

Innovating with RegTech

Turning regulatory compliance
into a competitive advantage

EY

Building a better
working world

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Executive summary

Successfully complying with the multitude of financial services (FS) regulations can be a complex, time-consuming and costly activity for firms. Industry participants and the UK regulator, the Financial Conduct Authority (FCA), are considering how to develop and adopt regulatory technologies (RegTech) to meet and simplify regulatory compliance requirements. Over the past 12 months, we have seen an increased appetite for firms, regulators and technology providers to consider the development and use of RegTech solutions.

The FCA is leading the way amongst global regulators in promoting innovation and competition throughout the FS sector. This is exemplified by world-leading initiatives, such as Project Innovate, the regulatory sandbox and the dedicated robo-advice unit. Advancing the RegTech industry is a natural extension of this and the regulator is already proactively engaging with industry participants through a range of activities.

Signs of initial 'scaled up' adoption of RegTech solutions are already in sight, including new technologies, such as risk and regulatory compliance management solutions.

EY recently completed a benchmarking exercise on behalf of HM Treasury to evaluate the international FinTech sector. It identified the UK, with an estimated market size of £6.6bn in 2015, as the global capital for FinTechs, due to the prevalence of FS expertise and the supportive regulatory environment. RegTech is a key component of this market and is expected to continue to attract a growing proportion of interest and funding.

This EY point of view analyses the various components of RegTech, including the roles of firms, technology providers and the regulator. It also highlights short- and long-term strategy, and actions to consider, in order to improve value and returns.

RegTech benefits at a glance

1. Supporting innovation

RegTech will play a vital role in the FCA's mandate to promote innovation, through the identification of technologies that help firms better manage regulatory requirements. In addition, RegTech will help the regulator to fulfil its primary objectives of protecting consumers, confirming market integrity and promoting effective competition.

2. Analytics and insights

Innovative technologies will support firms to develop advanced data analytics capabilities (including scenario analytics, trend and horizon scanning), which the regulator considers as important tools to improve the quality of information and insights.

3. Reduce the cost of compliance

The cost of compliance in financial services has risen sharply over recent years; however, a recent EY survey¹ revealed that 85% of the respondents consider that further opportunities exist to improve the linkage between risk and business performance. By harnessing innovative technology, RegTech, enabled by 'compliance by design', can simplify and standardise compliance processes thereby driving down compliance costs. Furthermore, using RegTech to identify risks, analyse data, generate reporting and remediate issues can also have a positive impact on business performance.

1. EY's 2015 Global Governance, Risk and Compliance Survey.



The evolution of RegTech

In a regulatory environment with high levels of scrutiny and complexity, we have observed the emergence of new approaches to risk and regulatory management practices across the FS sector; both in the UK and globally.

More stringent requirements within increasingly dense data landscapes and the rapidly evolving FinTech sector have led firms, technology providers and regulators to focus on new technologies to meet regulatory challenges. The objective is to drive down costs, yield efficiencies and disrupt the norm of conventional regulatory compliance. RegTech is at the centre of this movement.

The FCA describes RegTech as the *adoption of new technologies to facilitate the delivery of regulatory requirements*. Both the FCA and Prudential Regulations Authority (PRA) emphasise the importance of using 'tools and systems' to identify, establish and monitor mandatory controls that should be inherent in the future. In its 2016-17 Business Plan, the FCA stated that RegTech will be crucial to *enable more efficient and effective regulation and compliance*.

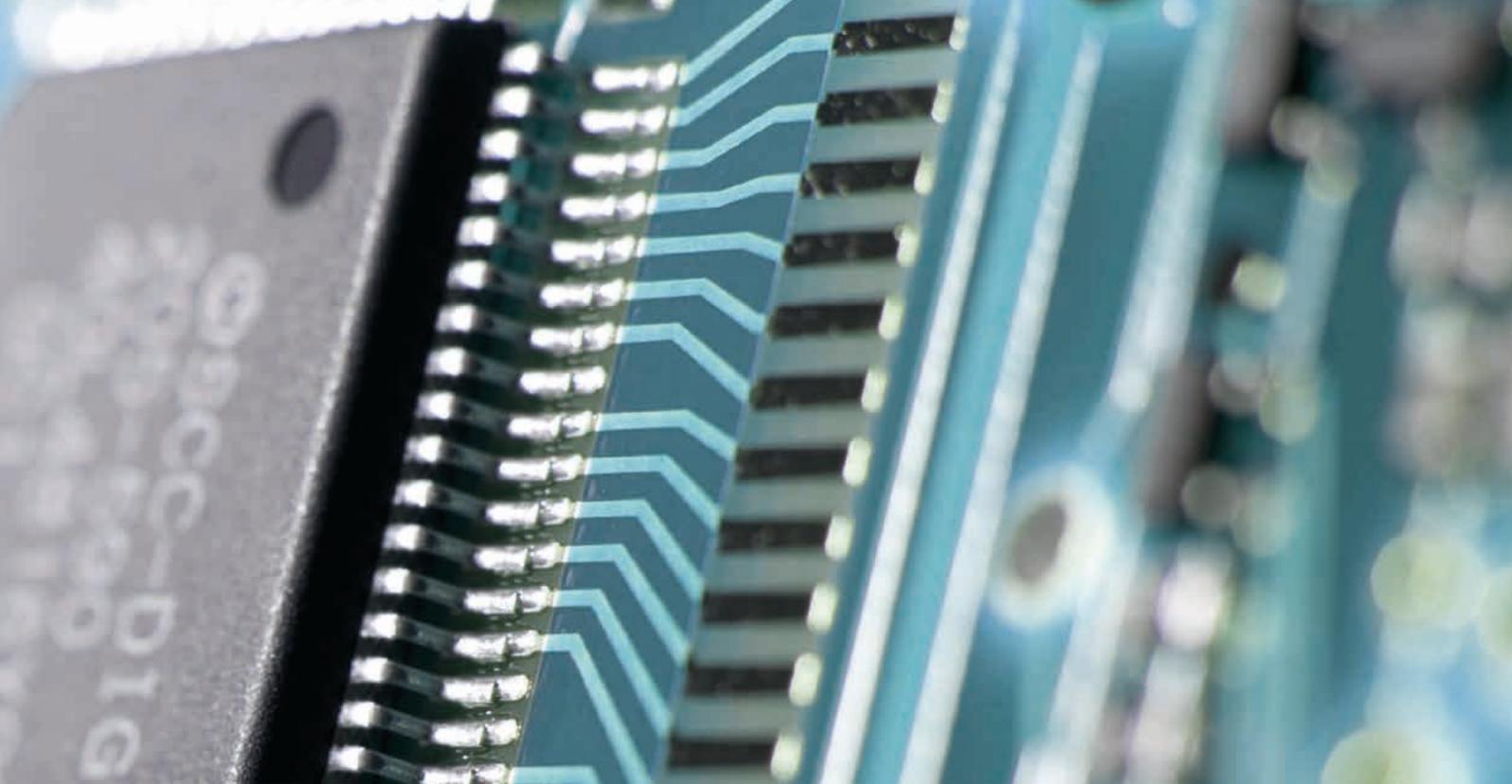
Growing importance of innovation in regulation

October 2014

FCA launches Project Innovate – an advice hub enabling businesses to introduce innovative financial products and services.

November 2015

FCA announces plans for regulatory sandbox to support firms testing innovative products and services in a safe environment.



“The FCA is encouraging firms to be innovative with technology and helping them to identify ways to integrate these new technologies into their business models. Most people refer to this as RegTech – thinking about solutions to issues that already sit squarely within the sphere of regulation.”

Christopher Woolard, Director of Strategy and Competition, FCA, February 2016, speech delivered at the FCA’s event on UK FinTech: Regulating for innovation.

April 2016

FCA Business Plan highlights the pivotal role technology (and RegTech solutions) will play in delivering innovative and cost-effective products and services.

April 2016

FCA completes its first TechSprint two-day event, aimed at fostering innovation for new FinTech companies.

May 2016

FCA launches a unit to support the development of automated advice tools to help provide low-cost, high-quality advice to mass-market consumers.

May 2016

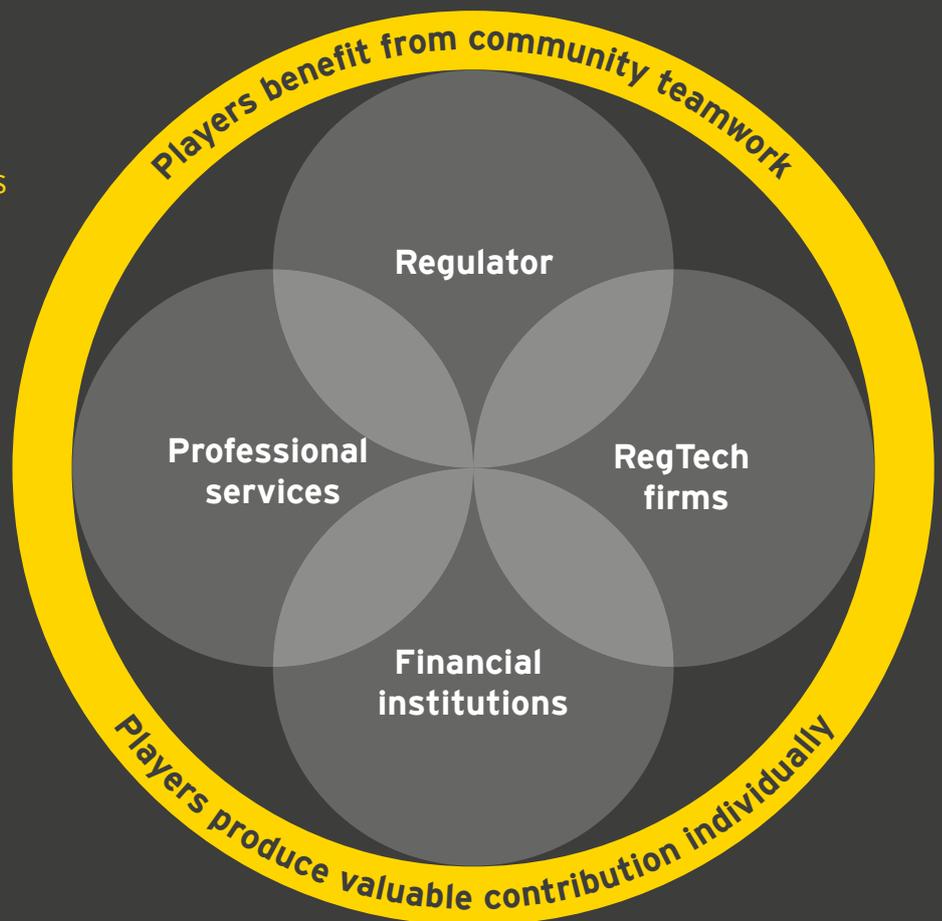
FCA opens its regulatory sandbox to firms, providing a safe space for testing innovative products and services, a tailored authorisation process and individual firm guidance.



RegTech ecosystem

Each of the key players in the system has a distinct role in the development of common industry solutions and successful integration into risk management frameworks within the wider regulatory change agenda.

Collaboration across the ecosystem will be key to success.



The RegTech ecosystem: current focus and anticipated roles

Player	Current focus	Anticipated role
Regulator	Encouraging dialogue and collecting market views	<ul style="list-style-type: none"> ▶ Continue to promote innovation around regulatory compliance ▶ Adopt an increasingly proactive role in driving efficiency and collaboration across the different parts of the RegTech ecosystem ▶ Assist in the creation of common integrated standards and development of guidance on the rules of engagement ▶ Progress initiatives focussed on how to manage internal change resulting from RegTech, including horizon scanning from a global perspective
RegTech firms	Developing understanding of engagement between businesses and the regulator to align solutions with regulatory and risk management frameworks	<ul style="list-style-type: none"> ▶ Development of solutions to meet business and regulator needs ▶ Confirming solutions developed are compatible with wider risk management frameworks and regulatory requirements
Professional services firms	Working across the ecosystem to understand requirements, needs and solutions	<ul style="list-style-type: none"> ▶ Driving cohesion of regulatory standards, institution needs and vendor solutions ▶ Using industry insights and network to connect providers and users ▶ Supporting on due diligence for new market entrants ▶ Providing regulatory, systems and compliance transformation advisory support, including proactively managing risks associated with implementing new RegTech solutions
Financial institutions	Development of RegTech strategy and road map, considering long- and short-term application	<ul style="list-style-type: none"> ▶ RegTech adopters ▶ Internal development of RegTech solutions



Market insights

EY conducted a series of interviews across the FS industry to better understand the market view on the flourishing RegTech sector. Our insights have identified a notable shift in client attitudes. Instead of a 'wait and see' mind-set, our clients are now looking to join the technological evolution and actively engage in the RegTech ecosystem.

“ RegTech solutions have the potential to make regulatory compliance monitoring and risk reporting simpler, more flexible and more cost-efficient. I can't wait to read the FCA's mandate on RegTech. One thing is already clear: if RegTech can make regulatory compliance easier, I see no reason not to adopt it. ”

Wealth and Asset Management,
Group Head of Operational Risk

“ We are looking for RegTech to help shift compliance's efforts from producing reports to actual analysis of data, leading to a greater value-added exercise. More automation by firms could enable the regulator to access compliance information on a real time basis, and thus completely change the dynamics of the relationship. ”

Insurance, Compliance Director

“ Both our senior management and board see the cost of compliance as an area for improvement. RegTech is hugely important for our organisation. It has the potential to integrate and simplify our compliance monitoring activities, reducing the time and effort it currently takes. ”

Banking, Head of Group Risk

“ We're focusing on cloud computing and open data solutions that enable (secure) sharing of data across individuals, financial institutions and regulators. ”

RegTech company

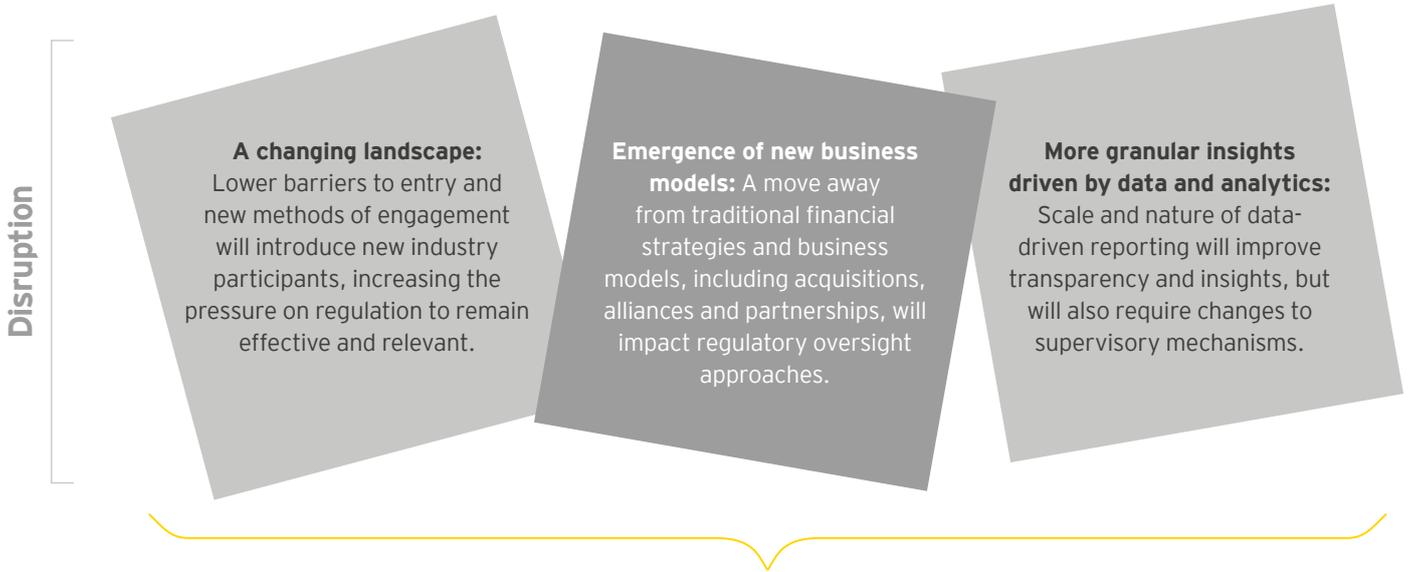
“ RegTech presents an opportunity to rethink how we approach and solve many intractable problems. By adopting a more creative and innovative approach to addressing some of the industry's regulatory challenges, RegTech might inform us on new ways of working that deliver more efficient processes with better regulatory outcomes. ”

UK regulator

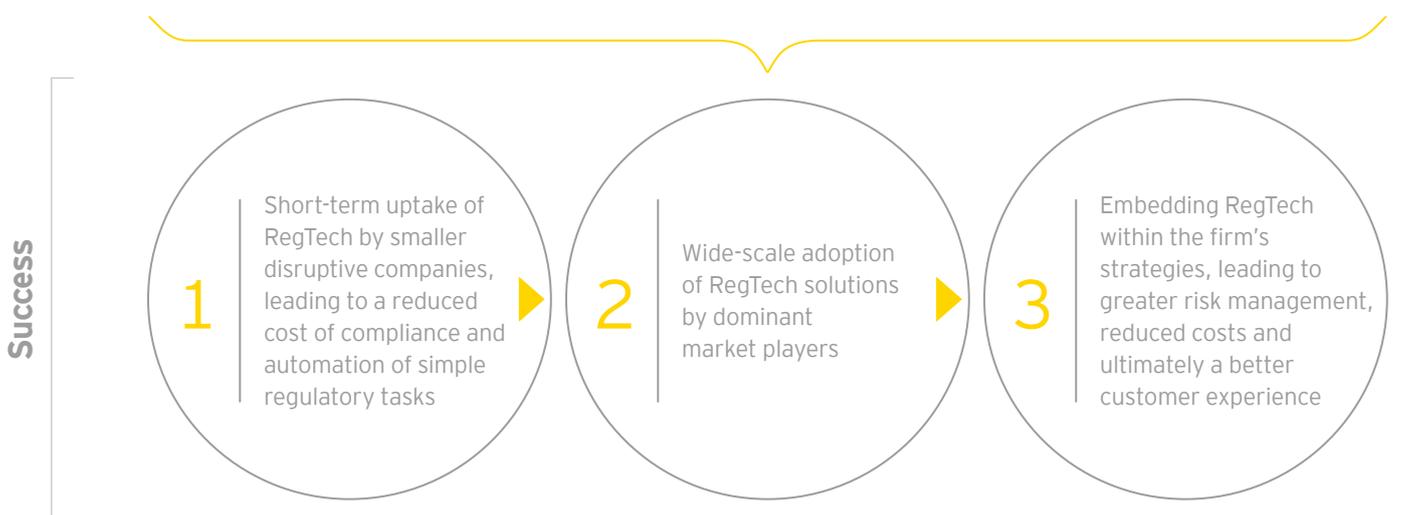
RegTech as a key component of FinTech

Alongside the rapid development of FinTech, we expect more financial institutions, both new and established, to adopt RegTech solutions. This will contribute to increasing volumes of data around regulatory compliance and will enable more granular reporting standards, scenario analytics and horizon scanning with the capability to generate better insights for senior managers.

Emergent FinTech will lead to disruptions for regulators and the FS industry



Emergent RegTech will drive innovation in FS regulation



RegTech: short-term benefits



In the short term, adoption of RegTech will provide operational efficiencies and cost benefits when applied to current compliance and risk management practices. Advanced regulatory data analytics allows big data to be examined in new ways, leading to more meaningful Management Information (MI) and insights into regulatory practices, rationale and further enhancements.

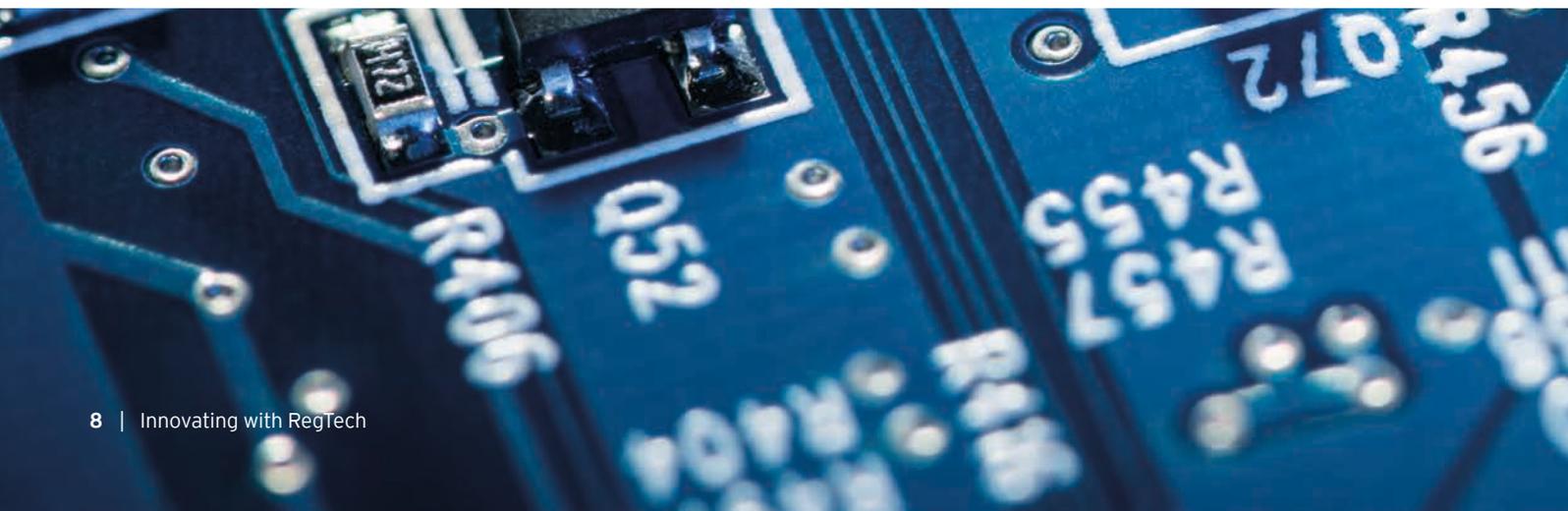
RegTech solutions will be aimed at providing a more automated, cost-effective way of meeting compliance and regulatory reporting needs. An integrated 'compliance by design' approach will be useful to achieve this objective.

Benefit 1: RegTech can help to drive down the cost of compliance by simplifying and standardising compliance processes through automated mapping of regulatory risks to key business processes, thereby reducing the need for manual and duplicate checks.

Benefit 2: RegTech utilises sustainable and scalable solutions, allowing for flexibility and growth as business needs change. Firms can move away from rigid enterprise risk management systems once the adopted RegTech solutions are stable.

Benefit 3: Advanced data analytics allows regulatory information to be analysed in various ways, including scenario analytics and horizon scanning for new regulations, thereby helping firms to proactively identify risks and issues.

Benefit 4: RegTech solutions, coupled with enterprise-wide governance, risk and control platforms, allow controls and risk frameworks to be linked seamlessly.



RegTech: long-term benefits

In the long term, the key benefit of RegTech will be its ability to enable innovation while enhancing consumer confidence through better customer experience. New RegTech platforms are also expected to allow seamless compliance reporting.

Developing a sustainable regulatory technology landscape ...

“... will enable innovation and positive competition in the FinTech sector with the objectives of being more flexible, efficient and productive; new and emerging risks can be identified and managed effectively, and consumers have the appropriate level of protection and suitable access to the benefits of FinTech.”

FCA call for input, November 2015

Benefit 1: RegTech will help to drive positive customer experiences. For example, a robust fraud detection platform could shorten the transaction life-span and improve consumer experience by reducing the number of false negatives.

Benefit 2: The same technologies that foster growth and promote customer experience can also be used to protect the financial health of institutions and prevent disruption of market agility and integrity.

Benefit 3: RegTech can provide greater confidence in meeting the board agenda on wider organisational governance, transparency and proactive reporting of risks and compliance.

Benefit 4: An expected application of RegTech will be to meet regulatory-driven data activities and support submissions to authorities. Early adopters will gain a competitive advantage by setting trends and gaining insights.



Compliance by design

'Compliance by design' refers to inbuilt regulatory compliance within an organisation's key business practices and operations. In other words, it signifies regulatory compliance being part of day-to-day activities which, along with the use of adaptive RegTech solutions, helps to drive down the overall cost of compliance and improve the accuracy of risk assessments generated, which in turn, boosts the confidence of the key stakeholders, including the Regulators.

A well-defined 'compliance by design' framework and the underlying methodology could assist in accelerating the implementation and embedding of RegTech solutions. Development would normally begin with a top-down assessment of regulatory compliance risks. This enables identification of inherent and residual regulatory risk and systemic issues. Once identified, a risk-based approach is applied to develop the framework.

Below is an indicative view of the key components within a 'compliance by design' framework.

- 1. Uniform compliance risk categories**
Assign different parts of the business into uniform compliance risk categories which enables grouping of similar regulatory risks.
- 2. Regulatory risk identification**
Identify and determine the baseline regulatory risks for each business area after considering both the internal and external factors.
- 3. Standardised compliance risk taxonomy**
Define a standardised compliance risk taxonomy including the inherent regulatory risk, control standard and residual risk, to enable regular monitoring and reporting.
- 4. Automated monitoring of compliance standards**
Conduct automated monitoring of compliance standards to assist in assessing the regulatory risks, including a set of remediation actions such as the activity plan, user accountability, nature of testing required and necessary documentation.
- 5. Monitoring change and application**
Monitor regulatory change by adopting a risk-based approach. Continuous feedback and rigorous change management processes are essential.



RegTech in practice



A selection of rapidly developing RegTech solutions being deployed across the Industry is shown below:

Fraud prevention

- ▶ These solutions monitor transactions in real time to identify gaps, issues and trends in financial crime; prevention reduces the risk and associated cost of loss funds due to fraud.
- ▶ Companies include a terabyte analytical capability with billions of different data points in a single transaction to identify potential threats to financial security.

Regulatory compliance automation

- ▶ Future RegTech platforms will be used to interpret regulations, including upcoming changes.
- ▶ A key challenge is to build a converged regulatory risk and controls management framework, where many RegTech solutions are currently being developed.
- ▶ Robotics are being adopted to perform routine compliance monitoring and testing processes.
- ▶ Robo-advice is growing in importance, with the use of sophisticated algorithms to provide customers with automated advice without human interaction.

Conduct and culture

- ▶ Solutions will be oriented to behavioural profiling and behavioural driven risks to indicate potential misconduct and map out company culture.
- ▶ Quantifying the impact of cultural change initiatives will be a natural progression.

Predictive analytics

- ▶ Analytics can be harnessed to forecast firm-specific operational and regulatory risks.
- ▶ Technology analyses the root causes of previous regulatory breaches and uses this to predict potential risk areas and disruptive events within financial markets.

What are the next steps for RegTech adopters?

1. Identify the relevant compliance and reporting elements that can benefit from automation

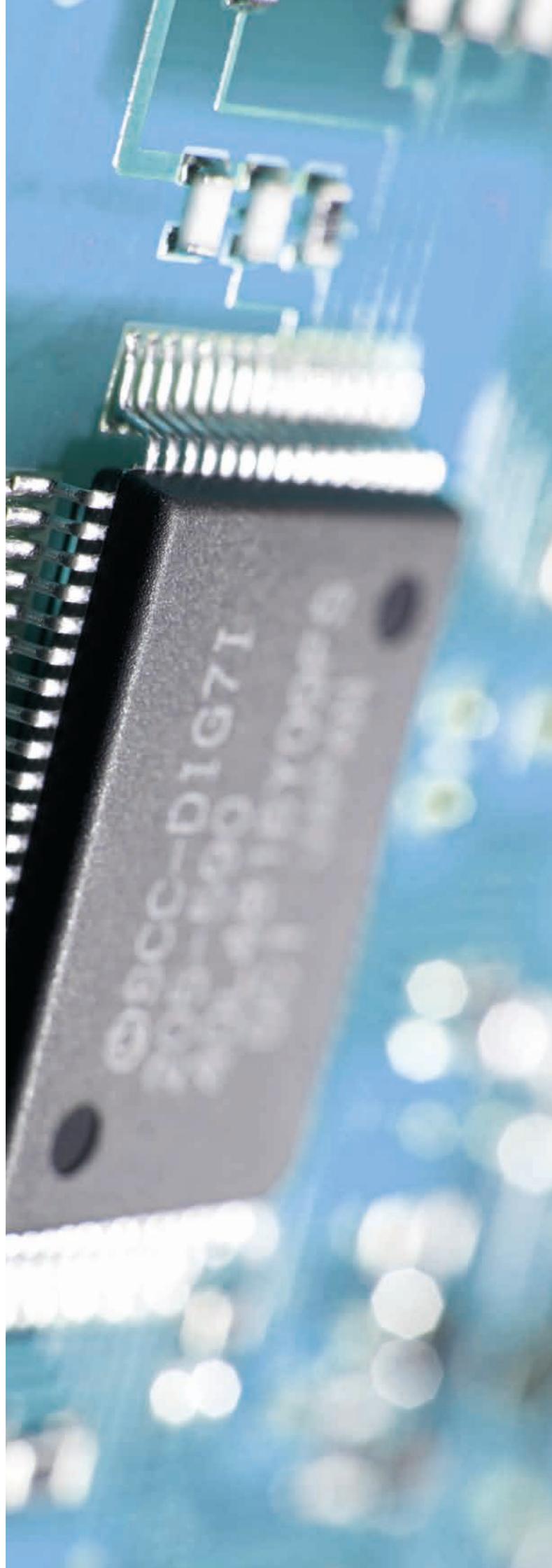
- ▶ Identify areas within your firm that could benefit from RegTech solutions (e.g., automation of controls, more meaningful MI from big data)

2. Understand your readiness position and develop a road map

- ▶ Recognise how to leverage your market position or expertise to embed a RegTech solution
- ▶ Determine your strategy, road map and test levels of senior stakeholder 'buy-in'

3. Assess the change impact against your existing risk management road map and strategy

- ▶ Assess the impact of implementing a RegTech solution within your business (i.e., impact of integration across a number of legacy systems)
- ▶ Evaluate cultural and infrastructure challenges
- ▶ Engage actively with the regulator to discuss your plans to embed RegTech solutions



Key factors to consider when adopting RegTech in practice

- ▶ **A clear view of your existing regulatory compliance risks and associated complexities**
Before investing further, it is key to have clarity of your compliance risks and resulting requirements.
- ▶ **A centralised compliance risk assessment and reporting framework**
The design and delivery of an integrated framework is fundamental, including standardised taxonomy for compliance risk mapping and monitoring.
- ▶ **Upcoming regulatory data and reporting requirements**
Facilitate a clear understanding of the existing and emerging regulations that impact your business. Provision of automated regulatory risk content is beneficial.
- ▶ **Skilled resources**
Determine if you have experienced people to deliver and manage change.
- ▶ **Pilot**
Always interact with a proof of concept, conduct a pilot and then test the automated compliance solution.
- ▶ **Network and collaborate**
Proactively approach your network and peers about what they are doing and what is available.

How EY can accelerate your RegTech journey

1. Identify, advise, support

We can provide recommendations and a level of support to early adopters of RegTech solutions around specific products and services. EY is currently monitoring various RegTech firms across five countries, and actively monitoring investment and client interest in 29 of them. Our regulatory experience and global market knowledge means we are well-positioned to identify the best RegTech solutions in each sector.

2. Your team for change

Following the identification of a suitable RegTech solution, we can offer an end-to-end collaboration from implementation to launch. We can assist with the replacement or dovetailing of legacy systems and support in the rebuilding of operational processes and retraining of staff.

3. Regulatory and technology insight

EY's global regulatory network leverages regulatory knowledge on an international scale. We can help our clients to implement RegTech solutions on a cross-border basis to confirm that they are compliant wherever they operate.

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