For banks facing a growing regulatory burden and more intense scrutiny, could 'RegTech' prove more than just the latest buzzword?

The rise of RegTech

The rapid re-regulation of the financial sector since 2008 has had a profound effect on the industry. And this pressure is only compounded by the fact that regulatory compliance and reporting generates no direct revenue to offset the growing costs it incurs.

In fact, financial institutions expect these costs to more than double over the next five years, according to professional services firm Duff & Phelps.

By 2022, this would amount to an estimated compliance spend of around 10% of total revenue, compared with up to 4% typically spent today. Meanwhile, the proportion of firms putting their compliance spending at less than 1% is expected to halve.

REAPING REGTECH POTENTIAL

Amid this ongoing reform, it is unsurprising that regulatory reporting dominates the list of challenges keeping clients awake at night, says Lory Kehoe, Director of Consulting at Deloitte Ireland.

Regulatory technology (RegTech) – in its simplest form, the use of new technology to facilitate the delivery of regulatory requirements – has the potential to relieve some of this pressure by helping firms to make their compliance budget work harder, says Kehoe. But why should banks take notice of what may sound like the latest start-up buzzword?

"If they are able to implement the technology intelligently, there is an opportunity for banks to respond more efficiently to new regulation and, at the end of the day, save themselves time and money," he believes.

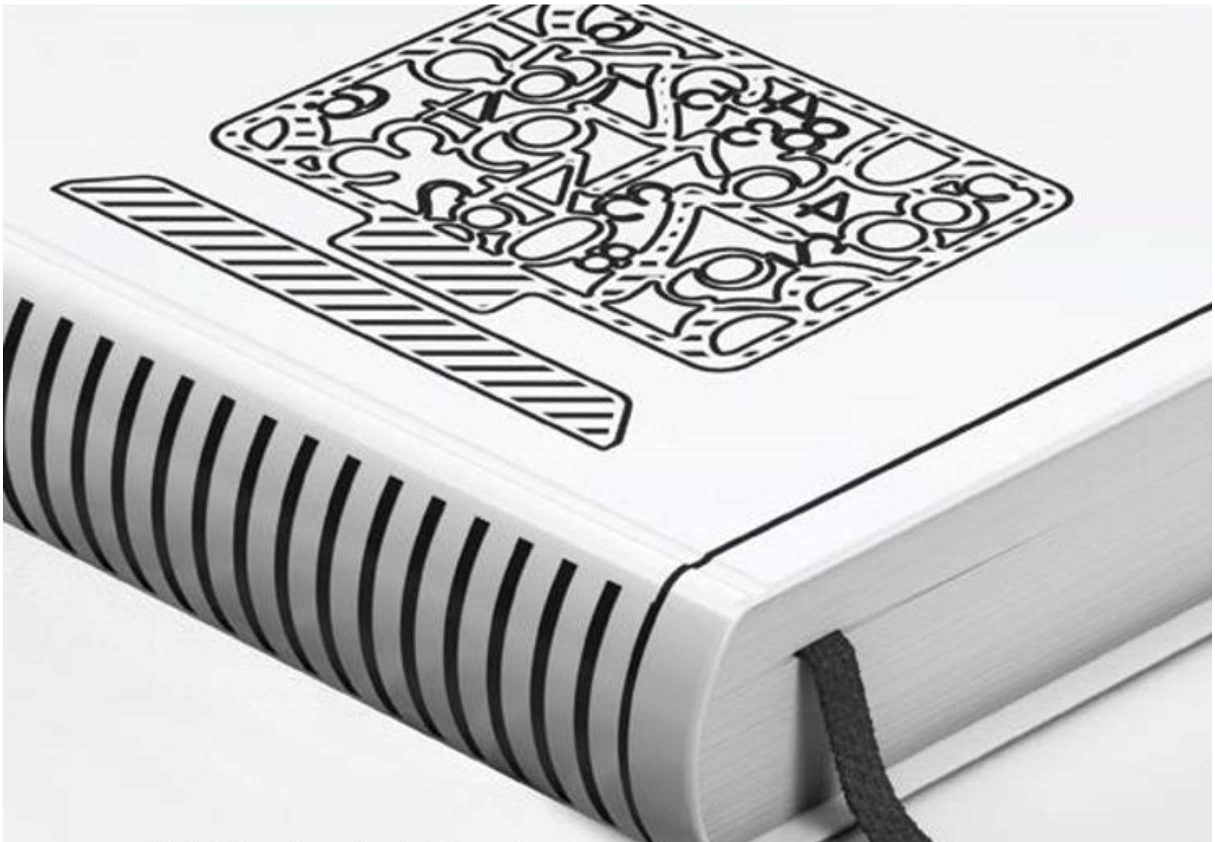
Organisations often begin the process from scratch instead of using existing data and datasets, he continues. "Simply taking the time to step outside 'business as usual' can help firms to operate more efficiently," he says. "The first step is to identify recurring challenges and deploy a strategic solution rather than a tactical one."

As the compliance remit continues to expand at speed, adding another five people to cover constantly evolving processes is likely to result in poor work and low employee satisfaction, Kehoe believes. The alternative is not to replace people with technology altogether, he stresses; instead, technology can automate time-consuming, manual tasks to allow employees to focus on more important cases.

CUT THROUGH THE HYPE

But, notes Robert Dickie, President of the Chartered Banker Institute, banks have become more cautious about their technology investments; they dread the introduction of yet another layer of system complexity. "Technology for technology's sake will only add to their complexity; banks must focus on making regulatory compliance more dynamic while also being cost effective."

When it comes to regulatory compliance, blockchain is potentially the most game-changing technology to emerge. "But just because the current buzz is around blockchain – or AI, or biometrics, for that matter – is not cause to abandon the usual detailed business analysis," says Kehoe. "Ask



yourself: what is the problem we're solving? How much of that problem has been solved today? If we implement this technology, how much will we save?"

At Deloitte Ireland, there is a focus on conducting meaningful experiments and building prototypes that demonstrate business value, Kehoe explains. He cites one example in which Deloitte demonstrated a 50% cost saving by using blockchain as a means to solve a regulatory problem for one of its banking clients.

TO BUY OR TO BUILD?

For any bank currently working to standardise and simplify its technology architecture, the impact of past legacy technology investment is likely to influence its attitude to introducing new technology, says Dickie.

But the potential is enormous, especially for distributed ledgers such as blockchain. The priority must be ensuring that RegTech is integrated and embedded, or it will become more complex and costly.

Banks currently struggling to overhaul legacy systems are only too aware of the costs involved when a major investment is no longer fit for purpose, adds David McNair Scott, CEO, Trailight. "Larger institutions have more recently focused on developing their in-house IT and compliance provision so they can own the intellectual property and flex the solution as required."

But he says this provision is often considered to be unsatisfactory. Rather than focusing on bespoke solutions, external compliance offerings such as Trailight's are now offered as a 'software as a service' (SaaS) licensing and delivery model. This allows a response to both external pressures and internal customer changes, instead of restricting clients to locked-down pathways, says McNair Scott: "This configurable software platform moves with the regulation itself, so we're always improving our capability."

NO "TRIED AND TESTED"

But whether the investment is internal or external, today's firms must ensure they are meeting current regulatory challenges and creating valuable data streams and platforms that can be adapted to serve future needs, stresses McNair Scott.

Agility is essential, agrees Trailight's Product Director, Callum Grant. "Many firms tried to tackle the accountability regime using spreadsheets," he recalls, "but very quickly found this to be a major risk in terms of resource and cost.

> **"RegTech is about unlocking the benefits and ROI for the business while ensuring that it follows the rules, not instilling fear and viewing it as a tick-box exercise."**

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"The benefits of the agility built into SaaS have become very clear to firms; we are able to listen to business problems, then quickly translate them into our software." The pace of change today means there is no "tried and tested route", he says. Instead, it is a constant journey.

Firms facing regulatory change on an almost daily basis, particularly those operating globally, need to be able to understand implications and build them into their policies – but it is hard, says McNair Scott.

Having a long-term partner is essential, regardless of whether they are external or internal, but the biggest barrier for both large financial institutions and RegTech firms will relate to the mechanics of how these new relationships are formed.

BEYOND THE TICK-BOX

What will differentiate RegTech firms going forward, believes McNair Scott, is the ability to help an organisation perform better, not just meet its basic regulatory requirements.

"We often talk about regulation as a nightmare slew of hard-and-fast rules," he says. "But the regulator's goal is usually to create better-run businesses that have proper controls in place, clear management information and a strong grasp of their culture and conduct."

RegTech also has huge potential to facilitate a better dialogue between firms and the regulator. "It's about unlocking the benefits and ROI for the business while ensuring they follow the rules, not instilling fear and viewing it as a tick-box exercise."

As Grant stresses: "It is not just about the software; what we offer our clients is a sense of community where firms can get together and discuss the regulatory challenges they are facing. We also facilitate direct engagement with the regulator to give clients the opportunity to talk through their business challenges and ask specific questions."

Facilitating this relationship could also help to build firms' confidence in working more closely with the regulator, he says.

TOWARDS REAL-TIME REGULATION

"Firms still want to carefully control the information they share – they think sanitation is required – but granting access to more data than would typically be required would be very healthy for the industry," says Kehoe.

"As transactions and interactions take place, why can't they be shared almost immediately with a tax authority, with the regulator, with the stock exchanges?" he asks. "Instead of having a punishing periodic reporting process, we'd move to this near real-time environment which allows the regulator to identify anomalies and take action much more quickly."

Blockchain is likely to be the mechanism, or recording device, to record all that information, says Kehoe. As the transaction is recorded on the blockchain, other third parties will have access to the information. "This makes it even more crucial that banks adequately explain the General Data Protection Regulation (GDPR) to their customers so they don't simply 'opt out' at the first opportunity," he stresses.

This kind of situation might seem far off, says Dickie, but the e-Estonia project, which has made Estonia the "most advanced digital society", according to Wired, shows that it is possible to work with the government and businesses to ensure their contribution in an open, transparent environment.

FOCUS ON OUTCOMES

Given the escalating cost of regulatory oversight, solutions that promise to avoid duplication, help to reduce complexity and minimise cost are undoubtedly going to be attractive, says Dickie. "Regulation should not be a constraint or hurdle, but a mutual responsibility that benefits the free market."

This may require a shift in perspective, he adds. "Firms and regulators are still grappling with this new technology, but if they can work together to ensure that information can be accessed in a more targeted way, the resulting reduction, in both complexity and cost, could be huge."

And, while there has been a detectable shift towards finding internal IT and software solutions, there is now a recognition that this does not always produce the best outcome, notes Grant.

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STRATEGIC INVESTMENT

Today's banks remain service providers, but they are – increasingly – also technology firms, says McNair Scott. "The ability to provide innovative solutions to their customers in a cost-effective manner is going to be essential if they are to maintain their margins."

These firms should be investing in their front office and identifying the changing technologies that are going to completely shift their marketplaces, he believes. "While there are still challenges for larger organisations, the good news is that firms are starting to recognise that RegTech is a solution best provided by one to many, rather than everyone working on their own systems internally."

THE COST OF COMPLIANCE

2017	2022
4% of revenue	More than double (10%)

Source: Duff & Phelps, 'Global Regulatory Outlook 2017'.

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