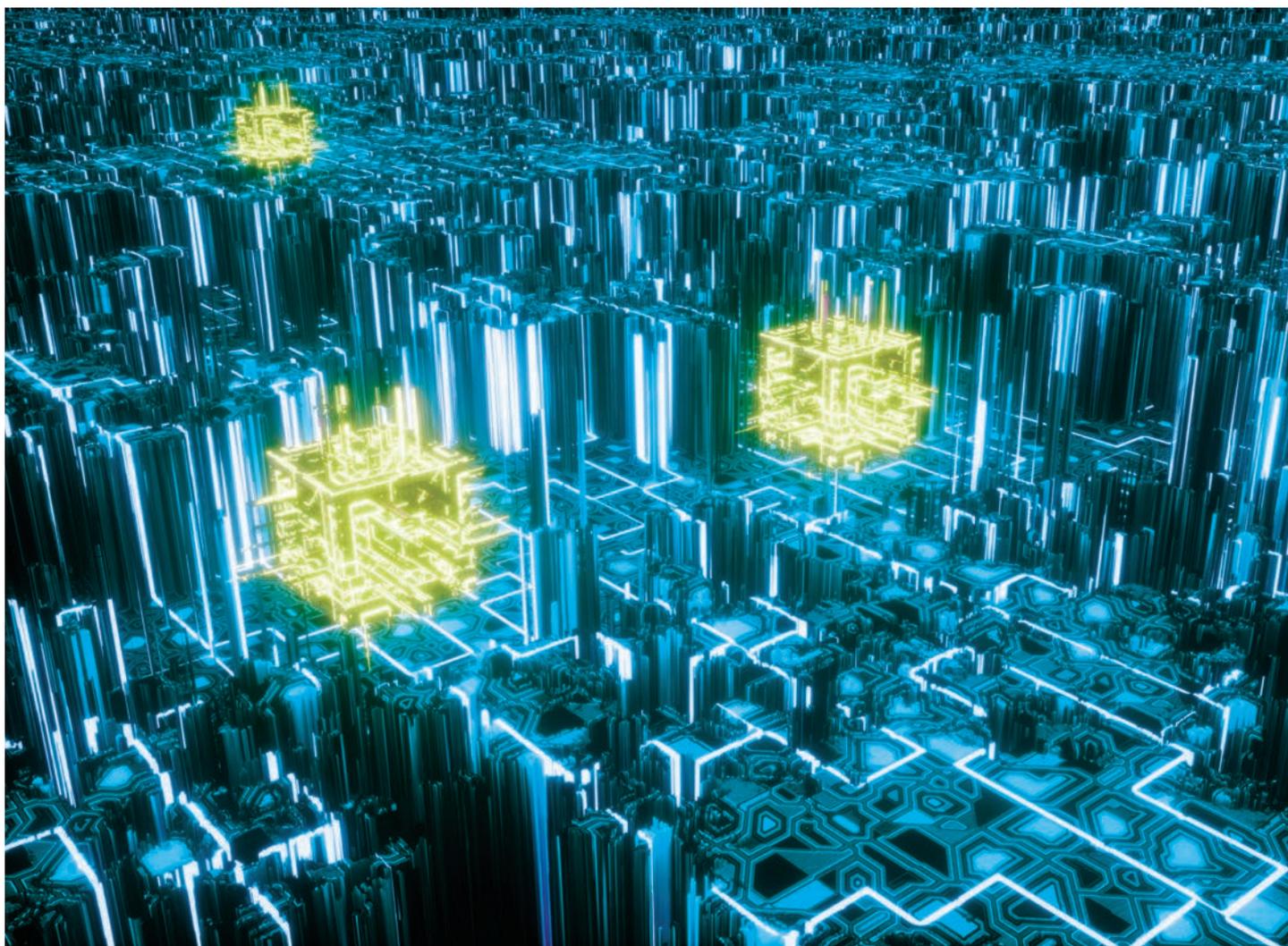


Regtech – Enabler of the shift from compliance to performance

Risk.net April 2018



Survey report & white paper

Risk.net

MOODY'S
ANALYTICS

Executive summary

Regulatory technology, or 'regtech' as it has become more widely known, might have started as a way for the financial services industry to deal effectively with myriad new directives and regulations, but today it is the catalyst for a host of strategic applications.

At its simplest, regtech has demonstrated the benefits of integrating risk and financial data. In doing so, it has revealed the weakness of considering technological initiatives as a series of separate silo-based projects. The holistic approach that has ensued is now extending far beyond regtech into everything from cloud-based protocols to credit portfolio analysis.

"Because the flow of new regulations has slowed, banks are using this time to take what they have learned in the regulatory space and apply it to their benefit in building their businesses," says Victor Pinto, senior director, banking solutions at Moody's Analytics.

Bank executives have seized on the potential of a regtech-driven approach at a challenging time in the industry. Low interest rates, regulatory-led constriction on lending and post-credit crisis strategic anxiety have combined to motivate senior executives to look for ways to get the most out of their operating infrastructures.

"Banks have been desperate to get off the compliance treadmill and focus on building their businesses. Judging by the results of this survey, regtech is playing a role in helping them to do just that," says Pinto.

Closely examining the findings of the survey, it is obvious that the industry's need to organise and integrate systems is made more challenging by the complexity of current regulations.

Additionally, the global landscape in this realm is heavily matrixed. Different geographies are under different pressures due to the various regulatory and commercial sensibilities they must contend with. Tier 1 global banks are in a different position from their counterparts further down the size scale.

But there is a factor common to them all. They all need to process and then produce data that sufficiently complies with regulatory demands, while cutting costs and maximising efficiencies through the application of the latest technology – be it legacy or otherwise.

As is always the case, the devil is in the details. This is not a simple binary question of, for example, transitioning from existing systems to new technology or operating 'on premises' versus the cloud. The survey's findings clearly indicate that most respondents are focusing on harmonising and consolidating their various regtech platforms, whether old or new.

"How well you manage your legacy systems in the midst of this harmonisation process is critical," says Sid Dash, research director at Chartis.



Victor Pinto, Moody's Analytics

Key themes

Comprehensive compliance

Configuring technology to meet your regulatory requirements is only half of this complicated equation. Fully grasping what those various, and sometimes overlapping, regulations require is the other half.

All the big data analytics and fully harmonised platforms in the world will only work if one can generate and then disseminate the appropriate reporting in a timely manner. This can only work if you can figure out what the regulator wants.

“When you start hearing the term ‘comprehensive compliance’, you know things are getting complex,” says Pinto. “When you have various regulators wanting everything from heavily annotated credit reporting to instant disclosure of trading positions, it does become a bit challenging.”

Expanding on that theme, Dash at Chartis says it is not a surprise that banks are still struggling with regulatory issues. “Although many things have slowed down, the ambiguity factor has never been higher. Basel II might have had clearly defined goalposts, but that is not the case now. And to make things even more interesting, we have accounting standards to contend with.”

It is convenient to look at regtech as a phenomenon unto itself, but the reality is that it exists within a financial services industry at a time when lower interest rates combined with post-crisis strategic challenges make cost-cutting imperative.

It is therefore to be expected that banks are looking to use regtech as at least one of the catalysts for change in the way IT, risk and finance interact.

“The path to reducing costs and fulfilling your compliance requirements leads to integration of the risk and finance departments. This is no longer a wish, it is a reality,” says Pinto. He believes the need to produce and then analyse such things as credit loss and asset-liability management calculations has naturally brought risk and finance together.

The old, the new and the cloud

The first – and one of the biggest – cost considerations comes when a firm must decide on how to blend the new with the old. “While much attention is being paid to the new technologies, the ability to manage your legacy systems is critically important,” says Dash, adding that there are ways of ensuring banks can efficiently integrate their existing platforms with anything new that is being brought into the fold.

The very idea of cost-cutting in the wider context is an intriguing one. The survey clearly indicates that overall regtech budgets will be increased, at least in the short term, despite some jostling for resources that would have been assigned to the overall IT budget. Pinto says there is a single clear area in which firms can



Sid Dash, Chartis

reduce expenses – the move to a cloud-based operating platform. “The move to the cloud could be seen as an outsourcing exercise,” he says.

Experience has shown, however, that transitioning to the cloud does not necessarily suggest a reduction in IT or operations staff. Increasing these teams’ focus on data management and quality can improve efficiency across many areas.

Further integration of the risk and finance departments naturally comes about with a move to the cloud as they use the occasion to structure integrated data feeds that would normally have come through their respective departments.

Why then does the survey indicate a near 50/50 split between using the cloud? It could be because there is not the necessary clarity within institutions over what can be moved to the cloud. “It’s one thing for a bank to be comfortable moving some of its more basic data to the cloud, it’s quite another for them to move things that require analytics and big data management,” says Dash.

Regardless of the survey’s findings, the momentum behind cloud adoption is building. “There is a huge appetite in Europe at the moment to move everything to the cloud,” Dash adds.

One could easily argue it is data management that is mission-critical in this discussion. The issue is how quickly firms can put their hands on the most appropriate data to ensure not only regulatory compliance but also, increasingly, to make the right commercial decisions.

“When I see banks push integration, they are usually talking about combining heavy datasets,” says Dash.

Older and bigger isn’t bad in the fintech world

The regtech phenomenon has also had an interesting impact on the perception of what could be described as new and small versus old and big within the broader fintech world. It was not that long ago that start-ups were seen as the answer to moving finance from the analogue to the digital world. And while those start-ups are making major contributions – particularly in the retail payment space – regtech has shown that the bigger, more established firms with bigger budgets, more resources and long-standing regulatory expertise can equally be innovative and fast on their feet.

One notion the findings of the survey discounted was that banks were rushing to hire people from non-financial backgrounds. The logic implied that, if you were familiar with , for example, big data in the social media world, you could easily translate that into banking. Reality suggests otherwise. Banks found themselves spending too much time and money training people in the regtech space when they could have been developing their own staff or turning to an outsourcing solution.

“There is a huge appetite in Europe at the moment to move everything to the cloud”

Sid Dash, Chartis

Survey findings

In examining the survey findings, it is clear that risk managers find themselves needing to deal with various issues to keep up with the different regulatory protocols coming their way. The survey indicates that roughly one-third of the respondents said their major challenge was improving data quality for risk aggregation and reporting.

At the same time, one-quarter of survey respondents said they were concerned about securing sufficient budget to maintain all the necessary regulatory related projects.

Interestingly, one area that was not an issue was personnel. Only 4% said they were concerned about attracting appropriate staff to meet their needs. And, while a fair amount has been written about the trend towards bringing non-financial technological expertise into the financial services industry, this isn't reflected in the survey findings, with one-third of respondents indicating that their hiring initiatives extend into non-financial areas. Strangely, when asked if they were seeking personnel with different skill sets than those they have today, 77% responded affirmatively.

One area of consensus is what the future holds as the pace of regulation slows. Approximately 60% of respondents indicated they intended to consolidate and harmonise their systems to achieve efficiencies.

Unsurprisingly, nearly 75% said that within the next five years they expected their regtech solutions to be used for non-compliance, strategic objectives. Despite the concerns about securing sufficient budget, 63% reported they expected their budgets to increase over the next two to three years. Interestingly, 80% said they would be competing with other technology areas for that budget.

When asked whether they see any competitive advantage in regulatory compliance solutions, respondents were only slightly more inclined to answer in the positive. A total of 54% cited cost savings, efficiency and reputational risk as reasons for answering "yes" to that question.

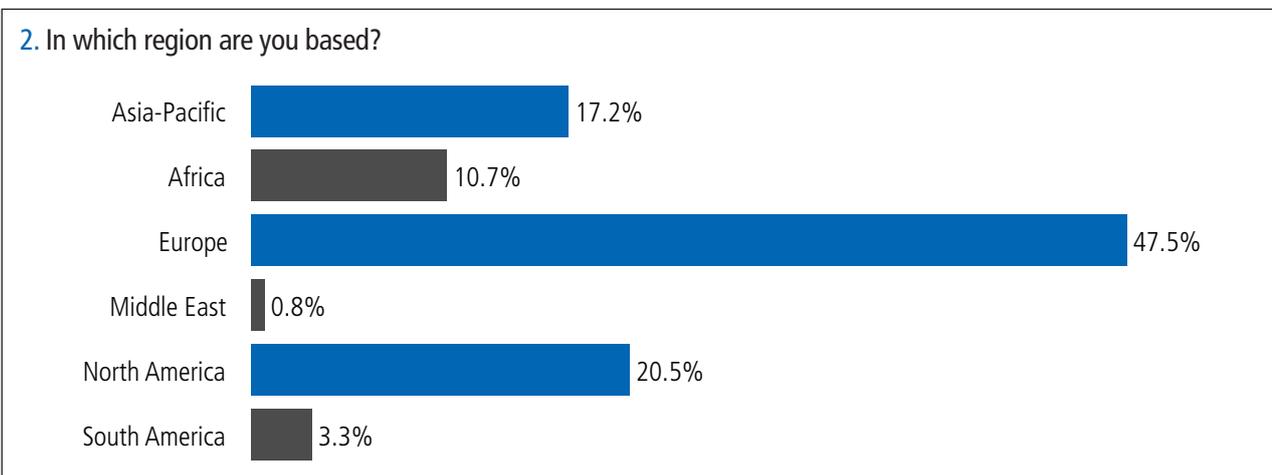
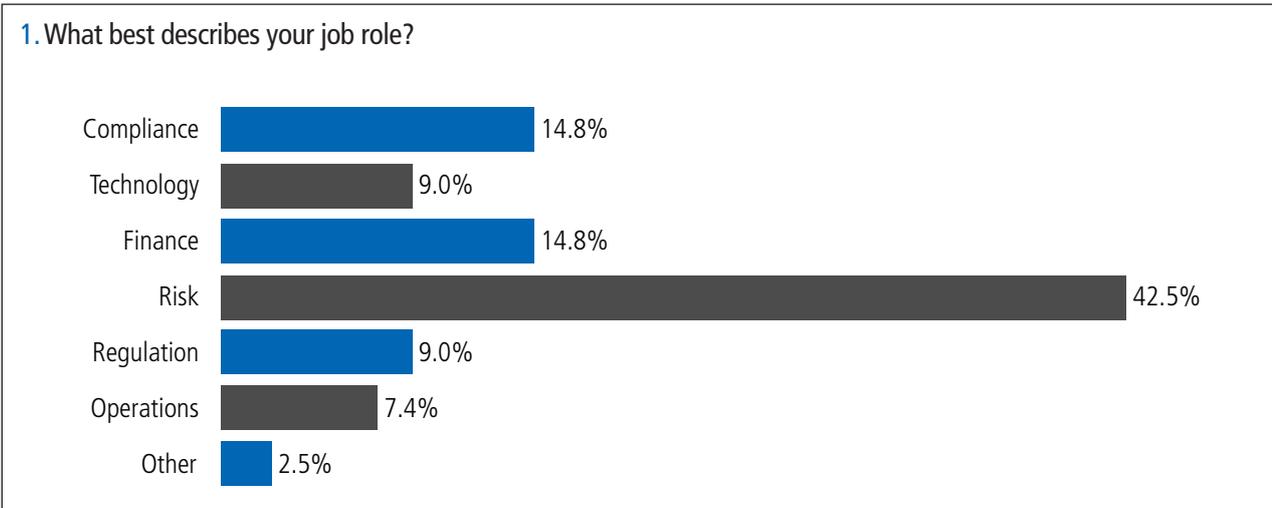
Moving regtech forward

The participation rate of 42.6% from the risk community is predictable, but the spread among other disciplines – when respondents were asked what best describes their job roles – points to a larger trend of overall integration of risk, finance and IT departments (see figure 1).

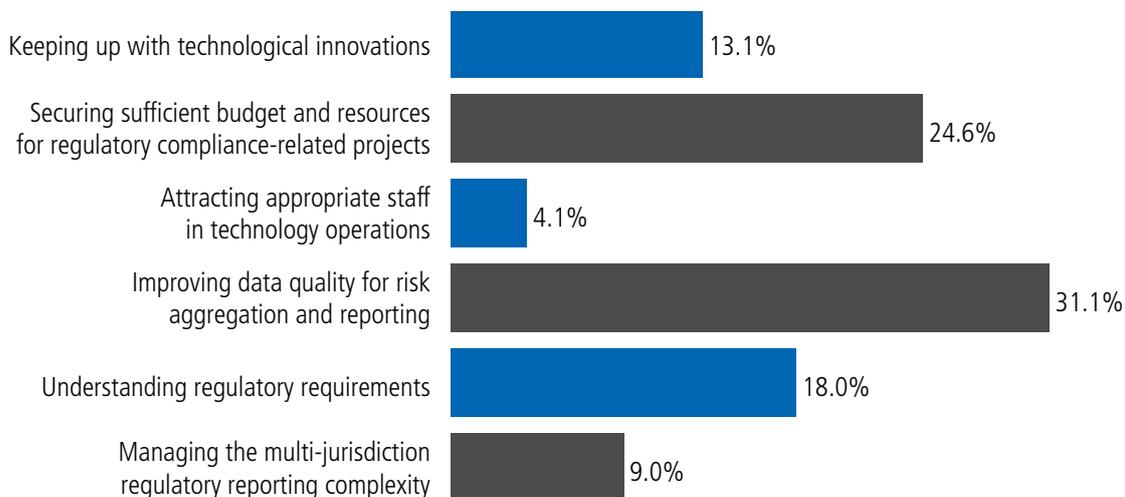
There are distinct geographical differences regarding regtech. Western banks are more advanced and aggressive in embracing the latest technologies, and Middle Eastern banks can benefit from these lessons. Those banks want to demonstrate to regulators that they are complying thoroughly with all existing regulations. In Asia and Latin America, the influx of smaller regional banks will mean compliance happens at a slower pace. The two biggest economies in Asia – China and Japan – will also have different patterns of adherence (see figure 2).

The fact that there is no single dominant response to the question of what the major challenge is with regulatory compliance underscores the matrixed nature of the issue. While nearly one-third of respondents identified data quality as paramount, the need to adequately resource the regtech effort while staying on top of the relevant technology is clearly important. If you were to combine the percentage of respondents who cited understanding regulations and managing them in a multi-jurisdictional setting, you would see an equally important issue (see figure 3).

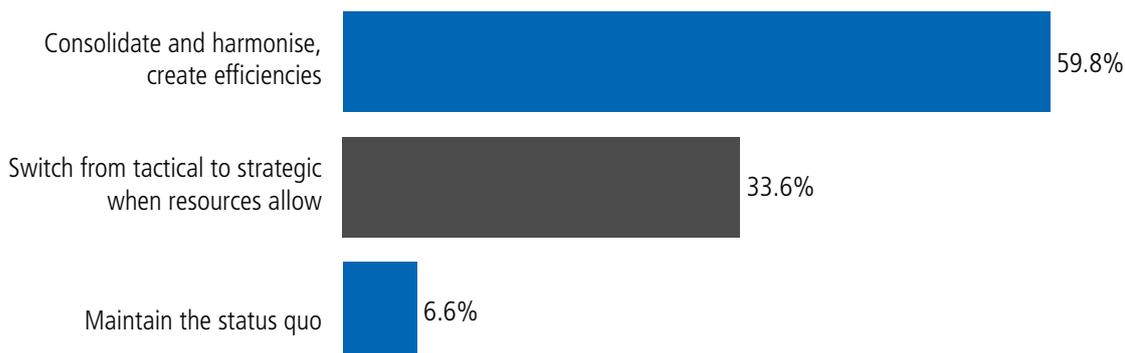
Nearly 60% of respondents said consolidation, harmonisation and the creation of efficiencies were priorities as the pace of regulation slows. It is noteworthy that one-third of participants are looking at the best way to transform these into something more strategic. That is understandable in theory – for example, when using credit reporting to



3. What is currently the major challenge with your regulatory compliance?



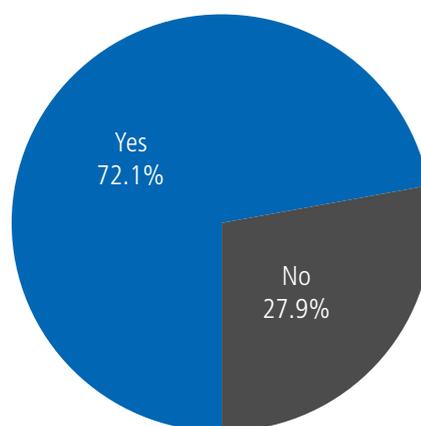
4. As the pace of regulation slows, what are your plans with regard to your regulatory solutions?



identify geographies and industries on which to concentrate. How consolidation and harmonisation play out in reality, however, is something to keep an eye on (see figure 4).

The 72.1% “yes” response to whether the current regulatory environment has changed respondents’ views of technology underscores the need among risk, finance and operations to trim expenses after years of budget flowing into various regulatory initiatives (see figure 5). The almost even split in these results as to whether respondents believe there is a competitive advantage in regulatory compliance solutions is likely attributable to respondents’ various perceptions of what creates competitive advantage. What can be inferred from the “yes” answers is respondents citing factors that underscore an efficient, responsive system. That might not appear to be competitive in a proactive, strategic way, but an inefficient regtech platform would definitely place a firm at a competitive disadvantage (see figure 6).

5. Have the current regulatory environment and initiatives changed your view of technology selection from “best in breed” to “integration-friendly”?



The nearly three-quarters positive response to the question of regtech solutions being used for non-compliance strategic objectives in the near future is indicative of two interconnected phenomena. First, the amount of energy and resources that have gone into building these platforms is such that no one wants to limit their applicability. Second, the ability to bring vast amounts of data into the process is clearly something that can be mined for strategic and, ultimately, commercial purposes (see figure 7).

We know there is more work to do in the regtech space, but it should be noted that those budgets are small in comparison to the potential cost savings from harmonisation of systems and the introduction of technologies such as cloud computing (see figure 8).

Fighting for resources is not new within the financial services sector. What will be interesting is how well the regtech business can hang on to its space after it is fully transformed into a more strategic entity (see figure 9).

The idea that social media and online retailers would be the source of new talent is no longer viable. Right or wrong, the majority view is that hiring initiatives that extend into non-financial sectors require too much effort to be brought into line with how things work in the world of finance (see figure 10).

The overall positive response to whether respondents are seeking staff with varied skills is indicative of the appetite – or necessity – for people who have experience beyond the traditional programming and operating skills. One could argue that this is a reflection of how the area is moving from a reactive support function to a much more creative, proactive one. Considering this move, there will always be a need for people with expanded capabilities (see figure 11).

Given all the constituencies and vested interests in this field, it is not surprising there is appetite to get everyone around a table and figure things out in the form of a regtech council. Since, in recent years, all of the major regulators have shown a willingness to be active participants in the development of innovative regulatory initiatives, it might make sense for one or more of them to take the lead (see figure 12).

The almost even split between respondents who would or wouldn't adopt cloud-based regtech solutions is difficult to understand. Those who would, cite the traditional cloud benefits of lower cost and greater efficiencies. It can be assumed that those who would not are considering

security concerns and lack clarity about what can actually go onto the cloud. One word that appeared regularly from positive respondents was 'blockchain', which will probably be the next turn of the wheel for regtech (see figure 13).

The advantages of start-ups are well documented – faster, newer thinking without the burden of a bureaucracy. However, there is an increasing perception that, in internally systemic matters where regulatory sensitivity is required, larger institutions have an edge. This edge can take them beyond the regulatory arena (see figure 14).

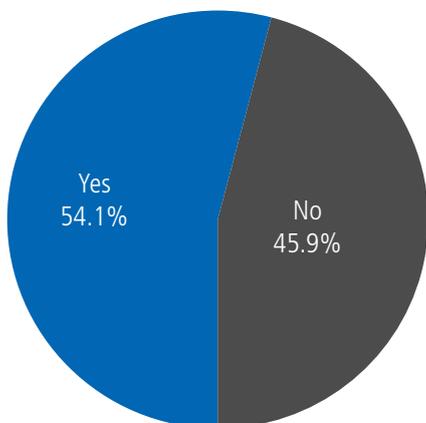
It is no surprise that respondents believe regtech is being used most effectively among international banks, but it is worth bearing in mind that challenger and international banks paid the price for the position they hold. Expect to see mature domestic UK banks – as well as non-Western regional banks – learn from the experience of others (see figure 15).

SURVEY METHODOLOGY

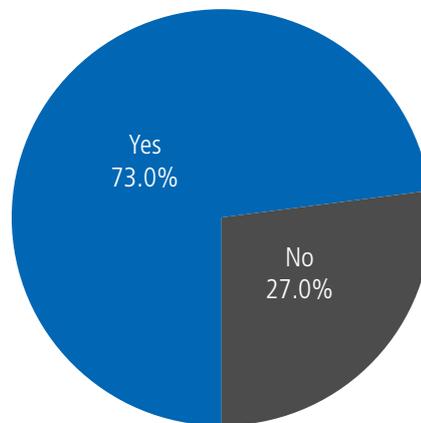
The regtech survey was conducted by Risk.net and commissioned by Moody's Analytics, receiving 122 valid responses.

The survey was conducted between November and December 2017, and respondents were drawn from individuals working in compliance, technology, finance, risk, regulation and operations at banks, and the results collated from respondents who answered 100% of the survey. Responses came from Asia-Pacific (17%), Emea (59%) and the Americas (24%).

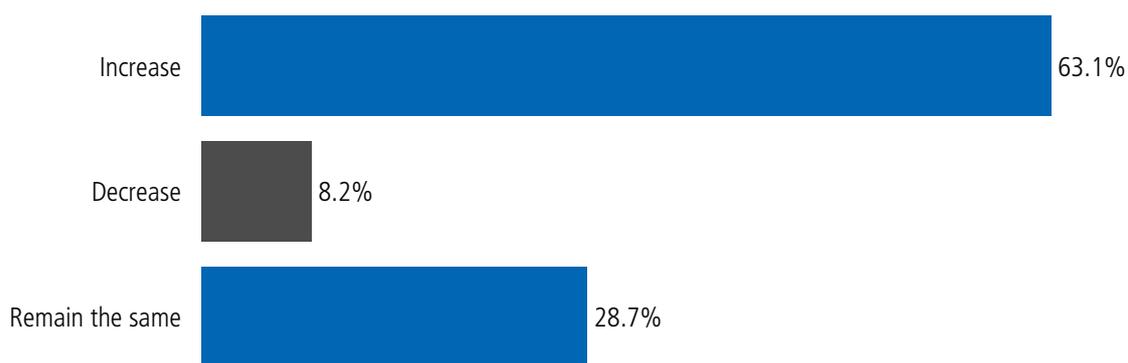
6. Do you see any competitive advantage in regulatory compliance solutions?



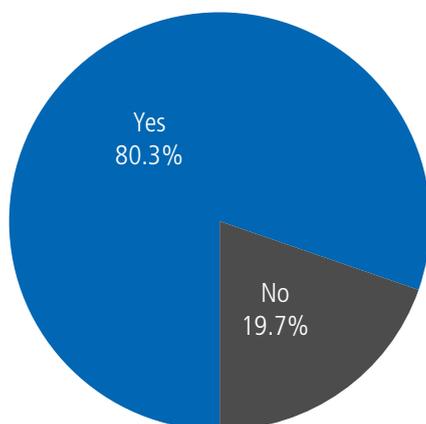
7. Within the next five years, will regtech solutions be used for non-compliance strategic objectives?



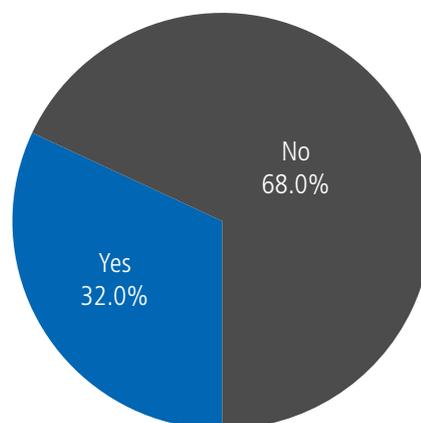
8. What will be the direction of your regtech budget over the next two to three years?



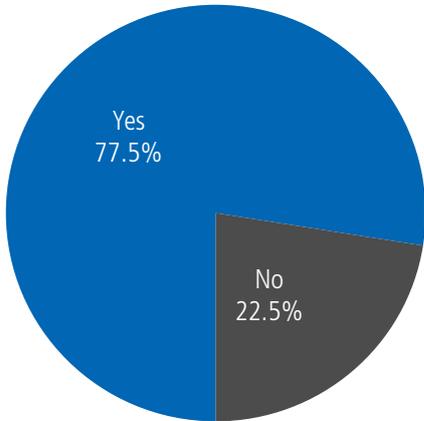
9. Do you see a competition for budget between regtech and other technology expenses?



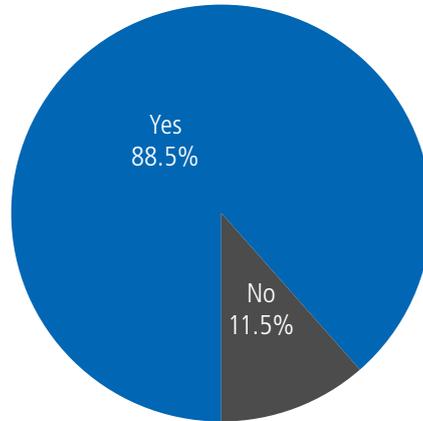
10. Do your regtech hiring initiatives extend into non-financial sectors?



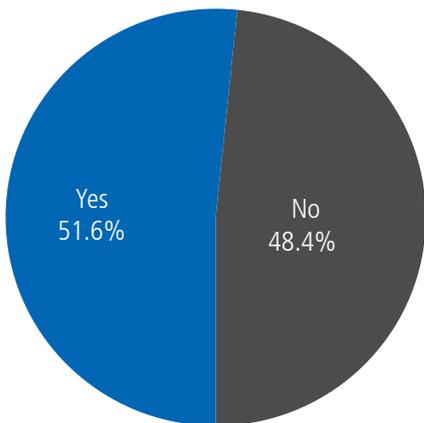
11. In the regtech space, are you seeking personnel with different skills than currently in your bank?



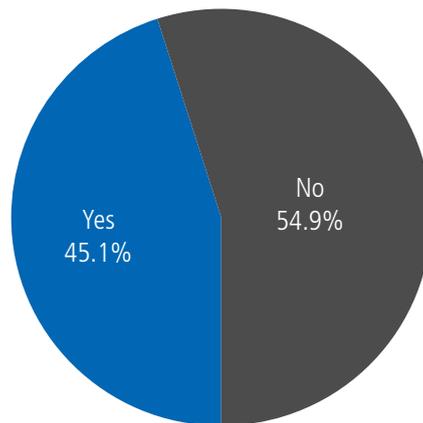
12. Would you be in favour of a regtech council?



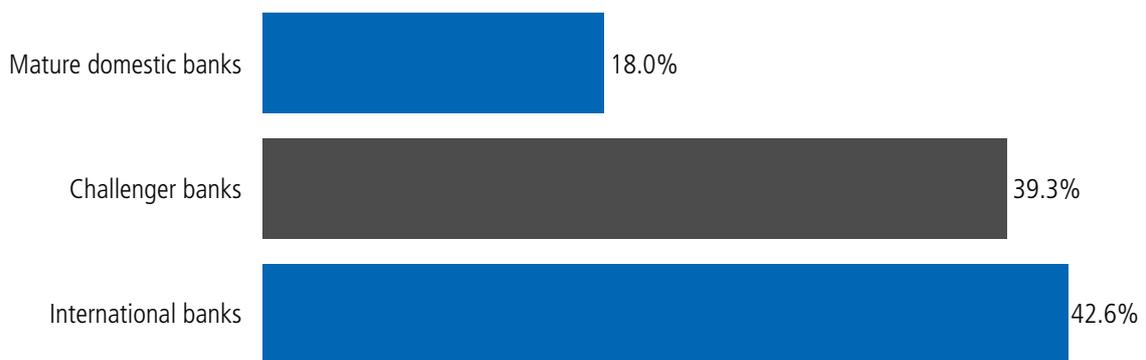
13. Would you adopt cloud-based regtech solutions?



14. Are smaller regtech start-ups better than more established companies?



15. In which banking sector is regtech being used most efficiently?



Conclusion

Surveys are insightful snapshots, but regtech is such a fast-moving phenomenon that one can expect significant changes in attitudes and actions in the near future. The results provide a glimpse into a world in which banks have been trying for nearly 10 years to meet the changing needs of the regulatory community through existing technology platforms. Those platforms, however, haven't always been optimised to produce the most efficient results. While that challenge has put a strain on budgets and personnel along the way, it has also alerted banks to the role regtech can play beyond its original mission of delivering compliance. To accomplish that, banks must first fully understand the vast world of new technology and then make the right decisions on how to marry existing and new technologies. As always, those that act quickly and correctly will benefit the most.

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