the need for multiple RegTech providers to address the vast regulatory agenda. Furthermore, regulatory body collaboration needs to be accelerated both internally and towards the institutions. This can facilitate more widespread approvals of the new technologies meeting compliance requirements and ensure that the supervisors can handle the interfaces both from an IT and knowledge perspective.

> Fragmented Legacy Infrastructures

Many large financial institutions are already faced with deeply fragmented legacy systems, built up of data silos which have become entrenched in both business and IT behaviour. Simply integrating new RegTech providers into the solutions can be treacherous and potentially compound an already fragmented IT infrastructure landscape. Such a scenario could proliferate vendor administration efforts and potentially increase operational and compliance risk.

> Will of the Workforce

The emergence of RegTech must also be understood through the human lens. Many of the RegTech solutions aim to replace manual back office activities which are currently performed by large compliance units. If not handled carefully, job loss can lead to friction and unhappiness in the workforce, ultimately forcing the hands of management to stick with the status-quo. Moreover, for those that keep their jobs, many will need to take new trainings to understand the latest technologies and potential new ways of working. Undertaking such a significant adoption could generate workforce disruption and possibly lead to a rejection of the new tools.

However, such factors should not be allowed to prevent RegTech's arrival and widespread acceptance. At the heart lies a more fundamental element of how financial institutions view their own regulatory compliance units. 421 firmly believes that now is the time for the industry to look beyond seeing such units as simply high cost pain points and instead position and value their division as an opportunity to gain competitive advantage, with the adoption of RegTech as a central element.

421's Perspective

On paper the emergence of RegTech may sound revolutionary and a straight forward decision to take, but introducing such new platforms and ways of working into the existing landscape is a daunting task. However, with clear governance, strategy and a risk based approach, such obstacles should ultimately be recognized as opportunities for fundamental three-way regulatory enhancement, whereby the financial institutions and regulatory bodies are each intrinsically connected through the new RegTech providers.

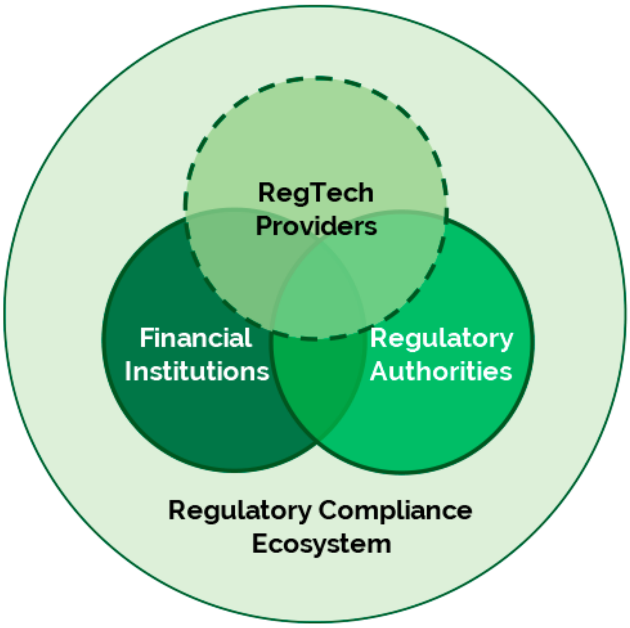

Fig.2 Three-way RegTech collaboration within a regulatory compliance ecosystem.

> Financial Institutions

One key focus area for institutions is to empower their regulatory compliance units to establish a strategic RegTech agenda which brings management on board as quickly as possible and sustains their backing. To achieve this, compliance leaders should initiate a holistic assessment of their existing regulatory landscape, which facilitates a more accurate prioritization of which areas are indeed viable RegTech opportunities, measured against their relative implementation risk. This will also ensure that the initial RegTech pre-studies and projects are planned and executed for the most critical areas, by delivering business value and ROI benefits as early as possible.

Behind such agendas there should be a focus on short term cost vs. long term benefit which is measured not only in monetary terms, but which places the human element at the heart of any RegTech transformation. This can be on two fronts. Firstly, RegTech should be positioned as a way to provide more opportunities to employees and improve job satisfaction rather than as a job threat. For example, the potential replacement of back-office tasks should be envisaged as an opportunity for employees to focus on more business and customer value generating activities which are more rewarding for all parties. Secondly, the customer satisfaction could be measured both from seeing the value-add benefits of employees having more time to focus on their needs and also by increasing their trust in the institutions' ability to handle risk, most notably by investments made in areas such as Anti-Fraud.

Another dimension to the strategy should be how to address the adoption of RegTech towards highly complex and fragmented legacy IT landscapes wherein data is typically managed in silos. Such a fundamental change should not be driven by RegTech alone, but rather in collaboration with other IT simplification programmes with the common goal to break data silos and enable a more standardised regulatory process. Such projects should ideally be initiated through specific pilots whereby change momentum can carefully and gradually be built up over time. RegTech should be placed at the heart of this approach, to be used as a key business case driver to initiate regulatory process change and re-ignite potentially stalled discussions surrounding IT infrastructure investment.

> Regulatory Authorities

On the other side, the regulatory authorities have a critical role to play. One of the key limitations to increasing the adoption and scalability of RegTech is the myriad of regulations which continue to be released, often with complicating geographical deviations. Increased support and collaboration from regulators by standardising definitions and models to create a clearer output based model, could help the institutions to improve standardization of their data handling, processes and understanding of requirements. This can also give more opportunity for the RegTech companies to collaborate and align their platforms, in turn making their offerings more attractive for broader adoption. Another important area is to increase the collaboration with the institutions and RegTech providers to generate an innovative environment which encourages further investment, new offerings and regulatory approval to accept and handle the new technologies. The UK Financial Conduct Authority's decision to create a regulatory sandbox in 2015 has been largely welcomed and has contributed to the rise of London as a RegTech hub. Other authorities should follow their lead.

> RegTech Providers

Finally, the RegTech companies themselves are now riding the cusp of huge potential which will likely need a range of landmark deals with key institutions to further accelerate their adoption and growth. Whilst there are a vast array of exciting companies providing tailored solutions, such companies should actively consider the option to partner or even merge with other RegTech companies to combine a variety of offerings in one platform, thus contributing to a more uniform IT landscape. Another angle is that such companies could also quickly become acquisition targets for the institutions themselves to bolster their in-house capabilities and gain competitive advantage.

Underpinning each area is the need to liaise closely with legal and policy departments and other support functions to ensure that new partnerships and ways of working are accountable to the law and correctly communicated to all stakeholders, especially when new boundaries may need to be drawn.

With such an intense regulatory agenda now and on the horizon, regulatory compliance will remain a major topic on the tables of all financial institutions for years to come. As RegTech continues to emerge and increase its presence on regulatory compliance agendas, now is the time to see the broader opportunity for widespread collaboration and standardization in the regulatory compliance ecosystem, spurred on by the new technology providers. Despite the array of obstacles, by following in the footsteps of many of the more established FinTech players, there are huge possibilities to embrace the technologies on all sides and transform the regulatory compliance space. Whilst many RegTech offerings are still in their initial stages, their businesses are quickly evolving and growing with speed and confidence and it's surely only a matter of time before one landmark deal leads to wave of agreements. Now is the time for financial institutions to start assessing opportunity areas and set a strategic RegTech agenda which focuses on delivering value as early as possible and which positions technological investments in regulatory compliance as a competitive advantage.

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