REGULATION TECHNOLOGY

RISK

Taking a risk-based approach to regulation

Regulatory risk is an increasing burden, yet many firms are still not taking an integrated risk-based approach to dealing with compliance

DAN BARNES

Financial services firms that can predict probable regulation can use this insight to improve business practices, avoid non-compliance, and create a more positive reputation with clients and authorities.

"Regulatory expectations are not static," says David Lawton, partner at consultancy Alvarez and Marsal, and former director of markets policy and international at the Financial Conduct Authority. "Issues and approaches, which might have been under the radar ten years ago, suddenly come to the top of the agenda, and firms will then have to scramble to confirm they are not falling foul of these."

Post-crisis banking has had a relatively consistent stream of court cases and regulatory rulings as historic practices are brought to light and found wanting. These range from engagement in cartel behaviour when setting the London Interbank Offered Rate (LIBOR) benchmark to tax advisory business, which was found to be helping evasion, rather than avoidance. Moreover the sets of rules that frame financial services activity have changed considerably in this period.

"We have had to manage a wave of new rules since the 2007/8 crisis," says Jean-Marc Guiteau, head of regulatory technology (regtech) for BNP Paribas Securities Services. "The size of the wave is reducing now, but that does not mean the flow of work is becoming less constant. While new topics are not arising, the rules that have been set are constantly being fine-tuned and corrected."

To keep abreast of both changing rules and themes, financial services businesses must have a solid set of processes, which can capture that information and integrate it into plans and operations.

"Even if you are capturing all the data from regulatory announcements and feeding that back into your bank, you still need to ensure you have qualified what effect that information has on your business," says Mr Guiteau. "You need business process management tools to bring the new rules into your workflow. That must feed into your policies, procedures and documents. As a result there is not one single technology that addresses the end-to-end solution; it will be a mix, and will depend on the complexity and scale of your business."

Technology providers are finding fertile ground in their support for managing regulatory risk. Research by Alvarez and Marsal, published in January, found that of 352 regtech startups, the largest segment (84) were offering support for regulatory compliance and the segment of firms that showed most growth (68.8 per cent) in their collaboration with banks, regulators and domain experts was compliance support.

Working with regtech providers can help financial institutions of all sizes to tap into new technologies and overcome any limits that existing IT infrastructure might have. Where the practical challenges of supervising activity once required an expansion of headcount and manual processing, the increasing electronification of business is making automated supervision more viable.

"If you are a human, you might have to look at samples of all the events that have occurred to monitor compliance. However, if you have a machine doing the monitoring, it ought to be looking at 100 per cent of events," says Michael Grecoff, chief executive of regtech firm Bay Street Technologies.

Brian Collings, chief executive of Torstone Technology, observes: "Recently the regulators have been making sure the relevant data is being provided from financial firms, but increasingly the focus will be on the quality and completeness of that data. Firms now need to show there are systematic controls in place to ensure you are providing accurate regulatory and compliance reporting."

A growing number of reporting requirements have made firms more transparent, particularly in the areas of trading activity, risk management and fees. Many businesses are capturing that data and feeding it back into the firm to build a single view of risk.

"An integrated approach, when dealing with regulatory compliance, is also a much more efficient way of providing accurate regulatory and compliance reporting, because the quality and completeness are already part of your regular daily operational processes, so with minimal additional effort, you can add the controls to ensure the accuracy," says Mr Collings.

The key to deriving value from technology in this way is to ensure that information is turned into usable knowledge, notes Mr Guiteau.

"This kind of widened data access and the capacity to manage more data is useful, but you can reach a point you have so much data you don't know what to do," he says. "So I do believe broadly that the more data we have, the more confidence we can get, but we have to be cautious regarding the qualification of the data, its analysis and that any decision we take [based upon it] is in context."

The classic model of risk management is to operate three lines of defence in which the business line manages risk, oversight is provided to check that management and then the process is audited to assess its success. Imposing this within compliance allows firms to improve control of their exposure to regulatory risk. This must be built upon thoughtfully if firms are to handle regulation successfully as they do other risks.

"To take a risk-based approach you need to first consider the inherent riskiness of what you do; secondly, the comfort you have in your first-line controls around what you do; and third, keep a forward-looking eye on the potential for regulators to move their own focus as to what is important," says Mr Lawton of Alvarez and Marsal.

To some extent that will require investment in, and engagement, with new technology providers to develop capabilities that meet the expectations of authorities.

"If you are a large firm and you do not budget appropriately to use the latest technology, then you could be failing your regulatory obligations," warns Mr Grecoff.

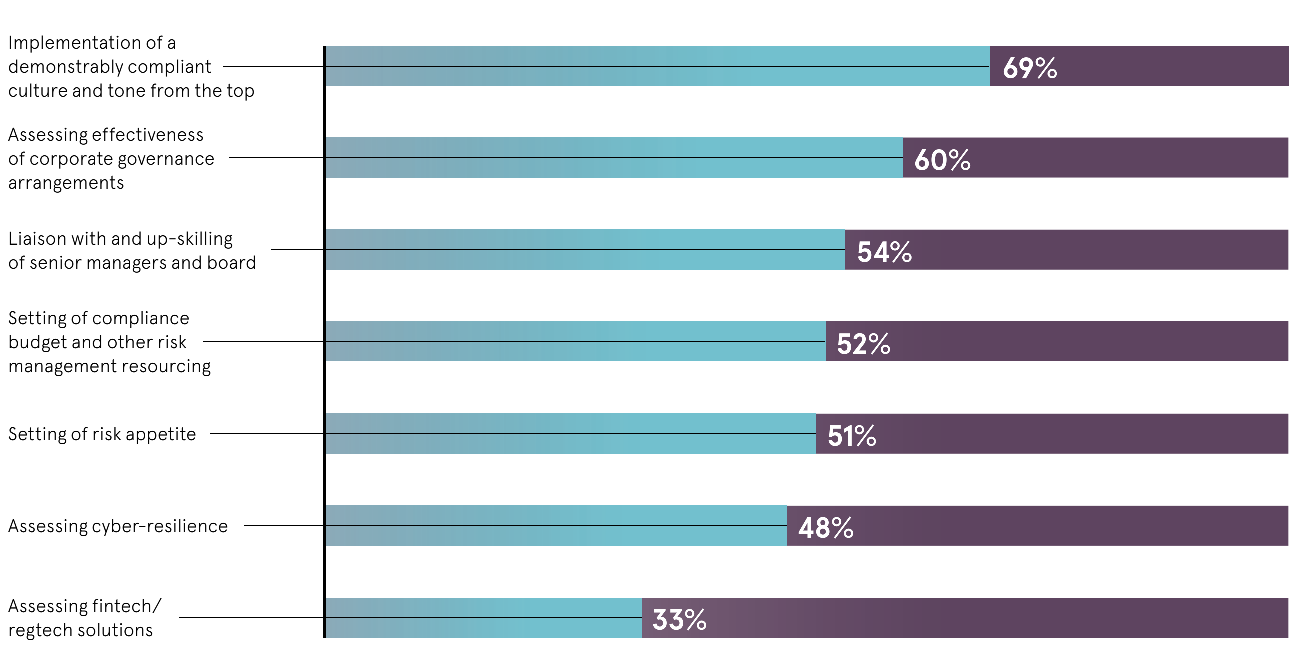
However, it will be necessary for business leaders to create the right environment for a risk-based approach to bed down and to enable change.

Mr Guiteau concludes: "Senior managers have to support not just the creation of ideas, but they must give the time to test and run new solutions." ◆

> It will be necessary for business leaders to create the right environment for a risk-based approach to bed down and to enable change

Rising compliance involvement

Areas where global compliance professionals in financial services expect more involvement



Thomson Reuters 2017

Main drivers for outsourcing all/ part of the compliance function

56% of compliance professionals in financial services said they needed additional assurance on compliance processes

41% said a lack of in-house compliance skills drove them to outsource

38% said cost was the main driver

Thomson Reuters 2017

Distributed in THE SUNDAY TIMES

Research partner CAPCO THE FUTURE. NOW.

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Commercial feature

COMPLIANCE AND TECH

Capital markets must both keep up to date with the latest technologies and stay agile enough to adapt to new regulations

A new dawn: driving innovation in capital markets

Ever since the 2008 financial crisis shook the global economy to its core, capital markets have been operating under much greater scrutiny

In an environment of tighter regulatory constraints, low interest rates and sluggish economic growth, capital markets have faced increasing pressure to demonstrate both their viability and profitability.

While capital markets have been slower than some of their financial services counterparts to embrace innovation, the need to utilise new capabilities and think beyond the traditional business model has grown too compelling to ignore.

According to James Arnett, partner and UK head of capital markets at Capco, the question for capital markets is no longer whether to invest in innovation, but how to do so effectively and to their best advantage.

As capital markets move beyond the regulatory agenda which has dominated the industry for the past eight years, Mr Arnett believes there is a definite shift in mindset towards revenue enablement initiatives, as well as renewed focus on cost reduction. Through the implementation of next-generation technology, spanning micro-services, cloud and grid technology, banks will be able fully to harness the true power of data.

Mr Arnett explains: "Historically, capital markets have developed new products only after recognising a gap in the market or the opportunity to create a margin, rather than deliver a data-driven proposition that anticipates what clients may need. Leveraging next-generation technology will reduce costs and enable banks to understand and commercialise the wealth of data they have to help them better anticipate and meet the needs of their consumers."

He expects investment banks increasingly to move to a model where they create alternative products and services based on trends they see in the transactions their clients make, as well as general market movements.

At a time when margins has become a leading watchword, there are only two ways for investment banks to remain profitable: shredding costs and embracing innovation. And that means self-disruption.

According to Kim Sgarlata, partner at Capco: "Focusing on what you're good at, and continually looking to improve and build upon those assets, is something we widely see in other industries, but need to see much more in the capital markets space. Innovation should be a tool used to help banks maximise their potential."

In the face of rising competition from startups, the need for banks to play to their strengths is key. Arguably the greatest loss for banks to competitors will not be from revenue, but data. The trend is already firmly underway in the retail market and, while the threat will be less invasive in capital markets due to the different nature of the beast, banks cannot afford to be complacent.

Jibran Ahmed, head of research and development at Capco, says startups will begin by taking small slices of business, for example by offering a faster, cheaper foreign exchange capability, rather than offering a full suite of capital markets products to rival legacy banks. But this move will have a detrimental impact on a bank's view of its client.

Mr Ahmed explains: "In this scenario, an incumbent would lose sight of certain transactions, in which their institutional client is engaging. This could reduce their ability to utilise next-generation data analytics to offer suitable products, such as hedges and interest rate swaps, at the opportune moment. This loss of data and the associated insights could be substantial for future growth, particularly in a world where new entrants are nimble, data-driven organisations capable of extracting valuable insights from their data."

Technologies such as blockchain, machine-learning and artificial intelligence are attracting lots of attention from the capital markets sector. However, the successful implementation of these technologies and the realisation of the touted benefits will be heavily dependent on how they are applied. This includes careful consideration of the types of problems they can solve, curating the relevant data and fostering a culture where new technologies can be implemented safely, pragmatically and with more agility than most banks are capable of today.

Mr Ahmed says: "While realising the benefits of blockchain technology is still several years away for capital markets, machine-learning can offer significant benefits in the very near future. Banks can identify patterns across data sets and accurately predict potential scenarios ahead of time. In addition to customer-facing use-cases, machine-learning can be used to enhance the automation of many time-consuming tasks that plague the back offices of incumbent banks. It can also enable smarter, faster decision-making in complex areas such as risk and collateral management."

Ms Sgarlata points out: "The way forward is collaboration with fintechs, rather than competing with them. Banks should embrace fintechs as partners and create a trusted partnership network. The concept of open innovation, where you look beyond your own four walls for inspiration and input, will ultimately make banks stronger, leaner and better prepared for future changes to the markets."

Exactly where the market is headed in terms of regulation remains an unknown. However, given the current political climate, with the outcome of Brexit negotiations and the impact on the UK financial services market still posing a huge question mark, the effects of capital and collateral optimisation have never been more important.

Ms Sgarlata says: "Many of the larger banks are sitting on a gold mine of data. The most successful ones will be those who analyse and commercialise that data by making use of their findings to better serve their clientele.

> Leveraging next-generation technology will reduce costs and enable banks to understand and commercialise the wealth of data they have

"While there is no mandate to share data between investment banks, if someone finds a compelling use-case, which offers significant benefits to the banks or their clients, adoption will be forced through the need to compete."

Banks should begin to explore the idea of working together to create a new ecosystem in which they buy, sell or even share services with each other. This would create higher standards for the industry and provide the best solutions to customer. But to be able to respond to future changes in the market and harness innovation to its best ability, banks must also adopt a more agile way of working, with greater cross-team collaboration.

According to Ms Sgarlata, innovation is not limited to technology and processes, but can disrupt and improve the base business model.

She says: "Over the next three years, banks should be focused upon transforming their workforce as part of their innovation process. They need to begin reinvesting in their people, including the ways in which they work and the environments they work in. This builds a culture that recognises the value of staff while simultaneously improving retention."

Arguably one of the greatest hurdles facing legacy banks is their legacy architecture and culture, which limits their ability to implement changes swiftly.

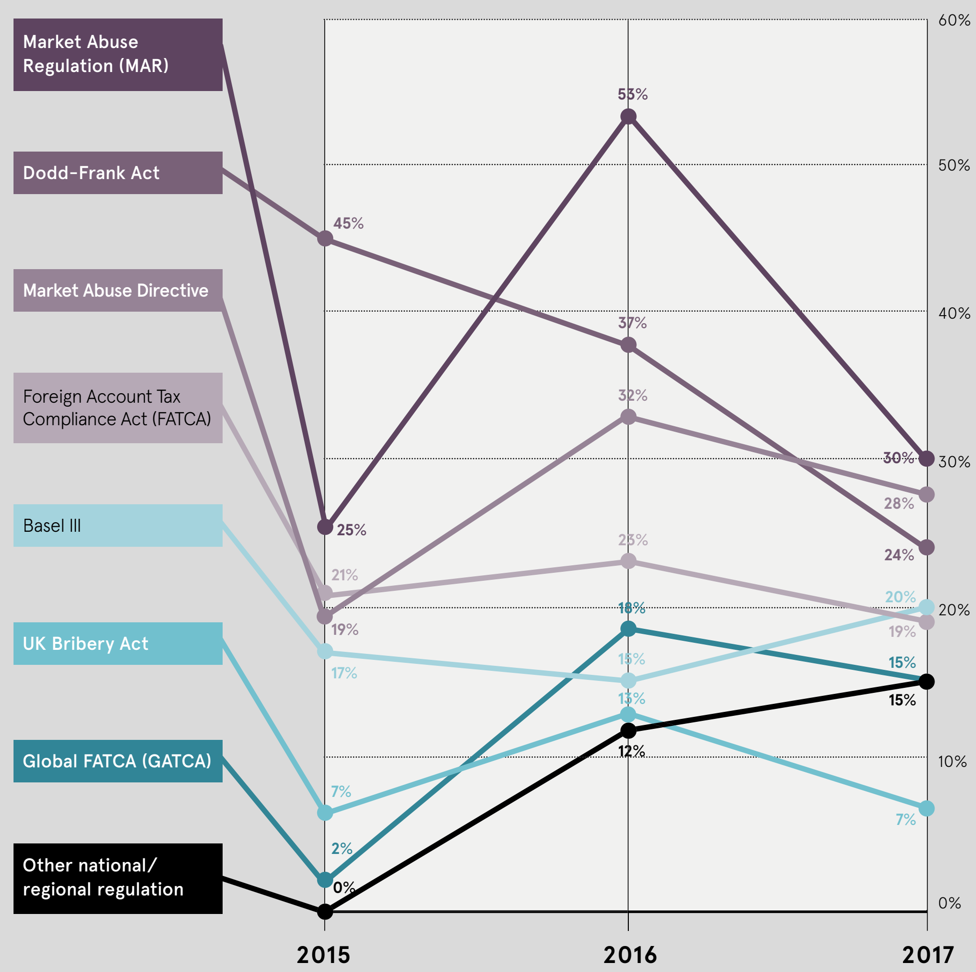
Mr Ahmed explains: "The issue you have with legacy architecture is that a change in one system may have a domino effect across other systems and business functions."

Capital markets are undoubtedly entering a new era. A rise in entrepreneurship, maturing markets and growing financial globalisation mean the demand for capital markets will remain strong, but only those who embrace innovation and a new way of working will flourish.

For further information please visit www.capco.com

Regulatory concern

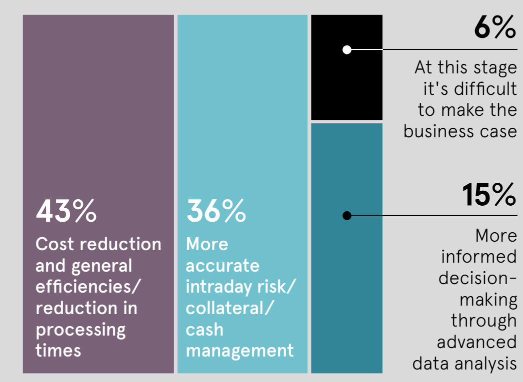
Most challenging regulations to address over the next 12 months



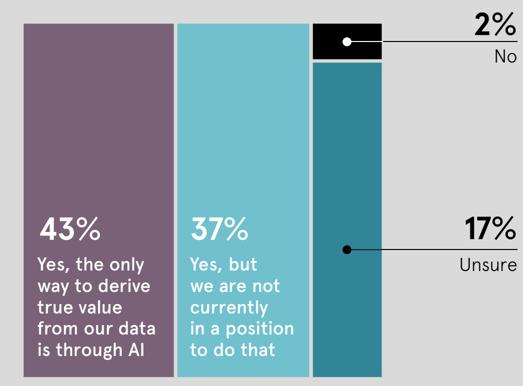
Nasdaq Global Compliance Survey 2017

AI adoption across capital markets

How can you make the business case for adopting AI technology?



Will AI give your business a competitive advantage by getting new insights to your data?

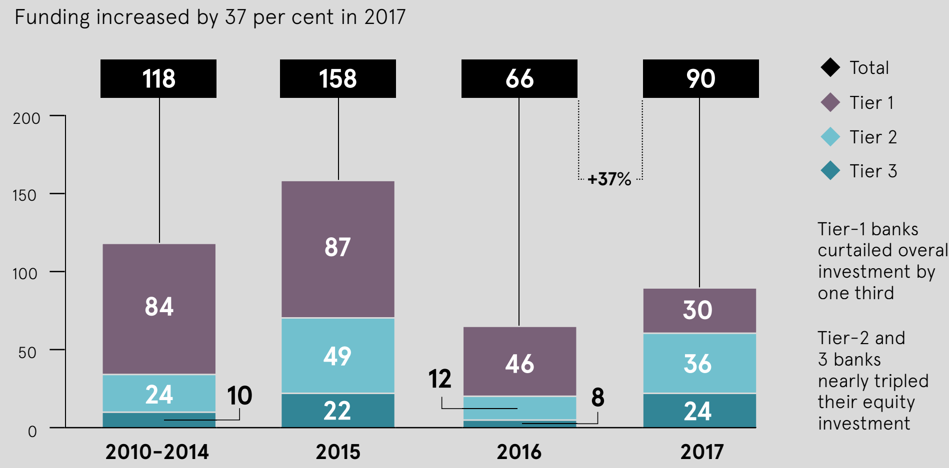


Figures do not add up to 100 due to rounding

Waters Technology 2018

Investment banks' fintech funding ($m)

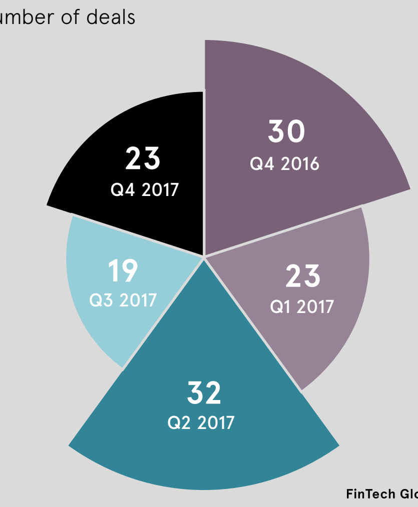
Funding increased by 37 per cent in 2017



BCG 2018

Global regtech investments

Number of deals



FinTech Global 2018

Questions of innovation

Capco CEO **Lance Levy** answers questions on a new era of change and innovation in capital markets

Q: Where do you think innovation in capital markets is going?

A: There is now a wide range of next-generation technology available for investment banks active in the capital markets space, including micro-services, cloud technology, machine-learning and automation. Over the past five years, banks' regulatory focus has meant that new technology has mainly been used to enhance trade surveillance and anti-money laundering processes. However, as investment banks seek to unlock new revenue streams with greater margin potential, we are now starting to see an increased appetite for next-generation technologies.

Many are collaborating with fintechs to offer new products to their institutional clients. There is also a growing recognition that banks must utilise the power of data to improve decision-making and provide immediate client insight through real-time risk management, reporting and analytics.

As new technology and innovation continues to gather pace, capital markets institutions will move to secure their future in a highly competitive and digital environment. This success can be achieved by partnering with consulting and fintech firms to help them enhance their service offerings, but they need to select the appropriate partners to suit their specific objectives and client base.

Q: What is the impact of globalisation on innovation in financial services?

A: Financial institutions can no longer innovate for local markets alone. Today's consumer wants to access their financial information at any time, on any day, from anywhere in the world. This means when we innovate in London, we must also innovate in New York, Frankfurt and São Paolo. This need for global solutions offers an unprecedented opportunity for consumers and businesses alike.

Globalisation isn't just driving product innovation; it is a key enabler when it comes to innovating business models, allowing for faster, more efficient and cost-effective cross-border transactions and services.

While the increasing globalisation of the financial services industry has in part been driven by converging, and in some cases diverging, global regulation, the new culture of instant execution and demand for sophisticated services will only spread, and products and solutions must be designed to meet this trend.

Looking forward, the growth of artificial intelligence, blockchain and digital platforms is likely to facilitate financial globalisation further, and pave the way for new entrants to capital markets.

Q: Will converging global regulations drive or hinder innovation in future?

A: Regulation doesn't actively seek to drive or hinder innovation; it is there to protect and improve the financial markets. Regulation is critical through the entire innovation process and banks will purposely build regulatory considerations into their transformation programmes, ensuring that new technologies and solutions are fit for purpose.

However, the sheer amount of regulation under which capital markets now operate has encouraged investment banks to explore new ways to optimise and maximise opportunities, rather than just meet minimum standards.

Q: What impact will incoming innovations have on the way people work?

A: One of the biggest misconceptions about implementing new technology to drive change is that you can do it without making any other changes within the company. Technology is undoubtedly a fantastic enabler, but that is exactly what it is, an enabler. It won't have the desired impact if the business does not also adapt.

A cultural shift is almost always required which is just as important as the innovations you implement. This is particularly relevant in financial services because talent is increasingly being lost to technology firms that have managed to embed innovation into their cultures. To remain competitive and make innovation truly work for them, banks must take a more agile approach to technology innovation. Typically, investment banks have an infrastructure built on legacy systems and teams working in silos; for innovation to work, this needs to change.

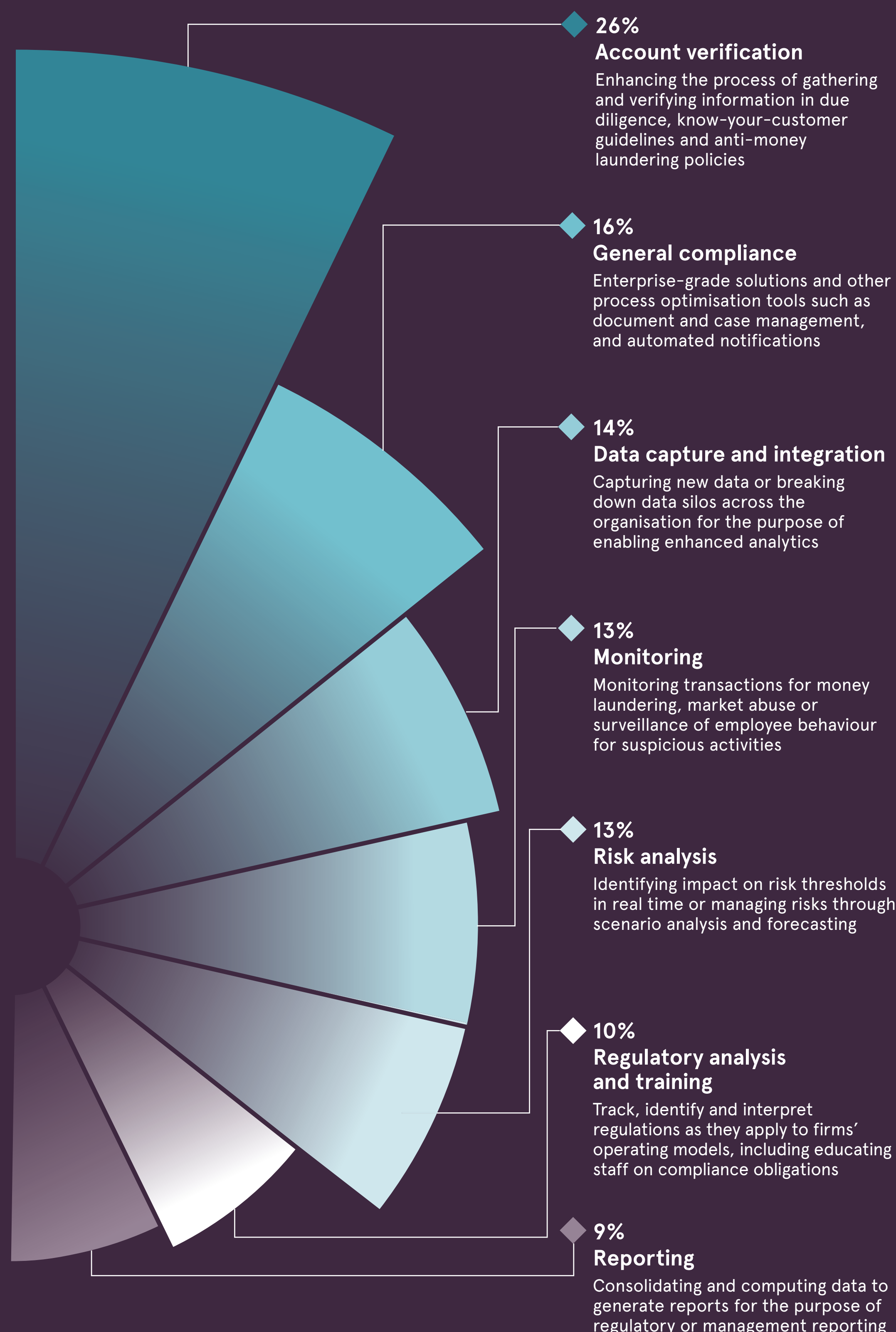
As the industry emerges from the regulatory agenda of the past eight years, which has seen it focused upon meeting new requirements, we are entering a new era of innovation and change. Banks have fantastic advantages: client trust, reputation and access to vast amounts of data. The onus must now be upon using these advantages to secure their positions in the changing landscape.

WORLD OF **REGTECH**

A steady stream of rules and regulations since the financial crisis means banks, insurers and investment institutions need to keep on top of compliance or risk heavy fines. Regtech providers have stepped in to offer support, helping financial services firms of all sizes meet growing regulatory risk with emerging technologies and automated supervision

Regtech firms by service

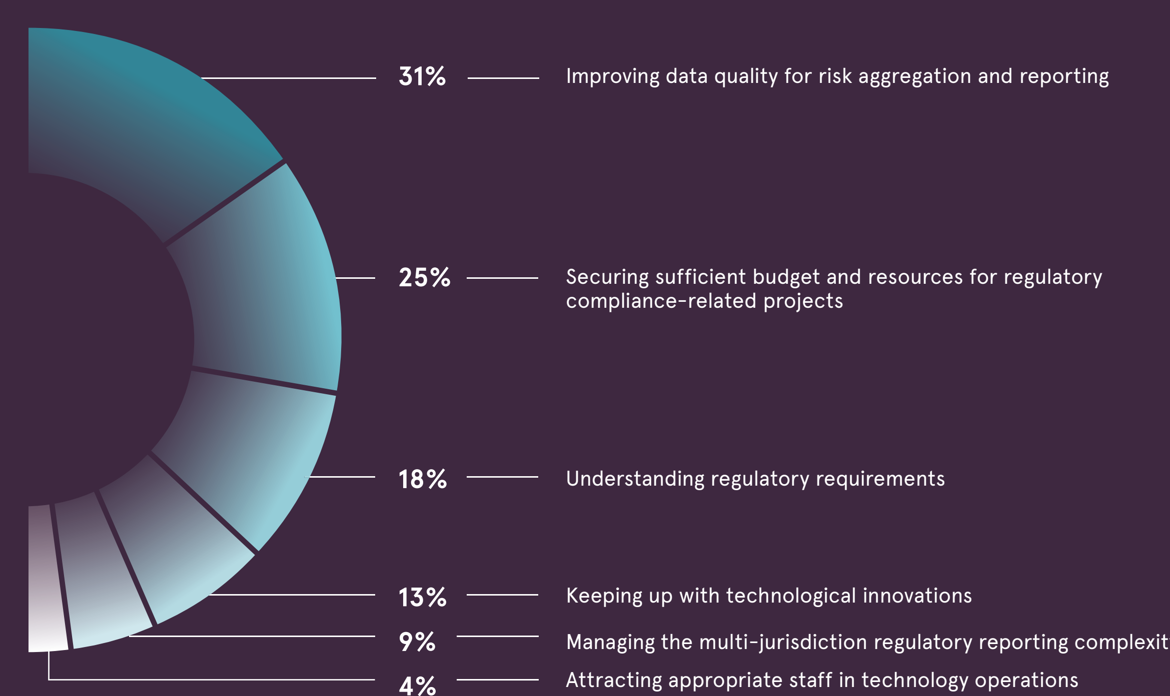
Sub-sectors of the 391 regtech firms worldwide



Boston Consulting Group 2018

Help needed in regulatory compliance

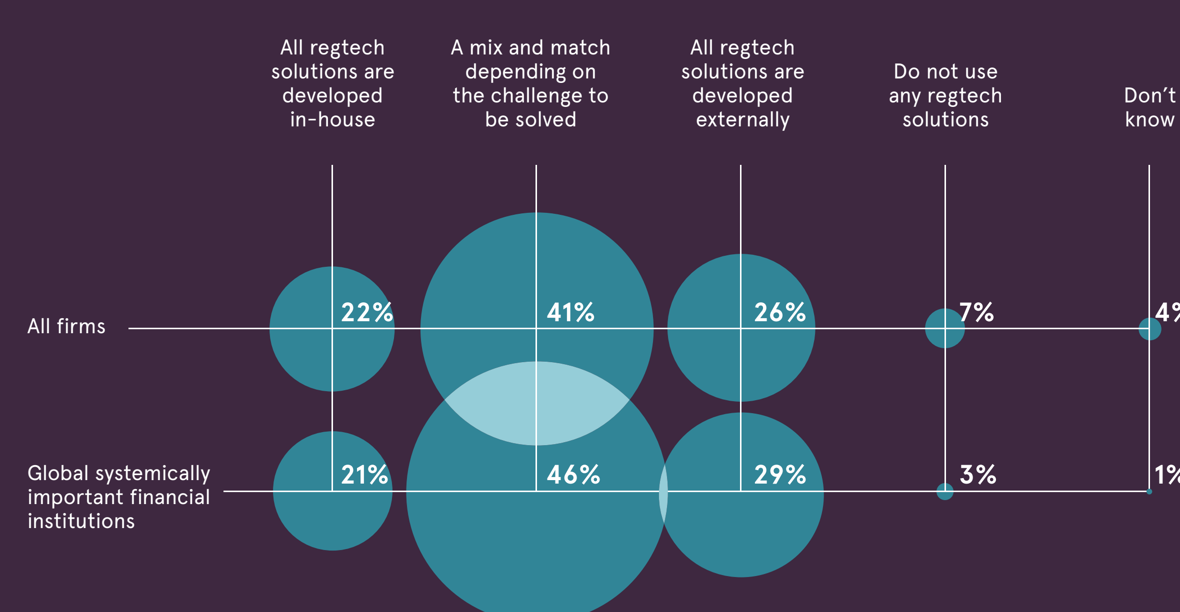
Percentage of compliance, technology and risk professionals in global banking who rated the following as the main challenge



Moody's Analytics 2018

In-house or external regtech?

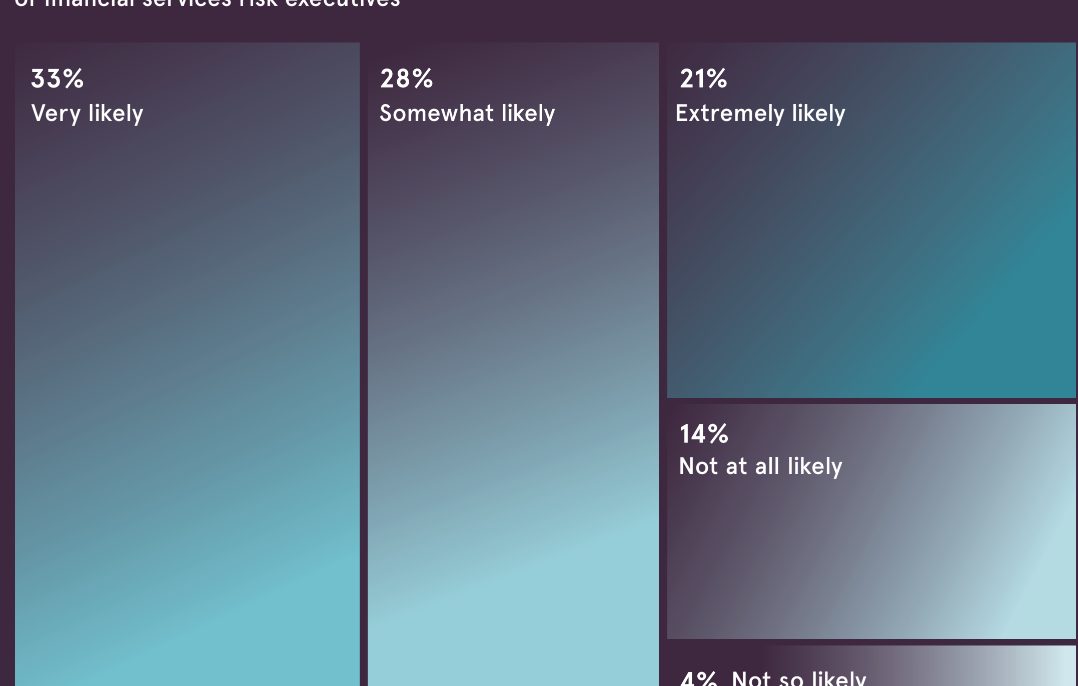
How global financial services firms are deploying regtech solutions



Thomson Reuters 2017

Regtech budgets

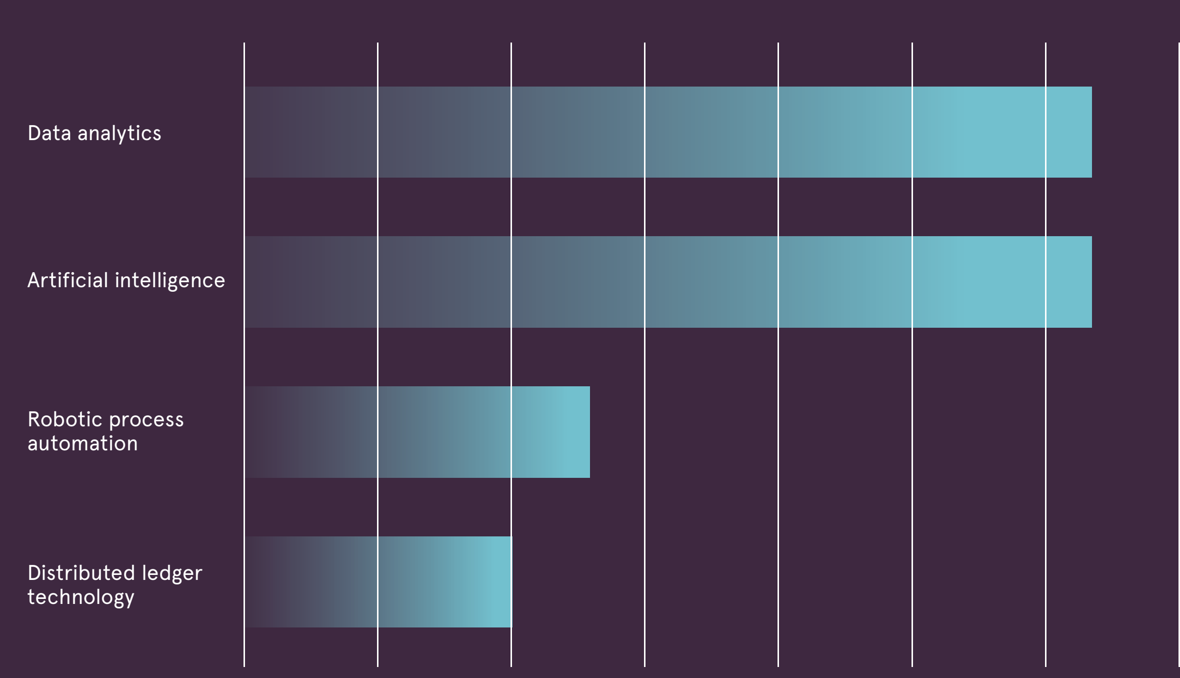
Likelihood of increase in regtech budgets; global survey of financial services risk executives



Dow Jones/SWIFT 2017

Underlying technology for regtech solutions

Survey of global regtech startups



Alvarez and Marsal/*Burnmark 2018*

Top benefits of regtech for financial services

Ranked by financial services firms, regulators and trade associations

BankingTech/BearingPoint 2017

Joined-up thinking on regtech

Successive waves of financial regulation are imposing new reporting obligations on financial services firms. With regulatory compliance absorbing increasing resources, **Compliance Solutions Strategies** argues for a strategic rather than a tactical approach to meeting reporting obligations

"We are drowning in information, while starving for wisdom," observed the esteemed biologist Edward Osborne Wilson. He predicted a future in which the world would be run by "synthesisers": "people able to put together the right information at the right time, think critically about it and make important choices wisely".

Wilson's reflections are apposite for the regulatory compliance challenge facing the financial services industry. Here the challenge is to make sense of the unstructured data that is the source material for regulatory reporting. What has been less clear is who exactly will step up and play the pivotal role of Wilson's synthesisers, aggregating and standardising the right sets of data to comply with each piece of regulation.

From fintech to regtech

The search for leadership has seen governments as far apart as Singapore, Hong Kong, Ireland and the UK promote a financial technology, or fintech, agenda with a spotlight on regulation, known as regtech. As far back as 2015, then-chancellor George Osborne used his Budget speech to outline government support of the fintech sector, calling upon the UK's Financial Conduct Authority to work with the Prudential Regulation Authority to "identify ways to support the adoption of new technologies to facilitate the delivery of regulatory requirements".

It was against this backdrop in late-2015 that two seasoned executives teamed with

69%

of chief compliance officers say their organisation leverages technology to support its compliance initiatives

private equity to first identify and then bring together leaders in the field of "disruptive" regulatory technology to create a global regtech platform. Up to this point the approach had, of necessity, been less joined up with financial services firms obliged to source regulatory solutions piece by piece from a collection of opportunistic fintech startups that had emerged in the aftermath of the financial crisis.

The goal was to create a single, well-capitalised platform with a global footprint that offered a broad set of software-as-a-service-based solutions to meet demand for compliance with a growing raft of mandatory regulations. A year-long search and evaluation led to the rollout of Compliance Solutions Strategies (CSS) in January 2017.

The timing could not have been better. Surveys that track annual trends in measuring the impact of regtech on the role and remit of compliance within financial services firms point to steadily increasing demand. In its most recent survey, Thomson Reuters shows that the adoption of regtech solutions among financial services firms almost doubled in 2017 to 30 per cent of respondents, compared with 17 per cent the previous year. Demand continues to grow. Approaching three quarters of those polled indicated that the successful deployment of regtech solutions increased the efficiency and effectiveness of compliance.

Integrated approach

A key factor in a coherent approach to compliance is ensuring that regulatory reporting and data management are not treated as separate functions. "The relationship between data management and regulatory reporting needs to be co-ordinated," says Ronan Brennan, chief product officer at CSS. "Otherwise you end up with multiple vendors interrogating the same data sources, demanding technical integration resources and requiring assistance from data analysts. In essence, it's an inefficient mess of data flows, exception management cycles and expensive resources tied up in repeated work."

John Lee, president of CSS, agrees. Clients really need data management and regulatory reporting to be provided in an integrated manner, he says. "While adoption of a robust reporting solution is often the demand driver, any report you submit to the regulator is only as good as the information you use to populate it and ultimately that is what you will be judged on," says Mr Lee.

He insists that data integrity is key to the quality of reporting. "You often find that the most economic and efficient way to undertake mandatory reporting across a raft of regulations is to repurpose data that has already been validated on your behalf," he says. "If, for example, you're doing client reporting, some of the data in your client reports could be repurposed for your regulatory reporting." In addition, Mr Lee notes, there is often overlap between regulations, where the same data considerations apply.

Vendor risk

From the regulator's perspective, a key concern in the whole process is what has become known as vendor risk. "Regulators are saying, 'You need to ensure that the vendors you engage are here for the long haul and that they are provisioned and organised in an efficient and highly available state'," Mr Brennan comments.

Beyond the operational vulnerabilities, he says industry purchasing habits often work against optimisation. "Regulations are coming through in waves, but for each new wave, the tendency is to go back to the market," says Mr Brennan. "Firms don't automatically use the same vendor for MiFID II and for SFTR, for example. What's needed is a strategic rather than a tactical approach to compliance."

Mr Lee adds: "Vendor risk is top of mind for regulators, concerned as they are about single points of failure. There are inherent dangers in adopting regulatory compliance solutions in isolation." Why? Because such an approach makes a single point of failure more likely. "There are a lot of single or dual-product vendors that are de facto the weakest link in your compliance architecture," says Mr Lee.

> There are inherent dangers in adopting regulatory compliance solutions in isolation

The private equity backing that underpins CSS enables it to invest in building out its global platform, while establishing synergies between different solution sets and broadening the markets it covers. "The single vendor offers a tactical solution," says Mr Lee. "We're offering a strategic partnership that helps a client identify where it is weakest in delivering on its compliance requirements and enabling it to strengthen those aspects of its approach."

Business channels

He describes CSS as providing three integrally linked business channels. One includes regulatory reporting, and regulatory data management and distribution. "This represents an axis of products that ensures your reporting and related data input is of the highest order," Mr Lee explains. "The second channel is what we call trade compliance monitoring, reporting and analytics, and that includes best execution, trade and transaction reporting, inter alia. Channel three is compliance services, where our knowledge base comes into play."

Mr Brennan adds: "There are firms that have a purely technology approach to regulation. A comprehensive solution, however, requires investment in knowledge, as well as technology and process."

For more information please visit compliancesolutionsstrategies.com

John Lee
President of CSS

Case study

CSS delivers strategic compliance and regulatory vendor services

01 Regulatory reporting Manage multiple forms and filings from a single platform that includes automated validations and compliance checks.

02 Regulatory data management Leverage CSS solutions to identify, source and enrich data, as well as to share data securely for regulatory purposes.

03 Trade monitoring and analysis Comply with post-trade reporting and surveillance regimes, position limit and substantial shareholding thresholds and other market transparency requirements.

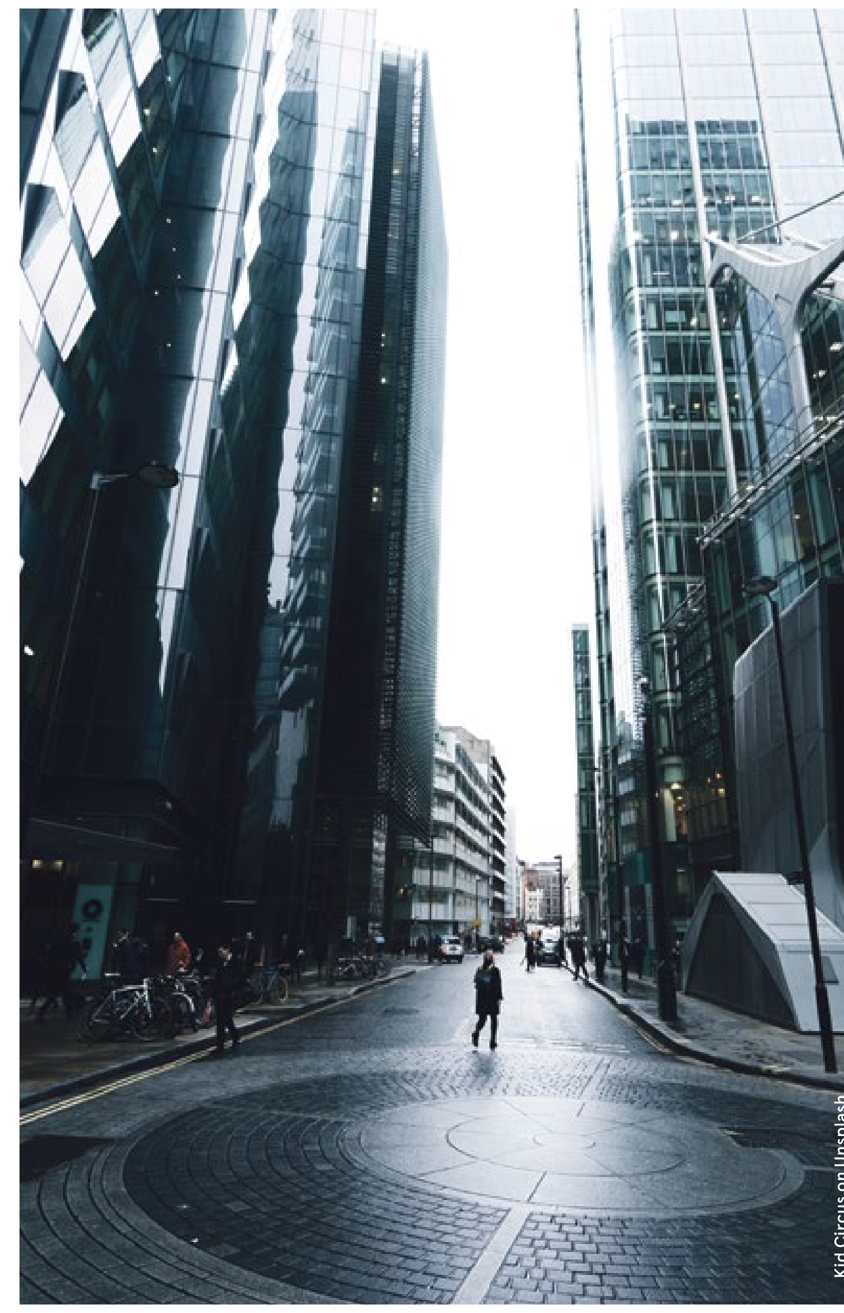
04 Compliance services Access technology-driven compliance expertise to solve the toughest regulatory challenges.

ADDING VALUE

It's more than a tick-box exercise

Treating regulatory compliance as merely a tick-box exercise is a lost opportunity to add value to your business

TIM COOPER


Kid Circus on Unsplash

The amount of regulation that financial firms must comply with has exploded since 2009 with around 60,000 documents published since then, according to regtech provider JWG. Companies are now collectively spending billions just managing this burden. If they get it wrong, fines and cost of lost reputation for non-compliance can run into yet more billions.

Anything that reduces this burden will impact bottom lines significantly, which is why regtech solutions have swamped the market over the last few years.

But cutting the cost of compliance and compliance failures is just one way that regtech can help companies increase competitiveness; myriad others are emerging. For example, making regulatory processes such as know your customer (KYC) and anti-money laundering (AML) smoother can help avoid putting new customers off and therefore convert more inquiries.

Analysing the data gathered in the process of compliance can add value in many ways, such as targeting customer segments more accurately and managing risk better.

Fintech platform Medici estimates that putting the benefits of efficiency and added value together means a regtech implementation can now typically promise a 634 per cent return on investment over three years.

A report from consultant Deloitte sums up the opportunity and why so many firms have been slow to realise it. It says: "Regtech solutions powered by emerging technologies, such as blockchain, robotic process automation and cognitive computing, offer transformative potential. These solutions reduce costs through compliance efficiencies and deliver richer, faster insights and foresight into emerging risks.

"However, many organisations are struggling to leverage them. The market is saturated with regtech firms and the choice of technologies can seem overwhelming. Also some regtech firms approach the solution from a technological rather than strategic perspective. And many are in nascent stages, solve only a small compliance need and lack a deep understanding of financial businesses."

John Byrne, chief executive at regtech provider Corlytics, says: "Before the 2008 crisis, compliance was a small department in banks. They saw it as a tick-box function, with a legal approach. But for many large firms, compliance costs are now between 5 and 10 per cent of revenue. They need to use technology to reduce these overheads and improve outcomes with stakeholders.

"Regtech can speed things up dramatically, while also [adding value to the stakeholder experience] and freeing staff to do other value-adding things. So banks have to change. The trouble is they find it difficult to roll out innovation as it requires extreme change-management processes."

Matthias Memminger, partner at consultant Bain & Company, says: "The recent €2.48-million fine of five Scandinavian banks for breaching credit rating regulations has brought home that the biggest benefit of regtech is to eliminate non-compliance risk.

"However, it can add value in many other ways. For example, creating a smooth, data-driven onboarding or KYC process makes those experiences more convenient and puts fewer new customers off. The data gathered can also enable you to make clearer decisions about those that you take on and those you don't.

"But regtech has taken off only in the last 18 months. For large global banks, it's hard to implement regtech solutions on top of legacy systems. They can work well if they have good data, but the challenge is getting quality data out of their systems and working with third-party solutions. Smaller banks find this easier."

Mr Memminger says this situation should improve globally as he predicts financial services have reached or are close to "peak regulation". This means that in the future banks will have more time to focus on using regtech for efficiency and adding value rather than just compliance.

Bruce Davidson, principal consultant at Altus, agrees that KYC, customer onboarding and AML are the areas where regtech has been adding most value. Others include stock trading, asset management and tracking asset allocation limits, mainly because they help lift the onerous burden of regulations such as the Revised Markets in Financial Instruments Directive (Mifid II).

> In the future banks will have more time to focus on using regtech for efficiency and adding value rather than just compliance

New technology that tracks new and existing regulation helps map it to corporate strategy, and has also been successful, he says. These make sure compliance does not distract companies from their strategic goals and highlight areas where regtech could contribute to these goals, for example by enhancing business intelligence.

"The challenge is these regtech systems often need to share data with other parts of the business and companies struggle with that as the projects needed to achieve it are too big to countenance," says Mr Davidson.

"This is particularly true while they also have to comply with new regulations such as the General Data Protection Regulation (GDPR) and Mifid II. It takes time to bed in regtech solutions, but now Mifid II and GDPR enforcement dates are behind us, it's a good time to do that." ◆

201

average daily regulatory alerts across the global financial sector

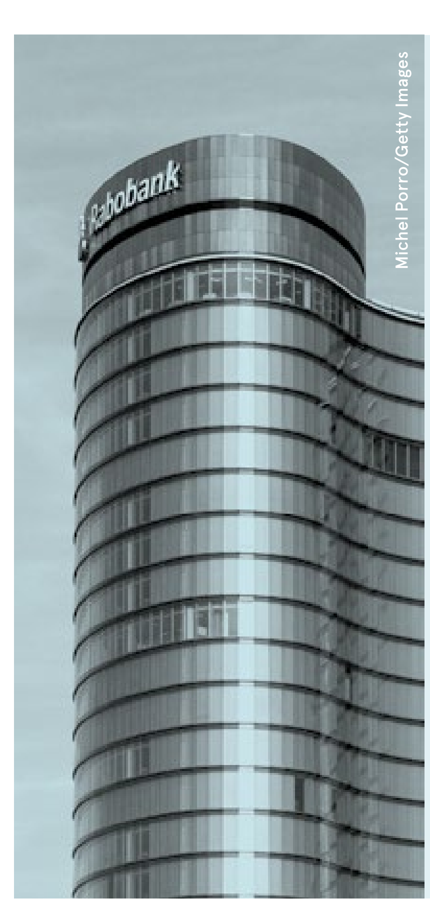
$300bn

regulatory fines have been handed out since the financial crisis

$270bn

spent by banks worldwide on compliance and regulatory obligations

Medici 2018



Michel Porro/Getty Images

Case study

Rabobank

Financial services firm Rabobank has been using regulatory technologies to add value in ways that few others have yet attempted.

Up to now, most financial firms have only used solutions from the relatively new regtech market to support compliance in a tick-box fashion. But Netherlands-based Rabobank has taken a more innovative, strategic approach.

One of its latest solutions is a login and identity service launched last year in collaboration with identity specialist Signicat.

According to Harrie Vollaard, head of Rabo Frontier Ventures at Rabobank, the service helps meet standards such as secure identity across borders linked, known as STORK, but also makes it much easier for customers to input the required information, thus improving conversion rates. Plus it can provide services such as signing and archiving, and soon it will provide data validation.

Rabobank realised that Signicat was a better identity service than many of its large corporate clients, such as insurance and telecommunications companies, could develop themselves. So it also started offering the service to clients, in collaboration with Signicat, under the badge Rabo eBusiness.

"Signicat provides the technology, marketing and sales in the Netherlands," says Mr Vollaard. "Rabo provides access to its customer base. We have already signed up large clients including financial services group Aegon."

He says the biggest challenge for Rabobank was adapting its architecture to allow access to third parties.

"The service only currently brings in a small revenue compared to our core activities," he says. "But, in the future, large banks will rely increasingly on additional services like these for revenue. This broader, competitive view is new to regtech companies, but they are taking advantage of it.

"For us, it's opening a new revenue stream by leveraging existing assets and is about reinventing ourselves as a bank."

Are banks future-gazing through lens of regulation?

Financial services are constantly evolving, so how will regulation help shape the future of banking?

CLARE GASCOIGNE

Ten years after the financial crisis of 2008, there have been significant changes in the regulation that governs the banking sector. Banks now face a plethora of regulations, which "have been successful in building a safer financial system", according to Vitor Constancio, vice-president of the European Central Bank. But how will the interaction between regulation and the banks change the sector in the coming years?

That banking is undergoing a sea-change is not in doubt. The traditional players, the Big Four, have been challenged by the likes of Monzo, Atom and most recently Revolut, which earlier this year achieved unicorn status by becoming a privately held startup with a valuation of more than $1 billion.

Payment systems have been shaken up by the development of mobile technology, with new apps appearing to meet changing demand for old services, while the development of crowd-funding has changed the face of lending.

A brave new digital-only world is potentially fragmenting the traditional banking services and everyone is scrambling to find their feet; financial institutions have invested more than $27 billion in fintech and digital innovation since 2015, according to a recent report from KPMG.

Challengers claim to be redefining the banking business model and part of the opportunity for some is to escape the weight of regulation. Revolut, which advertises itself as "a world beyond banking", does not currently have a full banking licence; Monzo set up three years ago as an emoney company, though it now has a full banking licence. So is there a future for a bank that is not a bank?

Andrew Stevens, global banking specialist at Quadient, a technology company that focuses on the interaction with customers, has his doubts. "Challenger banks typically don't sell a full suite of products," he says. "When they want to be a full bank, they will find they are in a much more difficult position to make a profit."

He believes the banking sector could split, with challenger banks becoming niche players, a bit like a luxury brand. "Their customers are of a certain demographic, who accept they won't have an omni-channel experience," says Mr Stevens. "That's a far easier relationship to manage than in the larger organisations, which have customers of every demographic."

Both regulators and the financial services sector have been running to keep up with the fast-changing world of digital technology, and the innovations have increased complexity for financial organisations. Dean Nash, general counsel at Monzo, believes the level of regulation is hampering the larger traditional players from innovating. "A rapidly changing regulatory environment ties them up in knots," he says. "As a new challenger with greenfield technology, we are more agile and can step up to create better customer outcomes."

> **Challengers claim to be redefining the banking business model and part of the opportunity for some is to escape the weight of regulation**

The weight of the regulatory regime means big banks can struggle to find the money to invest in the same way as the challengers, which come to the market unimpeded by legacy systems and so are able to develop new services.

But the regulator is engaged in a complicated game. Regulation has three very different and potentially conflicting goals: consumer protection, improving competition and innovation, and the stability of the financial system. Much of the focus since 2008 has been improving stability and resilience, and the sector is still dealing with the fallout from the financial crisis. But the past few years have seen an increased emphasis on competition and innovation, such as the regulation surrounding open banking.

"The regulator is trying to open up the monolithic structure of data," says Mr Nash. Monzo took advantage of the New Bank Start Up Unit, a joint initiative between the Prudential Regulation Authority and the Financial Conduct Authority (FCA), which offers help and advice to any organisations thinking about becoming a bank.

The FCA's regulatory sandbox, which has been in existence for two years, allows businesses to test innovative products and services to establish the regulatory touchpoints. It was set up to promote competition in the interests of consumers. It "met a genuine demand in the market", according to the FCA's *Lessons Learned* report, published last October. The report notes that about a third of firms "used the learnings to significantly pivot their business model ahead of launch in the wider market".

So will the level of technical development change banking, increasing competition for our hard-earned money? Let's face it, banking is at heart a very simple operation: customers make deposits, banks lend out those deposits and turn a profit on the difference. Putting a slick graphic interface over the top of that doesn't alter the fundamentals.

Mr Stevens sees missed opportunities because the sector is still not considering the customer's point of view. "Some regulatory change is to do with helping the customer understand their relationship with their bank and ultimately that should translate into a better customer experience. But I don't see that happening," he says.

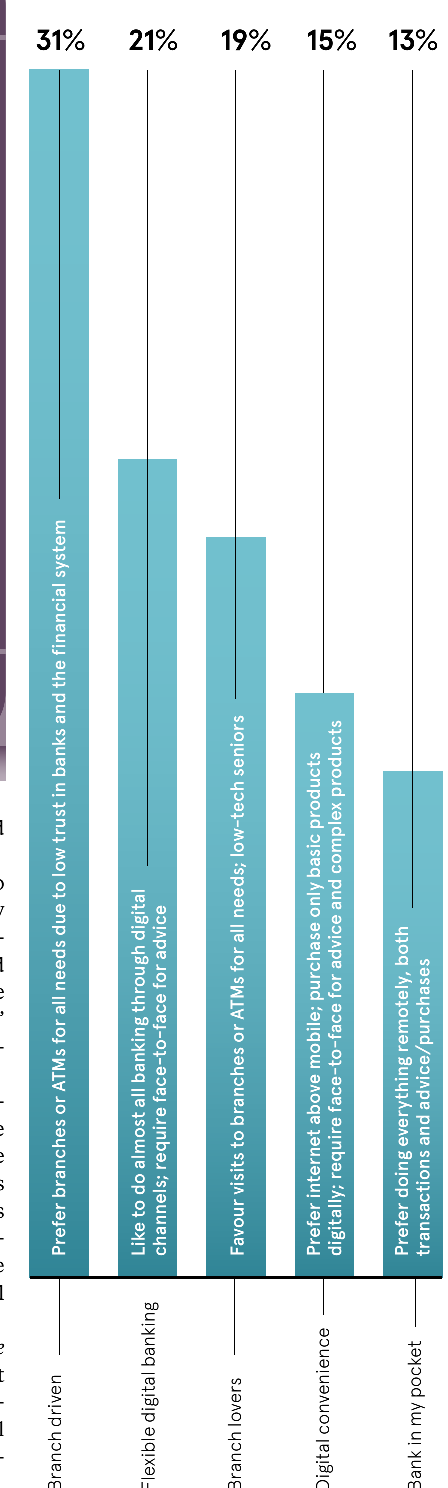
"Take General Data Protection Regulation; it's a real opportunity for someone to say 'we are going to excel at that' and ask 'why is the customer interested?' But it's a damp squib because the banks have asked 'how can we do the minimum possible?'"

He believes the future has less to do with innovation in terms of technology than good old-fashioned communication. "Communications are still filled with legal and technical jargon. Banks are not asking 'how can I best communicate?' and they are ruining the customer experience," says Mr Stevens.

So where does all this leave the banking sector? Increasingly, customers are demanding mobile apps, but alongside traditional bank branches. Metro Bank is a challenger that is opening new branches and Nationwide building society is following suit. Many of us have taken advantage of new payment services, but there's still demand for cash.

According to KPMG's *Forging the Future* report: "Financial institutions... must adopt the customer-centred innovations and back-office solutions that will help them provide a more tailored, value-added customer experience."

Technology can change how services are delivered, but the service remains the same.◆



McKinsey 2017

CAPITAL MARKETS

katjen/Shutterstock

Rabobank headquarters in Utrecht, Netherlands

Disruptors can innovate for big financial institutions

Technological disruption has been slow in capital markets, particularly regarding regulation, so how are disruptors persuading financial institutions to overcome their fears?

JOE McGRATH

The global financial crisis sounded a wake-up call for financial services companies the world over. The crisis not only raised questions over the solvency and stability of financial behemoths, it also fired the starting gun on a tidal wave of regulation, designed to clean up bad practices and increase transparency of global systemic threats.

While regulators sought to shape the future behaviour of capital market participants, they also took swift action to punish the reckless and inconsiderate behaviour that led to the crisis, dolling out hundreds of billions in fines to those companies considered responsible. A 2017 Bloomberg report, citing data from Boston Consulting Group, calculated the total amount in global fines paid since 2008 at a staggering $321 billion.

It would be easy to assume such a vast cost would trigger quick reforms at the major corporations, and that these companies would be keen to change their systems, practices, suppliers and technologies away from those which led to such opacity. But the reaction was quite the opposite.

In fact, the speed of change in capital markets has been relatively slow, particularly when compared to other areas of financial services, such as retail banking, consumer lending and payments.

"Disruptors looking to enter capital markets face an enormously complex environment," says Fiona Hamilton, vice president Europe and Asia for Volante Technologies. "Unlike, for instance, effecting wholesale payments, disruptors face a multi-asset, multi-dimensional and multi-faceted backdrop. Arguably it is a much harder process to find a disruptor that 'suits' all."

Senior City figures agree that major players in capital markets have shown themselves to be exceptionally risk averse when it comes to trying new methods and the reason may surprise.

Many believe that much of this risk-averse behaviour has arisen from the heavy regulation of markets, the complexity of regulatory requirements and resulting fear of being fined.

> Regtech firms are nimble, run by experts in the field and can move quickly; effectively they enable financial institutions to outsource the innovation process

Alistair Haynes, chief executive of London-based trading venue Aquis Exchange, also acknowledges the widespread fear, but goes even further, blaming naivety, misconceptions about costs and, most notably, business concerns about losing a competitive advantage if they split from the established way of doing things.

"It is all about fear. Fear of being caught doing something you shouldn't, the fear of being fired, the fear of making a mistake. Of course, the world is changing so fast that this is completely the wrong attitude. There should be a fear of doing nothing."

Despite this culture of fear, the past decade has seen a wave of new companies, emerging in response to the seemingly never-ending stacks of new regulation, that are specialists at assisting financial services firms with the regulatory burden through technology.

These so-called regtech businesses use advances in technology to improve corporate understanding of the risks to which they are exposed, improve compliance oversight and offer solutions to mitigate risks, and at a cost which they claim is lower than traditional methods.

RSRCHXchange is one of the myriad businesses to spring up since the crisis. It offers asset management firms a way to read, purchase, evaluate and monitor research services from banks, brokers and boutique providers, through its platform.

Like most other regtech businesses, RSRCHXchange has had to elbow its way into the capital markets community. Co-founder Vicky Sanders says capital markets is one of the toughest sectors to crack.

She explains: "It's heavily regulated, has mission-critical functions, operates twenty to twenty-four hours a day six days a week, has networks of co-dependencies and is highly competitive. That makes it tough for any vendor.

"Scale is often a prerequisite for success, building a wide and deep moat. Disruptors need more than a proof of concept. To win new business, they require a live product and usually an existing pool of customers. That raises the cost to getting started compared with the other industries and presents the challenge how to win the first customer."

The issue doesn't stop there. Ms Sanders says regtech firms looking to get even a toehold in the sector know that driving growth while maintaining stability is a tricky business, so firms should expect sales cycles to be long.

Given that it can take a long time to secure that all-important account, new challengers also need to have the wherewithal to stay around long enough for the market to come their way.

But once a regtech company does achieve widespread recognition, it can have radical repercussions for corporate cost efficiency, transparency and speed of operation. It is no accident, then, that companies are beginning to spend big on regtech.

A *Financial Times* report in 2017 estimated that spending on regtech would reach $76 billion by 2022, up from $10.6 billion in 2017. A separate report from Juniper Research found that investors are also backing the regtech revolution, with $1.37 billion invested in regtech companies in the first half of 2018, more than in the whole of 2017.

Terence Chabe, a capital markets specialist at Colt, says regtech companies have several advantages over incumbents.

He explains: "Due to regulation and market conditions, a lot of banks are retrenching from non-core activities. They don't have the internal expertise to develop these innovative solutions and internal processes mean any new technology projects are tightly controlled.

"Regtech firms, by contrast, are nimble, run by experts in the field – often ex-employees of the institutions themselves – and can move quickly; effectively they enable financial institutions to outsource the innovation process."

While the challenges are very real for those actively making inroads into the market, there is a genuine belief that the capital markets landscape is finally starting to change, to become more accommodating to the new businesses offering alternative solutions to legacy approaches.

RSRCHXchange's Ms Sanders believes things are changing for the better. She concludes: "Big regulatory changes come about once a decade in capital markets. Those changes create opportunities for regtech firms to implement technology to solve problems, old and new. They can innovate faster than incumbents and pivot when something isn't working." ◆

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Insight

Know your customer

Regtech firms have been assisting established capital markets players with the vast global sets of regulations on anti-money laundering since 2007.

Rules have been introduced in Europe, Asia and the United States for banks to know the identity of their customers to guard against money laundering or financing terrorism. These know-your-customer (KYC) requirements are extensive, but regtech companies have proved popular with banks, in particular, to help in adhering to these new rules.

BNP Paribas, China Merchants Bank and Deutsche Bank are three international banks in a consortium of 39 global players that have been trialling a KYC application developed by regtech firm R3 on its Corda blockchain platform.

Transactions have been tested across nineteen countries in eight timezones, where banks requested access to customer KYC test data and customers could approve requests or revoke access.

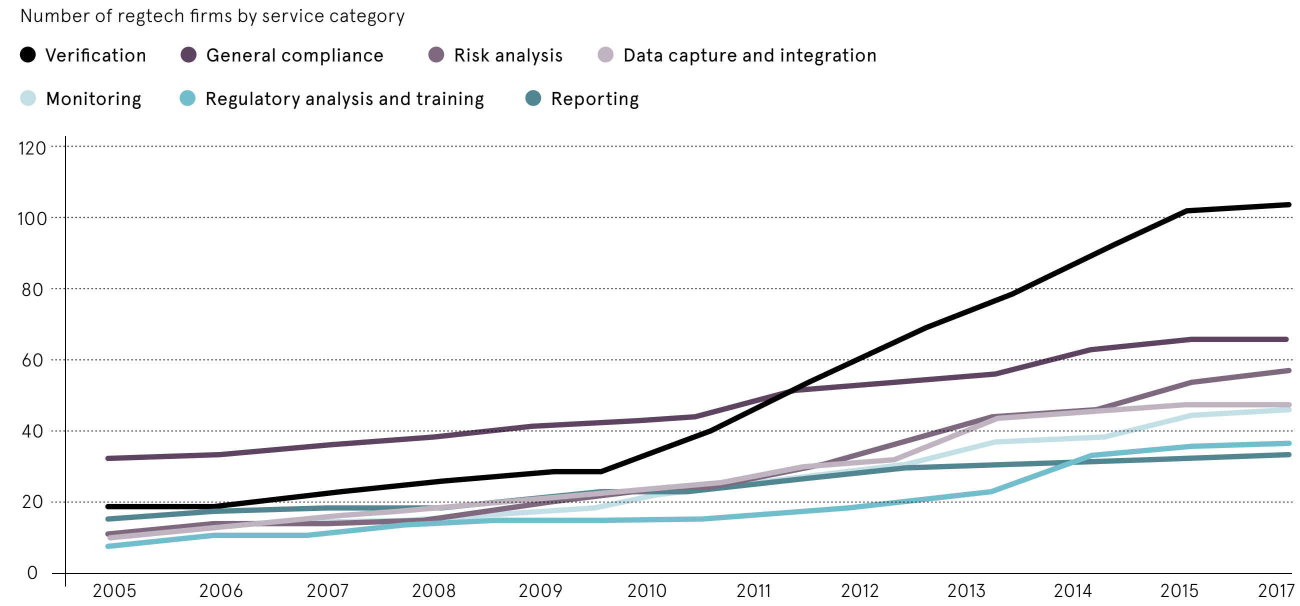
"KYC requirements present a significant challenge to financial institutions and the process is often slow and time consuming," says R3's head of regulatory affairs and partnerships Isabelle Corbett. "Corda reduces duplication and costs by providing a single, shared database of KYC records."

Ms Corbett explains that regtech companies are increasingly collaborating with banks, regulators and incumbent infrastructure players to look at how this new technology can complement and enhance existing systems.

She adds: "To an outsider, some parts of market infrastructure can seem illogical, but they are often the way they are for good reason, ensuring market stability. You need a collaborative approach to ensure change doesn't bring unintended consequences."

Rise of the regtechs

Number of regtech firms by service category



Boston Consulting Group 2018

Regulatory sandboxes go global to spark innovation

DreamBig/Shutterstock

A collaboration of financial regulators aims to support innovation in a sector which does not recognise borders

NICOLA TAVENDALE

On the surface, regtech innovation should have no need for a global approach. These technologies seek to alleviate the regulatory burden, but even reforms which were initiated at an international level, for example by the G20 or the Basel Committee, vary greatly in how they are interpreted and applied by national regulators. In turn, regtech firms would only be expected to benefit from working closely with the regulatory body for their target market.

Yet the major emerging innovation trends within financial services are "increasingly global, rather than domestic" in nature, according to an industry consultation launched by the UK's Financial Conduct Authority (FCA). Digital transformation has also enabled financial businesses to expand into new regions and new markets, with a number of regtech firms following suit and also expanding their own footprint.

> **Sandboxes help regtech companies substantiate their claims to regulatory compliance in a safe and controlled environment**

Following the success of the FCA's own sandbox, a number of other countries have established a similar scheme at the domestic level in the United States and Asia, with China being among the most recent country to launch a sandbox programme. These initiatives aim to provide fintech and regtech firms with a valuable opportunity to test innovative products, services and business models in a live market environment, while ensuring that appropriate safeguards are in place through temporary authorisation.

"In particular, sandboxes help regtech companies substantiate their claims to regulatory compliance in a safe and controlled environment," says Claus Christensen, chief executive of Know Your Customer, a regtech firm with offices in Hong Kong, Ireland, China and Singapore.

In early-2018, the FCA proposed the creation of a global sandbox to address some of the challenges facing technology innovation at an international level. This led to the launch of the Global Financial Innovation Network (GFIN) in August, a first of its kind collaboration between the FCA and 11 other financial regulators and related organisations. According to the FCA's GFIN consultation document, the network plans to provide a more efficient way for innovative organisations to interact with regulators and help them navigate between jurisdictions as they consider and look to scale new ideas.

One of GFIN's proposed functions will be joint policy work and regulatory trials, which the FCA says could also include regulators collaborating on regtech solutions. Husayn Kassai, co-founder and chief executive of Onfido, a regtech which helps businesses verify identities, explains that supporting cross-border experimentation through initiatives such as the GFIN is crucial for regtech firms to be able to export their innovations more smoothly across regulatory jurisdictions.

"The GFIN will also help businesses like Onfido to better serve global clients with innovative solutions," says Mr Kassai. "At the moment, the difficulty in engaging with foreign regulators is slowing this down."

The FCA began its own work to support innovation in the markets by launching Project Innovate in 2014. According to the FCA, its sandbox, which began two years later, has successfully helped reduce the time and cost of getting innovative ideas to market, with around 90 per cent of the firms that completed testing in the first cohort having progressed towards a wider market launch.

At least 40 per cent of firms which tested in the first cohort of the sandbox received investment either during or following their sandbox tests. Onfido has also used the FCA sandbox and plans to continue doing so as it further develops new product features. "We have found them to be extremely open to dialogue, keen to engage and we look continuing this positive engagement both through future UK sandboxes and beyond," says Mr Kassai.

Although regtechs aim to enable regulators and businesses to work together with greater ease, there is still an inherent risk for financial firms that need to justify the risk of collaborating with an external technology company.

90%

of the firms that completed testing in the first cohort of the Financial Conduct Authority's sandbox progressed towards a wider market launch

40%

received investment either during, or following, their sandbox tests

Financial Conduct Authority 2017

"One of the challenges for any regtech firm is ensuring that corporate clients feel they can trust a small team to run what may be a very instrumental part of their compliance framework," says Ben Pott, head of government affairs at Nex Group. "In the case of regulatory reporting for example, if it all goes wrong then the client firm, not necessarily the regtech, is responsible for that. This is quite a difficult hurdle to jump over."

Mr Pott warns that one of the real challenges for a global sandbox is that the regtech space, like the regulatory environment itself, is vast and covers so many different aspects. "The danger will be that if the GFIN is not specific about their intent from the start, this could result in it being too generic to truly help the fintech and regtech firms in any practical sense."

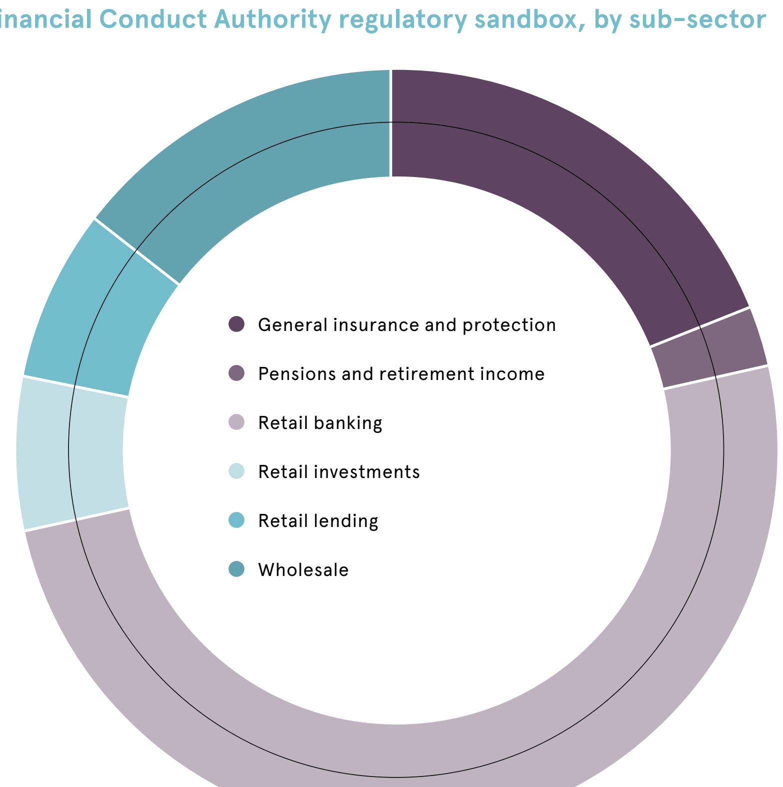
According to Sameer Gulati, head of policy and regulation at Innovate Finance, the industry will also need to see the GFIN ensure there is sufficient transparency from the start and will need to address how "plurilateral decision-making sits alongside national policy formation".

"We do, however, believe the potential positives outweigh these challenges," says Mr Gulati. "Based on the initial responses from the industry, we expect the reaction to be generally positive as fintechs point to the beneficial work done by FCA Innovate."

In addition, while the registration procedures to a sandbox environment are a lot simpler than a full jurisdictional licence, they still require a large effort from startups. "Introducing a global sandbox significantly reduces the burden of having to register in multiple jurisdictions," says Know Your Customer's Mr Christensen. "Getting access to such an international controlled environment would help organisations test and ensure compliance with multiple regulations at the same time."

Fabian Vandenreydt, executive chairman of collaboration platform B-Hive, agrees. Most of the fintech and regtech firms which B-Hive has in its ecosystem are geared towards internationalisation within Europe and beyond, he says. The next step for the GFIN initiative would then be to expand within continental Europe and even the G20 economies and markets. "Better understanding and support from regulators worldwide is a great step forward in promoting the adoption of innovation for the benefits of the financial services sector as a whole," Mr Vandenreydt concludes. ◆

Financial Conduct Authority regulatory sandbox, by sub-sector



Financial Conduct Authority 2017

Capturing the risk in communications technology

From the chief executive to the intern, the office of today is more productive than ever before thanks to new collaboration tools such as Microsoft Teams, Slack and Facebook Workplace. But there are undeniable risks to communicating using these tools that, if not properly captured and monitored, can prove very costly

Cast your mind back to the turn of the century. The Soviet Union was breaking up, Tony Blair entered 10 Downing Street, Blur and Oasis were battling it out to reach number one in the charts, while the threat of Y2K loomed large and the millennium was nearly upon us.

At the same time, technology was advancing apace. In the office, executives up and down the country were given their first BlackBerry handheld email device. For those of us old enough to remember such a moment, it was big. Email was big. It changed the way we communicated with our colleagues.

Fast forward to 2018 and communications technology is once again revolutionising the workplace. The BlackBerry has been consigned to the dustbin of corporate history. The office of today prefers to use new, more immediate tools that sit on your desktop, your phone, your tablet and even your wrist watch – all parts of a person's connected suite of technology.

Email remains a critical component of the modern office communications toolkit, but its influence is waning. For evidence, just look at Google's recent decision to kill off its Gmail Inbox platform.

Google's move away from traditional email shows the power of the movement towards collaboration platforms such as Slack, Workplace by Facebook and Microsoft Teams. These platforms are a modern response to the demands of an ever-changing workplace. And they are replacing email at a rate of knots.

Instant messaging, group conversation streams, file sharing and information tagging are all making companies second guess the suitability of email, a technology that has remained largely unchanged for years.

Nowadays, the most productive offices catch up on emails every few hours, while focusing most of their time on chat groups and work streams. This has resulted in massive growth for these platforms. As of March this year, Microsoft Teams was being used by 200,000 organisations, having only launched its preview version a year before. In the same amount of time, Slack gained two million daily active users. With a total user base of eight million people, it's no wonder Slack has a stock market valuation of more than $7 billion.

Then there are other social platforms such as Twitter, LinkedIn, and Facebook, which are in common use among younger employees discussing both their work and personal lives.

When you look at the progress over the past two decades, it is overwhelmingly clear just how much communication technology has changed. However, the archiving systems that companies use to store these messages have remained the same since the days of Oasis and Y2K.

In the early-2000s, the rapid ascent in popularity of email made companies aware of the need to file the millions of digital messages they sent and received each day. Archiving software companies sprouted up, offering systems that could easily manage the onslaught of data.

These same archiving solutions are still in use today. Based on the same technology that was suited to storing massive amounts of raw text data, these systems simply can't stand up to the complexities of modern communications.

Collaboration tools, instant-messaging apps and social media platforms use a vast array of messaging formats. Images, video, GIFs and emojis are now commonly used by the entire workforce, not just millennials. A person-to-person text conversation can change to a group chat at the press of a button and then extend seamlessly to a voice or video call.

But companies are not only facing more challenging communications technologies. Due to regulations such as Mifid II and GDPR, companies are now also facing a much more challenging regulatory environment. The rules set out in Mifid II mean that companies need to have complete oversight over their employees' communications, and must archive those conversations in a way that preserves the communications in their full and original form, and enables messages to be searched for and reconstructed.

If companies do not have systems in place that can capture, archive and supervise conversations across a range of platforms and in a range of formats, they risk facing serious compliance issues.

Companies are aware of this. According to Smarsh's 2017 *Electronic Communications Compliance* Survey, between 2016 and 2017 the number of companies requesting archiving solutions for SMS, corporate instant messaging and LinkedIn roughly doubled, while those looking for solutions for Twitter and Facebook more than trebled. Despite this, only 61 per cent of companies surveyed had archiving platforms that supported communications on social media.

> **If companies do not have systems in place that can store conversations across a range of platforms and in a range of formats, they risk facing serious compliance issues**

This is why Smarsh has launched its new Connected Suite. The truly unique platform enables organisations to respond proactively to the changing dynamics of their employees and customers, while mitigating the compliance risks that are often associated with new communications technology.

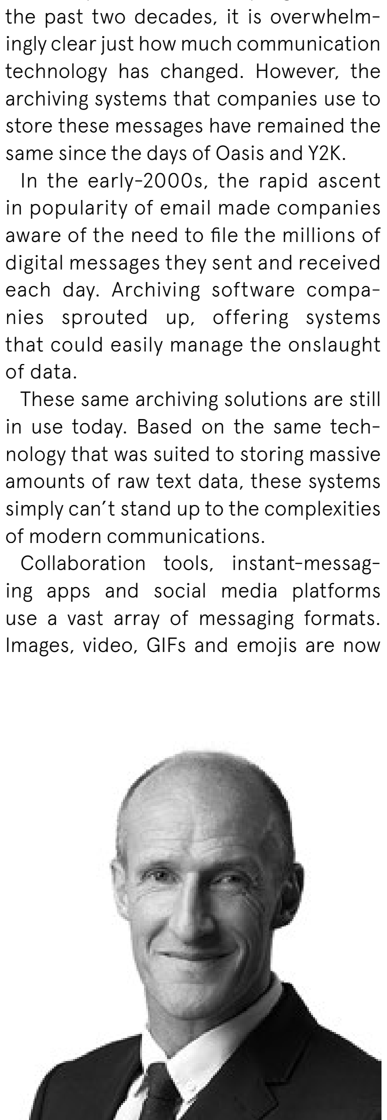
Having recently merged with Actiance, Smarsh has combined the two companies' industry-leading archiving solutions. These solutions are not based on technologies conceived two decades ago. They have been purpose built to match the needs of modern communications.

The Connected Suite is an entirely new product framework. It is made up of three components: connected capture, connected archive and connected apps. The platform gives clients an unrivalled ability to capture more than 80 different forms of workplace and electronic communication, spanning email, mobile messaging, social media and voice conversations.

Many organisations operating in heavily regulated industries have been put off adopting collaboration platforms due to compliance fears. However, forward-thinking firms must take steps to enable both compliance and productivity, rather than choosing one or the other.

Smarsh recognises that this new generation of collaboration and communication tools are not going anywhere. Fears over compliance should not get in the way of the enhanced productivity that these tools can offer. By tailoring its suite of archiving tools to meet the demands of modern communication, Smarsh is enabling their customers to focus on growth rather than communications compliance.

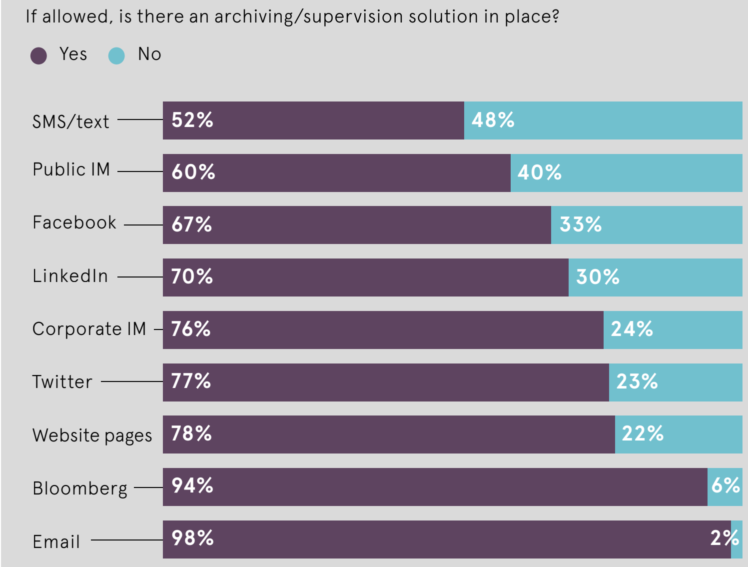
For more information please visit www.smarsh.eu



Ian Hook
Vice president and general manager Smarsh Europe

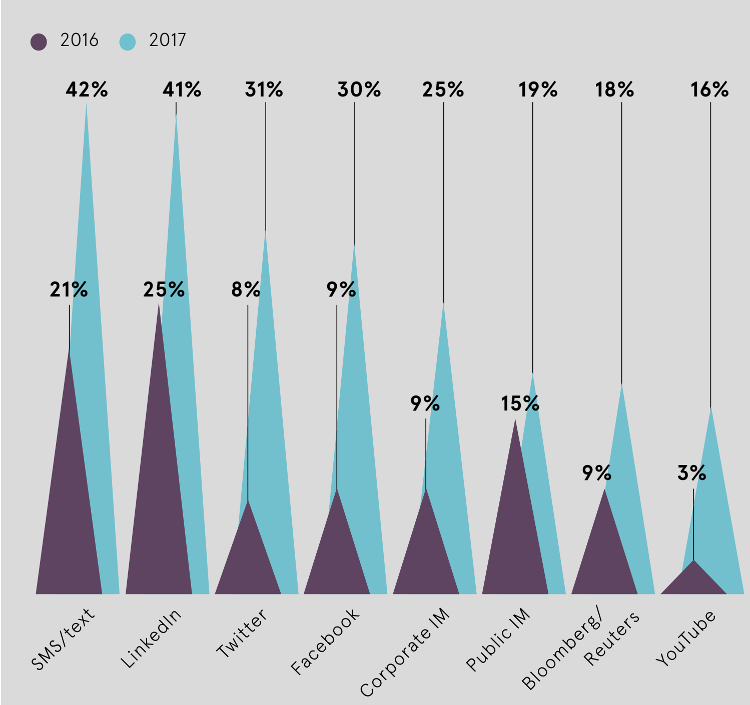
Compliance gaps narrow, but remain significant

If allowed, is there an archiving/supervision solution in place?



Electronic Communications Compliance Survey, Smarsh 2017

Most requested communications channels 2016-2017



Electronic Communications Compliance Survey, Smarsh 2017

OPEN BANKING

Casey Horner on Unsplash

Banks demand more, not less, regulation

Opening up banking to more competition remains in the slow lane while new regulations rev up the industry

CHARLES ORTON-JONES

It is common in politics to talk about a lack of bank regulation. The word salad of clichés involves stuff like “casino capitalism, Wild West, bonuses, financial crisis and Lehman Brothers”.

The leader of Her Majesty’s Opposition knows he’ll get an instant round of applause with blood-and-guts quotes like this: “For 40 years, deregulated finance has progressively become more powerful. Its dominance over industry, obvious and destructive; its control of politics, pernicious and undemocratic.”

Ah, but the view from banking is now rather different. Since the 2008 financial crisis, at least, the industry has been inundated with new rules. It’s an alphabet soup of initiatives. Since the crisis we’ve had AIFMD and UCITS 5 for asset managers, Basel III for banks, PRIIPS for retail investment providers and Mifid II for pretty much everybody. Not to mention GDPR, the rules to stop unauthorised data-sharing, something every business needs to obey.

And for high street banks there’s been the revolution known as open banking, or PSD2 for acronym junkies. Since January, they’ve been required to offer third-party providers access to customer bank accounts, so long as the customer consents.

> Far from complaining about the new open banking regulations, the industry is uniformly demanding more rules

And the really interesting thing is this. Far from complaining about the new open banking regulations, the industry is uniformly demanding more rules. It’s an instructive lesson in how business actually works, compared to how outsiders assume it must.

And the message from more than 30 financial institutions surveyed, including high street majors, open banking startups and global consultancies, is uniform: if open banking is going to succeed, the rules must keep coming.

Marten Nelson, co-founder of Token, a Silicon Valley-based builder of open banking products, says the notion that finance providers want less regulation is daft. For starters, the new rules opened up what had been a sterile industry.

“Regulation is the very thing that has enabled open banking,” says Mr Nelson. “Despite consumer demand for more customer-centric financial services, which has been evidenced by the early success of digital challenger banks, high street banks would not have opened up to third parties without the PSD2 legislation.”

Strict regulation ensures a higher level of consumer confidence. Mark Mullen, chief executive of Atom Bank, a new smartphone app current account provider, puts it like this: “A decade on from the banking crisis, I ask you, do you feel that banks have earned your trust? I don’t. And I’m a banker.”

He says innovation in the industry is at breakneck speed, so regulators are playing catch up. The deluge can seem onerous at first glance, but the innovators appreciate the clarity the rules bring. “It’s little surprise that regulatory intervention in banking technology comes across as intrusive or limiting,” says Mr Mullen. “But that doesn’t make it wrong.”

Regulations can establish uniform processes. This simplifies life for service providers. “It is where there is no common standard that problems start to arise,” observes banking entrepreneur Indrek Neivelt, chief executive of Pocopay, a current account and payment provider.

He offers a technical example: “The regulatory technical standards adopted under PSD2 specify a broad set of principles on how payment service providers should communicate with each other. But they do not define the specific standards to which the account servicing payment service providers’ (ASPSP) actual application programming interfaces (APIs) should comply.

“The result is that each ASPSP is now developing its own API. And an application compatible with one ASPSP’s API is not necessarily compatible with the application of another. The bottom line is that the current lack of a common standard materially limits the use and spread of open banking applications, and allows banks to enjoy their data monopoly for a while longer.”

> Take-up of open banking is low because the market is still waiting for regulations

To prove the point, look at areas where the rules have not yet come into force. The absence causes stagnation. Daniel Melo, senior director of business development, Europe, Middle East and Africa, at analytic software company FICO, points to security as an example.

“Open banking will only take off if it’s secure and the technical standards required to guarantee its security were only approved by the EU in February 2018, and will not be legally enforced until September 2019,” he says. “It’s difficult for banks, fintechs and others to begin investing in an open banking environment ahead of that. In a nutshell, take-up of open banking is low because the market is still waiting for regulations.”

Sometimes a simple lack of clarity around interpretation can stall progress. GDPR proves it. Senthil Ravindran of Virtusa, a Nasdaq-listed technology consultancy, says: “Banks are finding it difficult to know what data can be shared and when. What if a customer asks their bank to share data with a third party and then the third party suffers a data breach? Which party is ultimately responsible?

“Given all this uncertainty, not to mention the hefty fines that GDPR threatens, it’s no surprise banks are opting to worry about GDPR issues over open banking where there’s an overlap between the two.”

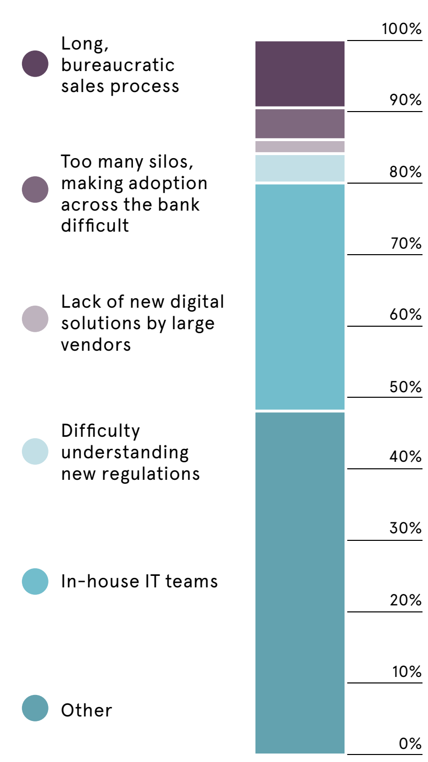
For these reasons the banking industry is unanimous in its demand for strong regulation of open banking. If there is a dissenting voice out there, it will come from a dubious provider, unable to comprehend or comply with the rules.

Duncan Barrigan, vice president of product at GoCardless, says: “In many ways, there’s a direct relationship between innovation and agility. Agile companies don’t see regulation for open banking as a roadblock. They see it as an opportunity to further differentiate themselves against the competition and aim to take full advantage.”

So the next time a politician quips about “deregulated banking”, it is worth contesting the point. The industry wants the freedom to innovate and that comes with, not against, strong regulation. ◆

Challenges in regtech-bank relationships

Survey of global regtech startups



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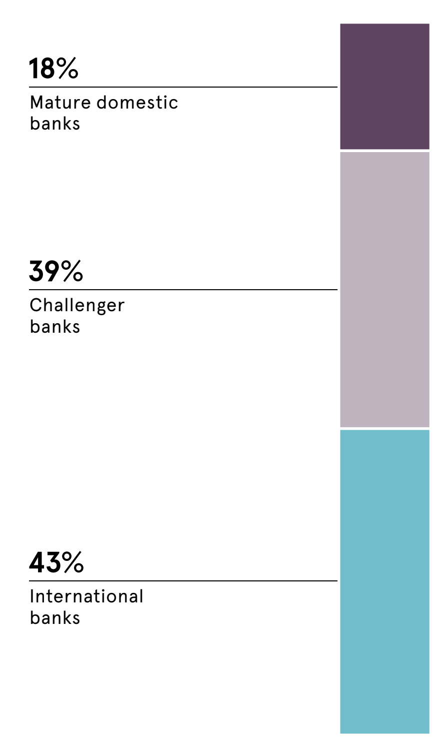
Banks that are using regtech most efficiently

Survey of compliance, technology and risk professionals in global banking



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