THE NEW WORLD OF REGTECH
IN MANAGING REGULATORY DATA
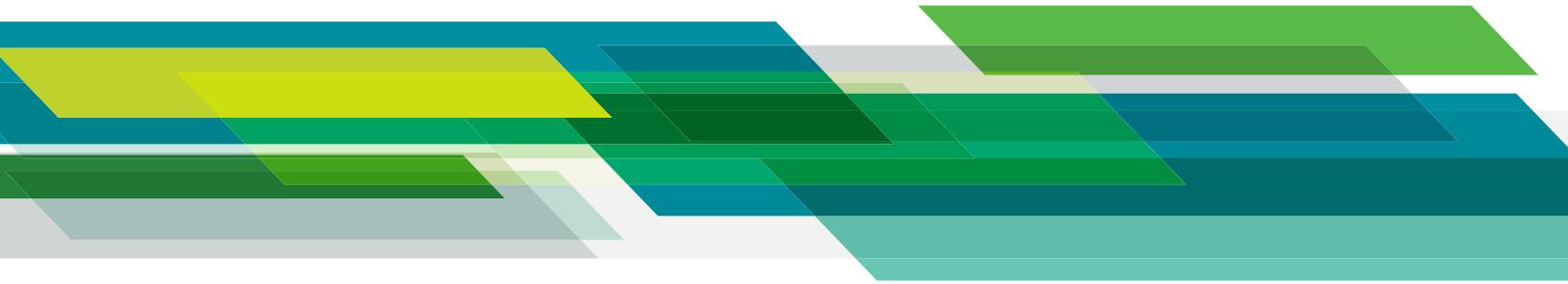
Following years of new and complex regulations, and with more on the horizon, financial services companies face significant strain in meeting these requirements. Data optimization, which can be a challenge in its own right, can help in navigating these regulatory shifts.[1] Specifically, leveraging technological advancements can ease the weight of compliance, and allow firms to better manage and analyze regulatory data—a concept generally referred to as regtech.

Regtech can help by automating what would otherwise be tactical and manual processes—such as data collection and reporting—and making these tasks more cost effective, efficient and strategic. Advances in areas like artificial intelligence (AI) and machine learning make it possible to automatically parse through regulatory filings, track employee compliance and more. Advanced regtech analytics solutions can also match and cleanse data from various legacy systems quickly and accurately.

These innovations are important because many firms have had to shift significant resources toward compliance. Consider that, on average, one small or medium-sized firm has 160 different regulatory requirements globally, according to Nirvana Farhadi, global head of financial services, regtech, risk and regulatory compliance affairs for Hitachi Vantara. Large firms with varying global entities and jurisdictions face many more.

"At the end of the day, financial services organizations' main business is not compliance," says Ms. Farhadi. "But because there are so many different regulations, firms were spending so much time and money on them that they were being hindered from doing their day job. They came to an inflection point and turned to this technology to cope with the demands."

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SAVING TIME AND ADDING VALUE

Complying with prominent regulations such as Know Your Customer and Anti Money Laundering rules can be labor-intensive, but data optimization can improve efficiency. Having orderly data management processes in place makes it easier to collect client data and fill out reports. And new technologies make it possible to automatically cross-reference records and pull data into reports to further speed up these processes.

In addition to saving time, regtech can add value by helping to manage risk. For example, regtech can introduce regulatory checks and audit requirements at each step of the investing process to make better risk decisions, notes Nikhil Shah, financial services expert at PA Consulting. These include monitoring portfolios for early evidence of problems like financial crime and even predict operational losses, all of which support regulatory compliance.

Furthermore, advancements in AI areas like natural language processing and optical character recognition make it easier to automate data capture from compliance forms while also expanding the pool of potential data sources. Financial services firms can use these technologies to turn text—e.g. regulatory

guidelines, rulings, speeches and news—into actionable data. An example of this might be analyzing the text of complex regulations like the Markets in Financial Instruments Directive II in Europe to ensure that all trades are compliant. Regulators are also getting onboard: the Securities Exchange Commission in the US has started to use this technology to analyze investment advisor regulatory filings and identify language that signals potential misconduct.[2] Other regulators outside the US are also looking closely at how they can use regtech and other technology advancements. For example, Australia and Luxembourg's financial regulators signed an agreement in October 2018 to share information on fintech and regtech innovation.[3]

"There are so many elements that need to be looked at and protections that consumers need that only technology will be able to facilitate efficiently," says Hitachi's Ms. Farhadi. "Technology and analytics reduce what used to take a team three months to accomplish down to three minutes, and it will help to close those risks [e.g. financial crime, operational errors] a lot more."

In addition, technology and analytics can provide opportunities to dive deeper into regulatory management. For example, regtech can be used when responding to the US Financial Crimes Enforcement Network's (FinCEN) Customer Due Diligence Requirements for Financial Institutions rule (the CDD Rule), which became effective in May 2018, explains Michael Dawson, managing director and CEO at Promontory Financial Group. FinCEN, a bureau of the US Department of the Treasury, is charged with examining suspicious money-laundering activity, and the CDD Rule obliges financial institutions to have a stronger understanding of the risk profile of their customers. To comply, regtech can help optimize and analyze large volumes of customer activity using dynamic, behavior-based data, rather than just static data points like customer age and occupation, explains Mr. Dawson.

"I consider this to be on the bleeding edge of regtech application," he says. "Firms now have a truer picture of the risk of the customer, not only at onboarding but also over time. This means they can concentrate their compliance resources on customers that are most risky. And they run a reduced risk of missing customers that are marked lower risk."

COMBINING AUTOMATION WITH THE HUMAN ELEMENT

The rise of regtech also goes hand-in-hand with the ascent of real-time data that can be used to track compliance within firms and provide early alerts for potential shortcomings.

"Those that stick to traditional industry approaches will struggle in the face of the growing flood of real-time data," says Mr. Shah.

Not only can real-time data and better data management overall help firms ensure that they're up-to-date with compliance, but they can also provide follow-on competitive advantages. For example, explains Mr. Dawson, if firms take a sophisticated interface approach to model customer risk or analyze information

for anti-money-laundering purposes, they're likely pulling all the data into one centralized place. "Once they have gone through that effort, the data can then be analyzed for another purpose, such as creating a new product or service," he says.

Getting to that next level, however, requires employees that know how to work alongside technology to identify new opportunities to create value while ensuring that the systems are operating properly.

"There's still a need for experienced staff to check the outputs and ensure the quality of the inputs," says Jason Hill, a financial services expert at PA Consulting. "People will also be needed to design new rules and understand the data requirements for new and emerging regulatory changes. The real benefit of automation is the way it frees experienced staff from mundane and repetitive tasks to focus on the more complex activities."

Furthermore, expert compliance staff can work with regtech solutions to cut through the clutter when dealing with complex issues. As an example, consider international sanctions like those against Russia, Iran and North Korea. Over time, governments have become more sophisticated about creating "smart" sanctions that target specific sectors and networks of activity. At the same time, the sanctioned entities have become more sophisticated in evading sanctions—two conditions that make it challenging for firms to make sure they are not facilitating sanctions violations.

Yet the AI in regtech can deal with 80-90% or more of the questions that arise with sanctions compliance, says Mr. Dawson. Many of these are "routine false alarms." Regtech therefore results in the conservation of expert judgment by making it possible for compliance officers to focus on the most difficult questions.

"I think overall you end up with a better compliance profile because the machine is dealing with the routine questions and experts are dealing with trickier questions. And it's helping ensure that regulatory experts are doing the work best suited to their role, and that they get more job satisfaction from that work," he says.

EARLY DAYS

Many firms are making significant investments in data optimization to help them meet regulatory requirements, and they are leveraging new technology to extract value from their data. While regtech is a fairly nascent industry, it has great potential to help firms manage costs and reform compliance roles.

"More sophisticated products are coming down the line," says Ms. Farhadi. "These are early days." As these advancements unfold, companies that have optimized their data for further analysis will have the upper hand.

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END NOTES

1   For more information, see Article 2 in this Data and Transparency series:
    http://www.eiuperspectives.economist.com/technology-innovation/data-and-transparency/article/navigating-regulatory-shifts-better-data

2   https://www.sec.gov/news/speech/bauguess-big-data-ai

3   https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-299mr-luxembourg-and-australia-enter-agreement-on-fintech-and-regtech/