Regulation Technology:
Enabling More Than Compliance

The Realization Group

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Financial Markets **INSIGHTS**

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One of the major outcomes created by the financial crisis has undoubtedly been the marked rise in regulatory scrutiny, coupled with an increase in regulators taking action against firms falling short of the required standards. For the banking industry, this has resulted in global regulatory fines of around $321 billion being imposed over the last decade, according to research from the Boston Consulting Group[1]. Significant regulatory changes have already come into force, including the introduction of Dodd-Frank in the US and MiFID II in Europe, with the number of rule changes needing to be tracked by institutions having more than tripled since 2011 to an average of 200 revisions per day.

Non-compliance is therefore not an option, with many in the capital markets having turned to technology in a bid to help meet their obligations. But with compliance taking up an increasingly large portion of overall budgets, the capital markets community is now seeking greater returns from their investment in regulatory technology and how it can transform their wider business for the better.

In this report, Nicola Tavendale and Mike O'Hara of The Realization Group speak to ***Tom Davin*** *of SIIA's FISD, Jordan & Jordan's* ***Barry Raskin, Frank Piasecki*** *of ACTIV Financial Systems, DTCC's* ***Mark Akass, Yousaf Hafeez*** *of BT and other senior industry executives, about how regulation technology providers can meet changing customer demands and provide solutions which not only aid compliance, but also enable technology innovation through the client's broader business.*

Introduction

One reason why it is time for firms to look at how regulation can drive broader innovation in the markets lies in a growing realisation that, as regulatory scrutiny is now very much the 'new normal', regulators are moving towards a more data-centric model.

SEC Commissioner Kara M Stein, in a September 2018 speech[2], stated, "Just this past summer, the Commission adopted rules requiring operating companies, mutual funds, and exchange-traded funds to report certain financial, expense, risk, and performance information in a better form of structured data".

Accordingly, even CFOs with very tight budgets cannot say no to spending on new technology if it is needed to support regulatory compliance, says **Tom Davin**, Managing Director of FISD, the Financial Information Services Association of SIIA, the Software & Information Industry Association. "That may have always been the case, but post credit-crunch the need for compliance technology is much more pronounced", he says.

[1] Staying the Course in Banking

[2] From the Data Rush to the Data Wars: A Data Revolution in Financial Markets

Yet while many technology initiatives are high priority due to regulatory demands, the resulting knowledge gained from such projects can have wider benefits to the firm as well. For example, a wide variety of applications are now available to help firms with the storage and retrieval of market and transaction data needed to demonstrate regulatory compliance. This has in turn allowed many institutions to build their expertise in using new technologies and analysing transaction data, for example. “There’s a beneficial effect when the firms begin to use new technologies successfully for regulatory purposes,” says Davin. “It breaks new ground for the company; they can then consider leveraging that same technology for other business-related functions as well.”

A new age of RegTech

This point is echoed in Commissioner Stein’s speech, where she says, “From securities transaction data, analysts can extract trends, patterns, or correlations. The ability to better forecast the future is, of course, at the core of every financial professional’s dream. Because of its predictive abilities, data has tremendous value, which can ultimately translate into tremendous profits”. The FinTech and RegTech sectors are also exploring how to help institutions harness prediction data technologies to address risk and regulation challenges. A recent report from KPMG[3] explored how the RegTech industry has matured and argues it is now on the verge of its ‘RegTech 3.0’ iteration. According to the report, this already rapidly growing sector is “on the cusp of a breakthrough” as it turns its focus to ‘know your data’, a paradigm shift which it argues has the potential to transform the industry’s approach to compliance and create additional value.

This will in turn further boost levels of investment in the industry, with RegTech spending forecast by KPMG to make up 34% of all regulatory spending by 2020. Investment levels in RegTech innovations have already dramatically increased according to KPMG, with global spending on this segment on pace to reach record levels in 2018, having exceeded $55 billion in the first half of the year alone. Additional data from Juniper Networks also confirms this trend, with RegTech spending predicted to dramatically increase from $10.6bn in 2017 to $76bn in 2022. Yet despite institutions typically needing to spend around 10% of revenues on technology, research by Celent[4] indicates that this can vary greatly by region, with European banks accounting for just 32% of the $261 billion investment in 2018 by major global banks.

Barry Raskin, Managing Director, Jordan & Jordan, states that firms simply will not be able to meet many of today’s regulatory requirements without the use of compliance technology. “Technology is a tool, it is an enabler - just as a cell phone is a communications enabler,” he explains. “In the past, regulations may even have been ahead of technology, but now there are a lot of creative solutions available, which allow firms to meet their requirements and improve their compliance activities.”

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Barry Raskin, Jordan & Jordan

The use of the cloud is a good example of this, according to Raskin. “Regulatory requirements that require large amounts of data to be properly retained and retrieved on demand would once have proved to be prohibitively expensive. But the use of the cloud and developments around big data applications have now made this possible,” he says.

[3] There’s a Revolution Coming

[4] Global Tech Spending Forecast: Banking Edition, 2018

Compliance costs and business benefits

It is also important to remember that the purpose of this new regulatory environment is to provide even more risk protection and transparency across the financial markets, while doing no harm, adds **Mark Akass**, Executive Director, Enterprise Infrastructure, The Depository Trust & Clearing Corporation (DTCC). "At DTCC, for example, as a Systemically Important Financial Market Utility (SIFMU) our process around executing trades is an area of interest to regulators. But how we achieve this, and with what technology, is not typically the regulatory focus. We are expected to meet regulatory requirements, regardless of the technology we leverage to achieve mandates." While there are certainly compliance costs as a result of regulation, DTCC has found a wider benefit to the business, Akass argues.

"If there are ways of capturing those compliance obligations and turning them into a service that could ultimately reduce the cost of compliance to all market participants, then it creates better investment returns for everybody," he explains. However, there is no simple answer for how that can best be achieved. "Take Cloud as an example," Akass suggests. "Like any new technology, Cloud is not without its own risks. There are still vulnerabilities. As a result, we must remain extremely diligent and cautious around risk assessments and implementations to ensure that the adoption of Cloud, or any emerging technology, lowers risk levels and creates additional business value."

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Yousaf Hafeez, Head of Business Development at Radianz, BT, agrees, adding that it is not a case of just moving to the cloud and considering your compliance issues to have been solved. Instead, he believes that cloud should be part of a broader technology strategy that firms develop to comply with regulations. "This will increasingly take the form of a hybrid solution for customers, which utilises some of the public cloud infrastructure but also has an element of proprietary cloud-based solutions," he adds. According to Hafeez, firms have to invest not just in technology, but in ensuring that the whole business is compliant in terms of people, processes and systems. Not being compliant is not an option, but increasingly he sees customers are looking for their investment to do more than only fulfil this function. "As a result, customers are becoming increasingly savvy about what the return on investment can be in providing a source of competitive advantage as well," he explains.

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"Many firms who have jumped to the cloud without carrying out full due diligence have found that public cloud has not been able to deliver all the technical features they anticipated, or the cost was significantly higher than expected", adds Hafeez.

The growth of Technology-as-a-Service

Initially firms used to buy technology-enabled services as direct infrastructure, but this model quickly became untenable in terms of cost and difficulty in scaling the solution for a global business, says **Frank Piasecki**, President and Co-Founder, ACTIV Financial Systems. "Then the public cloud came in and over-promised to organisations who committed to something they didn't fully understand," he adds. "But now firms are being smarter. They're using cloud as an enablement to build solutions which can be offered 'as-a-service' instead." Today, he believes customers are much more interested if technology providers can offer compliance activities, infrastructure and communications as a managed service or through an API. "Firms are getting smarter about using regulatory technology as-a-service, which can be much more than just moving to the cloud. It's a combination of building blocks, not just one platform or solution," explains Piasecki.

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This evolution may no longer be a choice for institutions looking to gain a competitive advantage, it may become more a matter of 'do or die'. That's according to one senior executive from a Tier One global bank, who adds that all firms need to build more scalable, micro-service architectures to manage their regulatory data. "It's becoming prohibitively expensive to solve for these issues in your own data centres on a server-by-server basis," he says. "Starting to shift all of that into the cloud with these data fabric architectures is the evolution that everyone is going to have to go through. The next two years will bring about massive transformation in terms of new regulations and requirements, which will force firms to adopt cloud and make other more radical technology decisions."

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Yet instead of reaping the benefits to be had from migrating to new architectures based on microservices, Agile and DevOps, many firms remain unclear about the tangible benefits to be gained from their adoption. Instead, RegTech firms and other technology providers would do well to stop focusing only on the latest buzzwords and help customers to understand the actual benefit to their business from adopting that solution, argues Hafeez. "There are a number of FinTech and RegTech firms who have a solution looking for a problem, rather than the other way around," he explains. "They need to focus more on knowing what compliance challenge the customer is facing and how they can deliver the required outcome."

Towards a utility model

However, when it comes to many of the post-trade or data reporting functions, or routine processes such AML or KYC checks, there is often little or no competitive advantage to be had. According to Hafeez, these areas, which are essentially the same for all businesses, are ripe to be served by utilities instead. Yet the utility model still needs to be able to integrate with a range of environments, in addition to addressing the risk of non-compliance and outcome delivery. "You need to ensure when outsourcing to any third-party supplier that the compliance operation offers the right level of integrity," he adds. "We perform a similar function with our CREST access service by managing the risk for the client of assuring that the movement of a message from one space to another has been completed, without the contents being tampered with and by also creating a record of a transaction having taken place."

Even once all these factors are taken into consideration, a significant proportion of most institutional budgets is still being allocated to meeting regulatory compliance, observes Davin. Although many of the these are considered 'must-do' projects, firms are also beginning to trial the use of emerging technologies, such as blockchain or artificial intelligence, to help alleviate the regulatory burden. For Davin, the growing use of alternative data sets in trading may also hold the key to creating a competitive advantage through their potential use in regulatory or risk management applications. "But in turn, the rise of alternative data and its use in the financial market also creates new questions for regulators and policy makers, which they may not have contemplated before," he adds. "New technologies are being adopted in the trading and investment world, yet policy and regulation now need to keep up."

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When DTCC first embarked on exploring the use of Cloud, regulators were also on a learning journey, says Akass. "But we found that the regulatory concerns were very similar to the questions and concerns with the current on-premises environments," he says. "Regulators took it upon themselves to make sure they understood cloud. In fact, many cloud operators are now forming direct relationships with regulators as a way to further this educational process."

Even so, it is clear that in the case of any new technology adoption, sub-contracting certain operational tasks through the use of cloud does not remove the company's compliance obligation. In addition, because providers like DTCC operate globally across different markets, they encounter a number of nuances across local regulations that create additional costs of compliance. "Regulatory harmonization would allow market participants and providers to comply with regulations across jurisdictions more cost-effectively, and more consistently," explains Akass. "There will likely never be complete alignment, but there is certainly an opportunity for greater cooperation to reduce costs and compliance burdens."

Finding a smarter approach

The regulatory challenge is also not localised by market, but is now very much a global issue for the whole capital markets community. According to Hafeez, regardless of where BT's customers are based in the world, they all seem to share similar compliance challenges. "Even so, there often isn't a one-stop-shop solution for all our customers' problems around regulation," he adds. "Instead, more and more customers will start turning to hybrid solutions, as well exploring new technologies that can help them reduce their costs."

He adds that in the ‘build-versus-buy’ debate, the subscription model seems to be gaining more traction. “There is a growing propensity towards consuming compliance solutions as-a-service, which is not only created by improved security considerations,” he explains. “In fact, the obstacles that previously stood in the way of firms adopting these technologies are now slowly being removed one-by-one.” Technology providers can help with this process, he says, by making sure they properly position and deliver the solution to the customer within the right service framework, in order to eliminate any potential risk from the process.

The onus should now be on the technology vendors themselves to start demonstrating their ability to work with legacy gateways, in order to make the move to better compliance solutions much easier for the client to commit to. Many firms are already connected to technology ecosystems already, which solution providers can leverage to easily introduce new services through the customer’s existing connectivity. “Working with existing providers overcomes many of the legacy infrastructure issues, enabling the customer to enhance and speed up access at minimal cost,” Piasecki concludes. “The smart firms have used the compliance budget to get things done, with the clever approach being to identify where the compliance needs converge. If you can build and then support the budgeting process to drive technical advancement, absolutely, why wouldn’t you?”

Viewpoint of the technology vendor, BT

Virtually all of the conversations I have with customers across the markets today contain an element of compliance. It is often the first thought for business leaders in finance, whatever their role. Meeting regulatory compliance obligations is also the biggest consumer of technology spend, soaking up both operational resource and capital budgets. Consequently, we have seen a huge growth in related technology innovation, from established tech vendors as well as start-ups.

This is why BT commissioned this Insights report from The Realization Group (TRG). We wanted to explore varying opinions and approaches to dealing with compliance issues using technology. Is it just an overhead or can it help to open up opportunities? And, of course, we wanted to confirm our belief that BT, with its Radianz portfolio, is in a position to help. TRG interviewed a number of influential voices in the industry offering different perspectives and in doing so, re-affirmed our position.

With Radianz, market participants can access a wide range of providers offering services to assist with regulatory compliance. For providers of such services, the Radianz cloud offers a simple way to distribute their offerings to a large community of potential customers globally. Across the industry, Radianz removes the underlying connectivity and infrastructure headache by providing solutions that allow our customers to free up people, manage costs and concentrate on other issues such as reaching new markets and generating revenue.

We are delighted to have worked with TRG to produce this market insight and we hope you find it a useful and thought-provoking read.

Michael Woodman, Managing Director, Radianz, BT

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