RegTech

Clearing A Path Through The Regulatory Maze

Whilst the financial crisis of 2008-09 resulted in a number of immediate corporate casualties, such as Lehman Brothers and Northern Rock, it was the ensuing and sustained pain caused to global economies that prompted widespread structural reviews and investigations by governments and industry regulators.

With many countries having adopted a free market approach, and driven by low inflation and continued growth prospects, the financial services industry had enjoyed almost two decades of unprecedented growth and profitability. It had truly embraced globalisation with a succession of mega-deals as the largest brands aspired and fought to become the biggest operators.

The subsequent collapse happened at pace - and became almost pandemic - as liquidity in the global markets ceased, and the resulting market reactions caused widespread panic among investors, regulators and governments.

Subsequent reviews highlighted that, although regulations had been in place in the years leading up to the crisis, regulators had largely adopted a light-touch approach for fear of stifling competition. Following the crisis a series of fines and settlements has highlighted the extent of corporate and operational wrongdoing within the industry; as well as enforcement actions, governments and regulators have responded with extensive programmes of reforms and fresh further regulations.

In a World of Rules

The systemic breakdown of global markets led governments to believe that the financial services industry required much tighter controls – legislation followed that would have significant impact on finance operations and the personnel employed to run them. In the USA Dodd-Frank[1] came into being in 2010 and provided a complete overhaul of how US financial institutions were supervised – new independent agencies were created, as well as rules and regulations governing the banking system. Some 6 years later it has been responsible for generating over 22,000 pages of rules, regulations and requirements.

In the UK the 2012 Financial Services Act was responsible for the formation of the Prudential Regulation Authority (PRA), to supervise the soundness of financial institutions, together with the Financial Conduct Authority (FCA) that regulates the conduct of financial institutions and its employees.

[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act

Such closer and exacting regulation has resulted in institutions dedicating significant amounts of resource and budget in order to achieve regulatory compliance – and whilst that might be regarded as the price for doing business, the punishment for non-compliance has been hefty. For instance, JP Morgan has paid over $40bn in fines and settlements since 2008 and has reached a compliance headcount of 43,000 in 2015 compared with 23,000 in 2011[2]. Such a response in the search for compliance has been common throughout the industry and has resulted in a dramatic cost impact.

Now, 8 years after the global crisis, some analysts had expected to see a plateau in fresh regulatory demands; however, compliance professionals have remained sceptical. In its latest compliance report Thomson Reuters[3] highlight that, in a survey of global finance compliance officers, 69% of respondents predicted increased requirements and information from regulators, and 26% predicted significantly more.

However, there also appears to be a degree of regulator empathy evident; the UK's FCA conceded that the raft of additional compliance and reporting requirements was also causing operational challenges to the regulator, as it was having to supervise the new requirements and the associated reporting outputs. The FCA has expressed a desire to promote effective compliance whilst also attempting to reduce the cost of regulation for both institution and regulator.

RegTech Arrives

Following the launch of its Project Innovate in October 2014[4], the FCA issued a 'Call for Input' on how regulation technology (RegTech) could help reduce the compliance burden for all involved parties. The FCA has defined RegTech as the application of 'new technologies to facilitate the delivery of regulatory requirements'.

In practical terms RegTech seeks to make sense of the large amounts of eclectic data that is generated within an institution's systems, configuring and generating timely reports using selected data, as well as applying analytics in order to optimise information.

Historically, financial institutions have operated through delivery channel and product related silos, with individual systems often disconnected and unable to communicate adequately. So, whilst data from such systems has always been available, the challenge has been to effectively interrogate the dats. Increasingly new technologies and approaches are being developed to overcome the legacy issues and challenges – and it is this aspect that the FCA has been keen to embrace.

Following its Call for Input the FCA issued a feedback statement[5] in July 2016 and highlighted the types of RegTech that could benefit the industry:

1. Technology allowing more efficient ways of sharing information

[2] Bloomberg Markets – The Rise of the Compliance Guru – June 2015
[3] Thomson Reuters – Cost of Compliance 2016
[4] FCA Project Innovate - https://www.fca.org.uk/firms/project-innovate-innovation-hub
[5] FCA – FS16/4 Feedback Statement on Call for input on supporting the development and adopters of RegTech

2. Technology that drives efficiency by closing gaps between intention and interpretation
3. Technology that simplifies data, allows better decisions and the creation of adaptive automation
4. Technology that allows regulation and compliance to be looked at differently

The same feedback also articulated a range of existing and future regulations where RegTech might provide effective coverage.

Given that the regulator appeared to be highly receptive to the potential benefits offered by RegTech it would seem likely that institutions could also take advantage of such technology developments. At a leading Compliance and Risk summit[6], attended by over 800 financial services professionals, more than half (52%) recognised the need to introduce some FinTech/RegTech solutions within their organisation, while 26% had already budgeted to do so within the following 12 months. Attendees confirmed a desire to adopt a more data-centric approach to compliance rather than simply expanding the team to undertake additional work.

However, institutions have made huge investments in legacy IT estates and are still willing to support their older systems – for instance Deloitte[7] estimated that, of the €55bn spent by European banks on IT in 2014, only €9bn was spent on new systems – the balance being used on incremental upgrades to legacy systems.

A further Deloitte report[8] suggests that RegTech innovations can help institutions satisfy both regulatory and competition requirements in a cost-effective way – highlighting that agile solutions can be deployed on legacy systems to improve compliance reporting as well as providing more monitoring controls. Further investment in analytics technology will enable managers to proactively identify potential issues and be prompted to take remedial action.

Data and information are at the heart of regulation – and regulators now demand transparency in all areas of the operation. Therefore, institutions need to provide evidence that key activities have occurred within a process or transaction, that specified standards have been reached and that the systems have performed correctly. Monitoring and controlling performance are now critical management functions and are increasingly required within the compliance framework.

Cost effective RegTech solutions will leverage the various data outputs from legacy systems into agile developments that will efficiently produce relevant and timely data and information for managers and regulators. It does though require the RegTech supplier to understand the industry domain and to work with an institution's key people to accurately define the regulatory objectives and targets.

[6] Thomson Reuters – 2016 Compliance & Risk Summit London
[7] Deloitte – RegTech is the new FinTech – 2015
[8] Deloitte – Top 10 for 2016 – Our outlook for financial markets regulation

RegTech – A Working Model

Whilst regulations might be wide reaching in nature, they tend to be focused around how, why or when 'something' was done – whether it was the provision of advice, a payment being made, the on-boarding of a new client – these are all examples of processes that follow a specific set of operational instructions or rules. From a regulatory perspective such processes would normally have to be undertaken within a specified time period, within specified limits, or upon receipt of specified data inputs etc.; it is for the institution to demonstrate or provide evidence that compliance has been achieved.

Alpha Insight helps institutions achieve compliance by working with them to identify the important steps within a business flow – where and when key activities should take place; the most important steps are referred to as Service Level Targets (SLTs). If SLTs are not achieved then it is probable that the specified business flow will be non-compliant.

To help institutions achieve SLTs parameters are set (monitoring points) that enable ongoing monitoring of the flow. The business flow is mapped with its monitoring points and SLTs highlighted, and with visualisation provided via real-time dashboards featuring a traffic light status with built-in management alerts.

In addition to real-time monitoring, performance reports are generated and target performance history is captured in a central repository, thus providing an essential audit trail. Such features provide management and control capability within the regulatory framework.

Most financial institutions are already utilising monitoring systems within the IT estate or have deployed 'big data' software; Alpha Insight works with such applications and can leverage their existing capabilities to produce specific and relevant monitoring of regulatory reporting activities. The cost benefit in these situations is significant as the Alpha Insight approach acts as a genuine and cost-effective bridge between the legacy infrastructure and an enhanced regulatory position.

RegTech – Go with The Flow

Alpha Insight has deployed its tried and tested approach across more than 100 business flows within the financial services industry, in a wide variety of areas. From SEPA and High-value payments in retail banking, Clearing Trades and Treasury in investment banking – where regulators need to see evidence that deadlines are being met – through to more pure regulatory plays such as AML, BCBS and MiFID.

Complementing the technology side of RegTech, the Alpha Insight team has deep domain knowledge and experience which forms the backbone of its comprehensive five-step methodology:

The up-front design and definition work is undertaken an in agile development environment and is fundamental to establishing the critical business flow and identifying the key SLTs – Figure 1 illustrates a typical business flow with SLTs

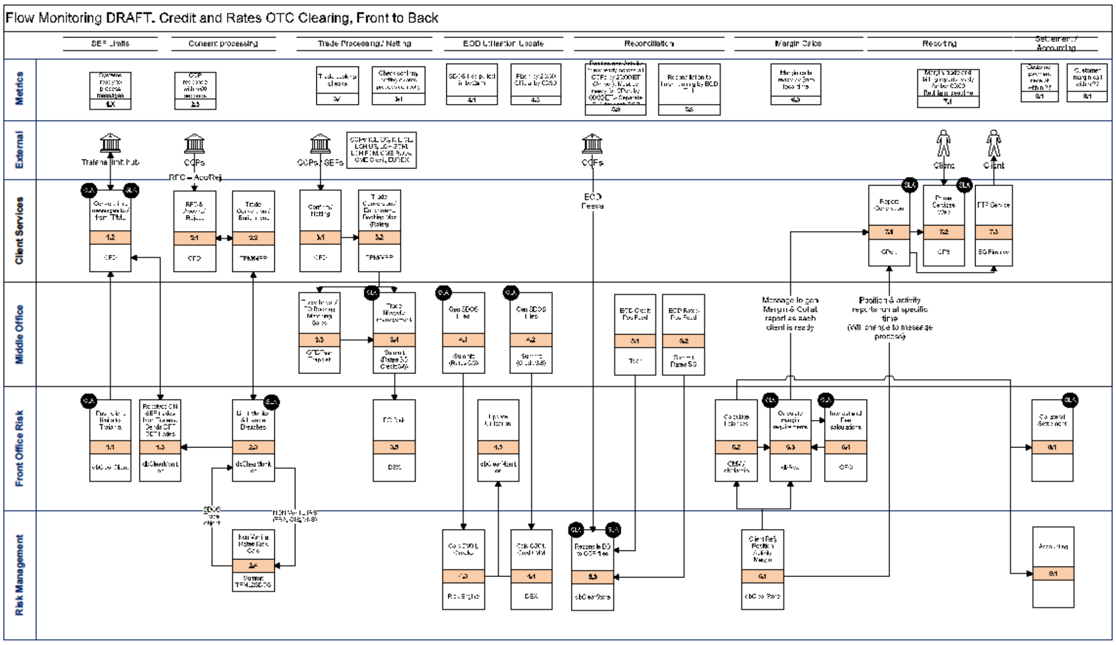

Fig.1 – Example business flow

Probably the most dramatic output from the methodology is the dashboard visualisation for real-time monitoring – this highlights through the traffic light status where any potential or actual problems are occurring within the business flow. Figure 2 provides a dashboard example:

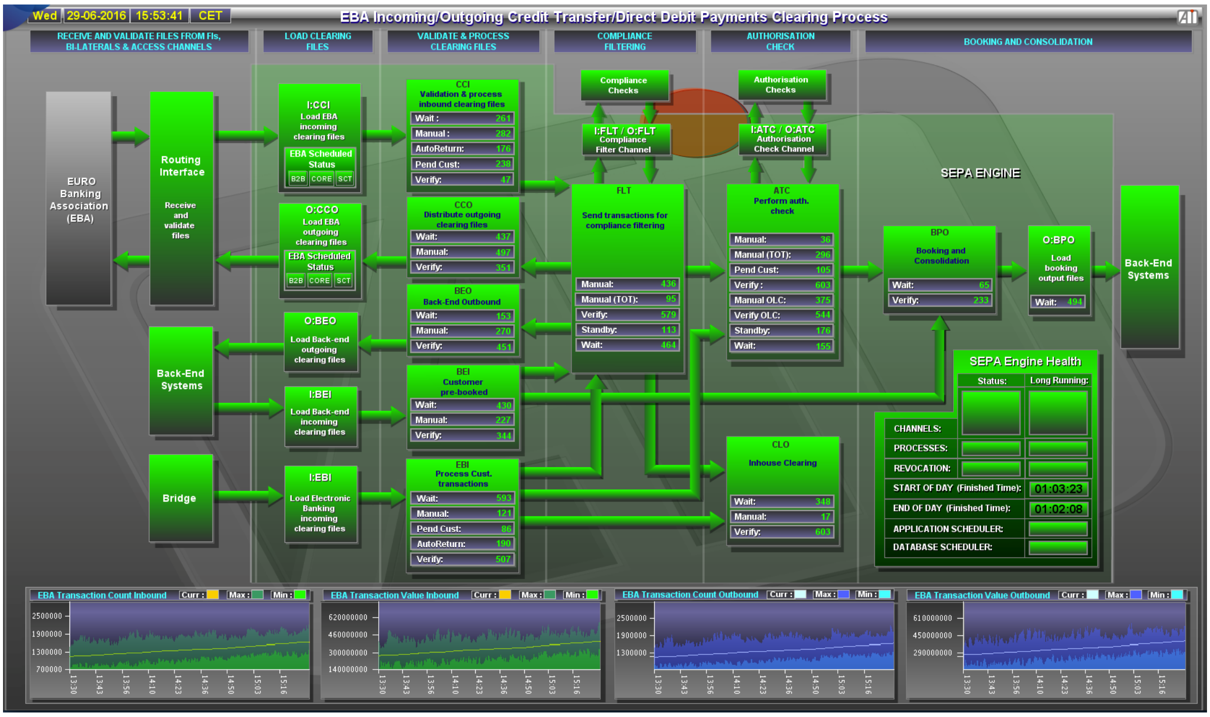

Fig 2 – Example dashboard

Performance against SLTs is measured and analysed; in addition to providing reports, results can highlight where there is need for improvement or fine-tuning to monitoring points and SLTs. The analytics enable the institution to take a much more proactive stance in its management of the operation, being able to consider or predict likely future impacts based on current or past performance.

The responsibility on senior management for business conducted within their areas has been formalised under the Senior Manager Regime[9] from March 2016. Under this arrangement senior managers are personally accountable for activities and decisions taken, even when they have been delegated, and are required to provide evidence to support strategies, changes to business models, and decisions made when issues arise.

One of the most effective demonstrations of control that senior managers can achieve is the close and effective monitoring that the above method provides. By defining an end-to-end business flow, setting performance targets for key activities, and then monitoring the whole flow in a visualised way provides tangible evidence of process control and should be an important component of any audit activity.

In addition to performance control the provision of analytics and information enables senior managers to consider improvements to processes or the underlying operations and IT systems

[9] Financial Conduct Authority – Senior Managers Regime

– again meeting regulatory requirements for governance and understanding of underlying business issues.

Whilst RegTech should not be viewed as the panacea to all regulatory challenges it certainly provides a significant opportunity to financial institutions and regulators. By harnessing the agile development capability of the RegTech supplier's technology, together with domain expertise, it will ease the burden and make regulatory compliance and reporting more achievable – and more cost-effective. The financial services regulatory environment has often been compared to a complex maze, through which the institution has to navigate – in which case RegTech will certainly start to clear the path.

About Alpha Insight

Alpha Insight is a RegTech and FinTech firm which specialises in delivery of Operational Intelligence across the banking sector. We help our clients define the F2B processes, design performance metrics, implement real time monitoring and analyse operational performance.

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