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FEATURE

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The future of RegTech: a skyrocketing industry?

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Amid an increasingly regulated global business landscape, many financial institutions (FIs) are turning to regulatory technologies (RegTech) to help them cope with greater scrutiny and the potential for hefty fines for non-compliance.

As a result of the uptake, RegTech – which according to Harvard Kennedy School is the "application of new technology to regulation-related activities in order to shift them from analog-era to digital and computational models and, thereby, gain dramatic increases in effectiveness, efficiency and scalability" – has risen to a position of relative prominence. Many FIs are utilising the technology to automate compliance tasks and reduce operational risks.

The demand for RegTech products – be it machine learning, biometrics, cloud

computing, blockchain or distributed ledgers – is particularly timely, with the implementation dates of new and complex regulations, such as the updated Payment Services Directive (PSD2), the revised Markets in Financial Instruments Directive (MiFID II) and the New York State Department of Financial Services (NYSDFS) Part 504, on the horizon.

Yet despite its burgeoning status as a go-to regulatory compliance option, issues do exist with the adoption and implementation of RegTech. There are concerns over its complexity and large, upfront costs – high barriers to entry associated with 'mission critical' services. How FIs address these issues going forward is therefore key if the RegTech industry is to evolve and truly become an essential regulatory solution.

Awareness

RegTech has really started to grow-up over the past year or so, with a significant expansion in the application of technology – including a range of sandboxes and the Financial Conduct Authority's (FCA) TechSprints – to solve regulatory problems.

"The willingness of development teams to embrace technology to overcome compliance challenges has played a crucial role in the growth of RegTech," says Philip Creed, director and head of RegTech at fscom. "Technology has been a major enabler for RegTech. Advances in AI, biometrics and Big Data means that problems, which previously could only be solved by people, can now be solved by machines. These advances significantly improve processing time, which allows employees to focus on more strategic activities."

Testifying to the vast increase in RegTech awareness is the £238m of venture capital invested in the industry in the first quarter of 2017. "Growth within the RegTech industry is likely to skyrocket over the coming years," declares Stephen Ball, vice president of sales and marketing at ComplyAdvantage. "Furthermore, as awareness of RegTech increases, FIs that are attempting to digitise their businesses are now actively seeking cutting edge technology to facilitate back-end processes such as compliance, which traditionally created a big drag on business. Established RegTechs that are now maturing, refining their offerings and building their market presence are well placed to capitalise on these dynamics."

Benefits

With RegTech solutions having scope to make regulatory compliance monitoring and risk reporting a more straightforward affair for FIs, any barriers to implementation need to be thoroughly analysed and, hopefully, overcome. "Without a doubt, RegTech has the potential to make mundane compliance tasks more efficient," concurs Mr Creed. "Regulators now accept regulatory reporting through web services and many RegTechs are now focused on converting legacy data from across an FI's infrastructure into an accepted format."

The main benefit of adopting RegTech, according to Elliot Burgess, head of product and client services at JWG Group Ltd, is that it allows FIs to establish and maintain their controls cheaper, easier and faster. Furthermore, he says, RegTech enables them to understand obligations, interpret vast quantities of data and compute precise findings in a way that humans and legacy infrastructure simply cannot.

Indeed, many FIs already employ RegTech technologies. "Artificial intelligence (AI) and Big Data tools are being used to monitor pre- and post-trade compliance," says Mr Burgess. "For example, MiFID II requirements are being fulfilled by the creation of breadcrumb trails for trade decisions throughout the execution process." RegTech is also beneficial in that it translates regulations into application programming interface (API) code in order to streamline compliance – a matter of particular importance to startup FinTech providers, given they are unlikely to have the resources to hire a bespoke compliance officer.

"RegTech could be incredibly powerful in bridging the gap between regulators and business, while protecting the best interests of consumers," believes Husayn Kassai, chief executive and co-founder of Onfido. "It enables regulators to successfully implement and audit their compliance requirements and offers businesses a cost-effective way of meeting them. Most importantly, RegTech makes these services available to those who, until now, have been excluded from our economy – the two billion unbanked people worldwide."

Barriers

Generally speaking, most compliance initiatives are not implemented without a certain degree of difficulty attached, and RegTech is no exception. "The main barrier for RegTech firms is a lack of compliance expertise on integration," says Mr Creed. "Most RegTech firms are heavy in technology expertise but light on the compliance knowledge. When it comes to solving the FIs' actual problem, there can be a skills gap. To overcome this, RegTechs will need to bring in talent to shore up the gaps or outsource that element to experienced consultants."

Another potential difficulty is that RegTech solutions are quickly outstripping awareness and trust within the financial services sector – a problem compounded by laws and guidance that predates automation, meaning businesses are slow to switch to technologies that could save them time and money, as well as offer a better customer experience.

"A big challenge is getting assurances from the regulator that these solutions are 'safe'," claims Mr Burgess. "With the large upfront costs involved, many firms are reluctant to take a different technical path without having either regulatory blessing or their peers using technology in a similar way. As RegTech continues to make its presence felt, we hope to see attitudes change so its full potential can be realised."

In Mr Ball's experience, most compliance and risk reporting challenges ultimately boil down to poor data and analytics. RegTech solves these inadequacies by automating processes, resulting in less manual work. For example, when screening and monitoring a portfolio of clients, it is difficult to spot bad actors if huge volumes of alerts are generated which require human intervention, especially if the majority of them are unnecessary. "RegTechs which use technologies such as machine learning and AI to perform the same tasks can provide an input of more

insightful data updated in real-time and an output of more relevant alerts with far fewer 'false positives', as well as spotting more accurate risks," he suggests.

Innovation

While the RegTech concept is innovative in itself, many FIs are already pushing the envelope and utilising RegTech as part of more complex collaborations in order to achieve regulatory compliance. An example of this is mapping functional taxonomy to the language used by regulators – while overcoming any semantic disjuncts that may exist – resulting in a direct link between regulatory authorities and designated compliance practitioners.

"One of the great things about RegTech is that it works better with collaboration," says Mr Burgess. "Obviously, if one firm is using a taxonomy to reduce the cost of onboarding a new regulation, it makes sense to involve others to ensure that this is being done correctly. This means that a number of firms will voluntarily give up their time to create an artefact that they can all use and pull their vendor ecosystems along with them. These types of solutions can provide great efficiencies if deployed correctly to ease the compliance burden."

Implementation, as ever, is key. "Anyone who has implemented a software solution knows that perfect does not exist. But you need to figure out what your version of perfect looks like in terms of compliance, regulation and your specific situation," advises Mr Creed. "Focusing on this will allow you to make the best of the resources you have, both from a technology and personnel standpoint."

Evolution

Although the term RegTech was only coined relatively recently, its future within the financial services sphere seems assured. FIs and regulators recognise the concept as being a likely part of future compliance strategies.

"As firms increasingly turn to RegTech solutions for compliance purposes, it is probable that the regulator too will increasingly play a more proactive part in the sector," suggests Mr Burgess. "We see key developments like the establishment of a RegTech Council as being critical to getting both the public and private sector on board and agreeing what their RegTech roles are. Over time, once the governance of the sector has been established and it is more engaged with traditional industry bodies, we will see a big push to RegTech utilities, standards and kite-marks."

As the implementation dates of a host of new regulations draw closer, it is expected that regulators around the world will follow the example of the FCA and the Monetary Authority of Singapore (MAS) and encourage FIs to adopt RegTech to help streamline their compliance processes.

"We expect to see RegTech having a real impact on reversing de-risking and improving financial inclusion in the coming years," suggests Mr Ball. "De-risking is often driven by the regulatory cost of dealing with specific customer segments. RegTech can help tailor approaches to different segments and reduce costs. Additionally, RegTechs enable FinTech firms – which offer innovative financial products that improve financial inclusion – by holding them to the highest standards of compliance and protecting their correspondent banking relationships without constraining their products."

Nutshell

At present, there are approximately 150 RegTech companies, a figure which, given the burgeoning reputation of RegTech as an effective compliance function, will assuredly rise in 2018 and beyond. Moreover, it is estimated that by 2020 there will be 300 million pages of regulations in existence, with fines for non-compliance likely to rise accordingly.

For Mr Burgess, the addition of tech and the removal of paper processes can offer a competitive advantage, as well as lowering overheads as the costs of increased compliance soars. "As thousands of FIs scream about costs, RegTech is emerging as part of the future of compliance and regulators are taking note," he says. "In a nutshell, the detailed, prescriptive post-crisis regulations have created hundreds of millions of pages of rule books that demand data. This has given market-leading regulators the opportunity to help shape technology solutions that produce the high quality information required by the regulator in an efficient manner."

In a financial world that has seen regulatory compliance obligations expand rapidly in the years since the financial crisis, RegTech is gaining traction as a cheaper, simpler and faster way of meeting said obligations – a go-to solution that is likely to skyrocket as FIs search for positive answers to probing compliance questions. ■

"WHILE THE REGTECH CONCEPT IS INNOVATIVE IN ITSELF, MANY FIS ARE ALREADY PUSHING THE ENVELOPE AND UTILISING REGTECH AS PART OF MORE COMPLEX COLLABORATIONS IN ORDER TO ACHIEVE REGULATORY COMPLIANCE."