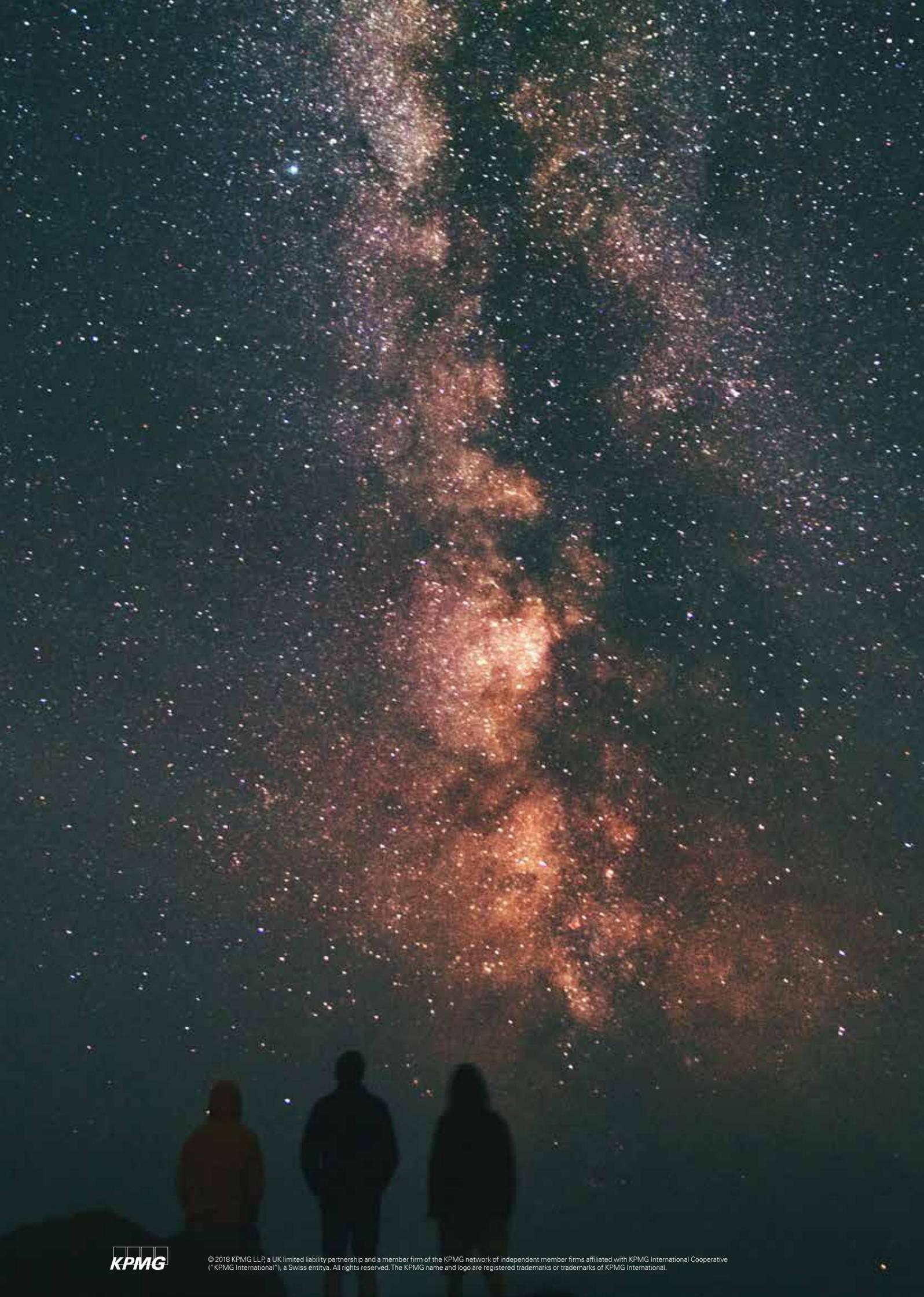




There's a revolution coming

**Embracing the challenge
of RegTech 3.0**



Introduction

RegTech as a term is self-explanatory – it's technology that helps financial services firms get better at dealing with regulation. As a key element of financial institutions' drive towards digital transformation, RegTech promises to:

- Strengthen compliance and mitigate risk
- Reduce the fixed cost of compliance and increase efficiency
- Improve protection for customers

But it can be more than that. Through direct improvements and freeing resources, RegTech also has the potential to:

- Provide valuable business insight
- Provide customers with better and faster service
- Drive new products and services

We are not there yet - in fact, if the RegTech industry were a mountain we'd only be at base camp. This article maps out RegTech's potential for transformation while staying rooted in the reality of where we are now and what is immediately round the corner. You can join the RegTech revolution now.

A sector under pressure

Financial institutions have faced an ever-increasing regulatory burden over the past 10 years. The cost of compliance has surged, particularly for global companies operating across jurisdictions.



RegTech is one of the fastest-growing elements of fintech/financial innovation. RegTech uses technologies such as advanced analytics, robotic process automation, cognitive computing and the cloud to achieve regulatory and compliance outcomes more efficiently and effectively.



The industry is also spending big on digital transformation.



It is easy to get carried away with new technologies that ultimately don't deliver. Most financial companies' use of RegTech is in its infancy and obstacles lie in the way.



Shareholders want management to show they can meet regulatory demands without throwing more resources at the problem.



But RegTech has the potential to improve service and protection for customers and to help restore trust in the industry.



The wider market is challenging. Margins are slim, interest rates remain low, competition is intense and political uncertainty is feeding economic and financial market volatility.



Financial institutions are turning to RegTech to fill compliance gaps, reduce costs, get ahead of requirements and detect enterprise risk before the regulators.



By 2020 RegTech is expected to make up 34% of all regulatory spending."



\$270bn

Financial institutions' annual compliance spending¹



>\$300bn

Fines paid by banks since 2008⁴



23,864

Fintech patents owned by the most prolific tech company⁷



\$1.37bn

RegTech investment in the first half of 2018 - more than for all of 2017²



\$76bn

Forecast RegTech spending by 2022 - up from \$10.6bn in 2017⁵



4,697

Total fintech patents owned by the top 15 banks⁸



7,000

Number of compliance staff employed by a global bank in 2014 – four times more than before the financial crisis³



10-15%

of financial institutions' staff work on governance, risk management and compliance⁶



34%

RegTech's predicted share of all regulatory spending by 2022 (4.8% in 2017)⁹

¹ FT, Banks' AI plans threaten thousand of jobs, 2017

² KPMG, The Pulse of Fintech, July 2018

³ FT, Banks face pushback over surging compliance and regulatory costs, 2015

⁴ Bloomberg, World's biggest banks fined £321bn since financial crisis, 2017

⁵ Juniper, Research Strategies for Financial Services 2017-2022, October 2017

⁶ FT, Banks' AI plans threaten thousand of jobs, 2017

⁷ Aistemos, Technology Disruption Through a Patent Lens, July 2018

⁸ Aistemos, Technology Disruption Through a Patent Lens, July 2018

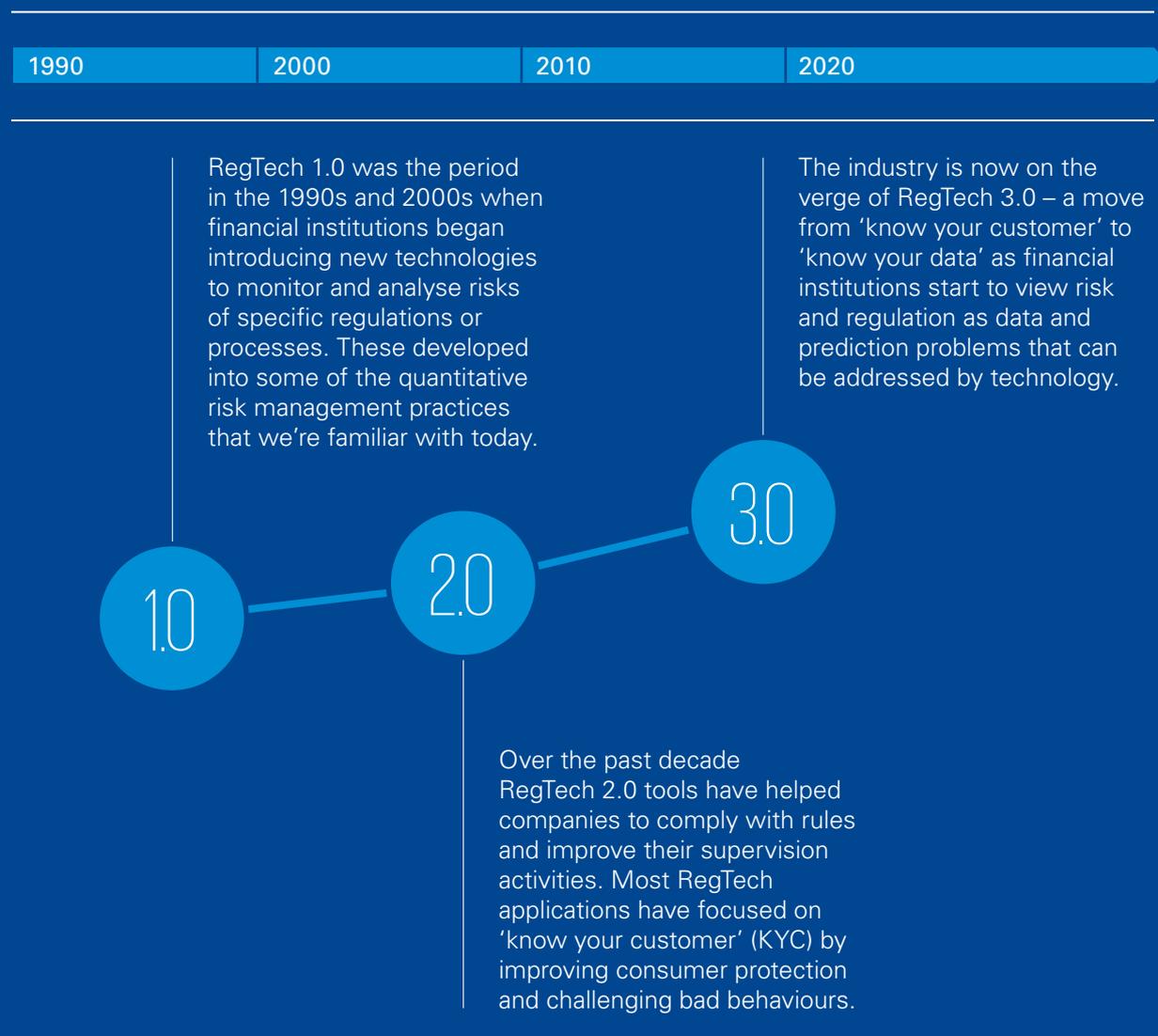
⁹ KPMG, The Pulse of Fintech, July 2018

Where are we now?

From KYC to know your data

RegTech is not a new category but – like other applications of technology – it is developing rapidly, driven by increases in computing power, the falling cost of emerging tech and the data explosion. We can divide RegTech’s history into three phases:

RegTech development



Technologies such as artificial intelligence and machine learning can enable companies to move from big data to 'smart data' to gain insights into regulatory practices, automate complex reporting, conduct meaningful analysis of critical compliance risk areas and even potentially create an end-to-end view of compliance.

Companies are using RegTech to deal with the huge amount of data they are generating. More data handled the right way also means better information and can provide an upside for risk and compliance.

Where will these technologies come from? Startups are mushrooming and financial services companies have become more active in developing processes and protecting their intellectual property. Leading financial institutions have applied for more patents on an increasingly impressive range of innovative products. But in-house innovation focuses on products and services rather than RegTech - and the financial sector lags way behind the big technology companies.

As noted earlier, the world's 15 largest banks together own five times fewer fintech patents (4,697) than the biggest single technology company (23,864)¹⁰. Tech companies' patents are not restricted to consumer-friendly innovations: they include credit checking, security and authentication.

Forward-looking companies regard patents as an important part of their innovation strategy. Investment in RegTech and smart use of IP can unlock long-term value for financial institutions' shareholders.

Companies should view Regtech as part of the wider digital transformation process that the industry is grappling with. While most institutions have built digital front-ends for their businesses, particularly in consumer-facing markets, these are built on legacy systems. Digital transformation requires a rethink of the whole business model and a redesign that spans the middle and back office as well as the front office – including risk and compliance.

When it comes to investing in fintech and RegTech, financial institutions can be broadly considered as falling into three categories: defensive, progressive and reinvention. These categories dovetail with the three Cs – compliance, cost and complexity – that are driving RegTech adoption.

¹⁰ Aistemos, Technology Disruption Through a Patent Lens, July 2018



Defensive, progressive or reinvention?



Defensive companies are concerned mainly with meeting regulatory requirements. Measures of success include keeping up with regulatory change, optimising capital and minimising conduct risk and investigations by regulators.



Compliance

The pace of regulatory change has slowed but compliance requirements will continue to grow as regulators focus on reforms ranging from supervision to systemic risk and priorities spanning data privacy and consumer protection.



Progressive companies have moved on to seeking efficiencies and customer benefits by automating some processes, making commercial investments and working with third parties to turn rhetoric about putting customers first into reality.



Cost

Regulatory constraints and low interest rates have made it harder for financial institutions to generate consistent profit growth. Financial institutions' need to reduce cost will see them embrace technology which enables them to increase efficiency and productivity in the risk and compliance function. As the cost of hardware and software comes down, investment in RegTech will become ever more affordable.



Reinvention requires the company to become an IP organization by bringing in senior managers, ideas and processes from other industries. The company will have its own innovation and commercial culture embedded.



Complexity

Political events are creating global uncertainties as the financial sector seeks to navigate new products, services and regulations. Added to these factors is the complexity created by the data environment, legacy systems and operating models.



As RegTech 3.0 beckons, all the three Cs are on financial institutions' agendas but those still in defensive mode are most focused on compliance while progressive firms have made the move to deal with costs. A few global investment banks have entered the reinvention phase that enables them to seek solutions to complexity and uncertainty and make the transition to become data companies.

There's a revolution coming

RegTech is on the cusp of a breakthrough that has the potential to transform the industry's approach to compliance and create additional value. The potential for RegTech 3.0 is backed by support from regulators, impetus for digital change, growing levels of investment and a proliferation of startups seeking to meet demand alongside big tech companies.

Regulators are also looking at how they can apply technology to their own processes. The Financial Conduct Authority is exploring how technology can make it more efficient and relieve the burden on firms. It has sought the views of firms and holds events to explore potential innovations. In the future, companies should expect mandatory requirements for tech that lets regulators scrutinize their data more effectively.

You don't have to believe the hype – or have made the move to our reinvention category – to adopt RegTech to deal with immediate issues and improve your business. Here are some real-world examples, including projects we have worked on, of improvements using RegTech:

- A multinational bank needed to demonstrate control of its inventory management system to regulators and eliminate spreadsheet errors. The bank deployed a RegTech system to automate the regulatory process, gain a complete view of its spreadsheets and save time and money. The services cover policies ranging from regulatory to internal policy as well as identifying other control issues such as operational incidents.
- Combining workflow automation and robotics with advanced analytics, a European bank automated credit decisions to reduce approval time for existing customers from two days to a few minutes. The number of credit office employees required to handle the transactions halved as a result – and customers received better, faster service.

- A bank used robotics to record the maturities of products when trades were executed and loans were made. Before, three parties would enter different categories of information on a manual spreadsheet in a highly inefficient process. Robotics and workflow technology enabled the bank to complete work in less than an hour that had previously taken five days.
- To combat financial crime, a bank wanted a scalable solution to review 400,000 SME customers, gain a holistic view of risk and establish a robust audit trail. The company adopted a cloud-based solution that halved the time required for a customer review, improved monitoring of financial crime and enhanced the bank's understanding of customers' business activities.

There are obstacles that could impede companies' willingness to invest in RegTech and innovators' abilities to develop the solutions that meet the industry's needs. These include:

- A changing regulatory landscape that means costly investment in technology might not meet compliance requirements down the line
- The difficulty for financial services firms in assessing the possibilities from an increasing array of new technologies and startups
- The absence of a common framework for handling complex data across borders
- A lack of common networks and collaboration platforms to bring together regulatory experts, software developers and financial institutions.

How KPMG can help

KPMG has the capability to act as the architect for your RegTech programmes. We know the role of RegTech as a compliance solution. We also understand how financial institutions can use RegTech as a digital transformation enabler, helping them improve customer service, develop new offerings and achieve greater competitive differentiation.

We can advise you on your long-term RegTech strategy and your immediate requirements. Our approach is to identify the issue you want to solve and then find the correct technology. We have close contacts in the RegTech sector – from startups to the biggest tech companies – and can help you find the right partner or solution.



Our services include:



Model Validation Automation

Allows us to automate the execution and compilation of model validation tests in a procedural, standardized, traceable, comparable and repeatable way. This enables the client to spend more time on tasks with greater value – such as analysing test results, arriving at conclusions and generating critical opinion.



Third Party Intelligent Diligence

Uses industry-first AI and advanced data aggregation techniques to produce due diligence profiles in an average of 15 minutes. It also incorporates continuous monitoring of media and legal sources for relevant legal, regulatory or reputational issues. The tool, which provides a fully integrated third party management system, can vastly reduce the cost of due diligence.



Client Due Diligence

CDD is a fully automated, end-to-end infrastructure hosted in the cloud. The solution ensures due diligence checks are completed throughout the customer lifecycle, harnessing the power of technology to focus closely on compliance reporting processes. CDD enables you to demonstrate full transparency and traceability in the management of your security and regulatory response.

Conclusion

RegTech 3.0 forms part of the transition from defensive mode to reinvention. Financial institutions should think about RegTech as part of their wider transformation strategy and be clear about what they want to achieve. Yes, the potential is enormous but you can start using RegTech to improve your business now. And if not RegTech then how are you going to deal with the demands of complexity, cost and compliance in an environment that isn't getting any easier?

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