HOW REGTECH IS REVOLUTIONISING COMPLIANCE

Whitepaper

JUNIPER RESEARCH

1.1 Introduction

With the explosion of interest in the fintech market, it is natural that many other markets are being analysed to see if technology can revolutionise operations. One such area which is feeling disruption from technology is regulatory compliance, primarily in the financial services industry.

The UK's FCA (Financial Conduct Authority) was the first body in the world to recognise and support the growth of Regtech in 2015. However, prior to this, companies were already seeking to leverage technology to help with their regulatory burdens.

Regtech is defined by the FCA as:

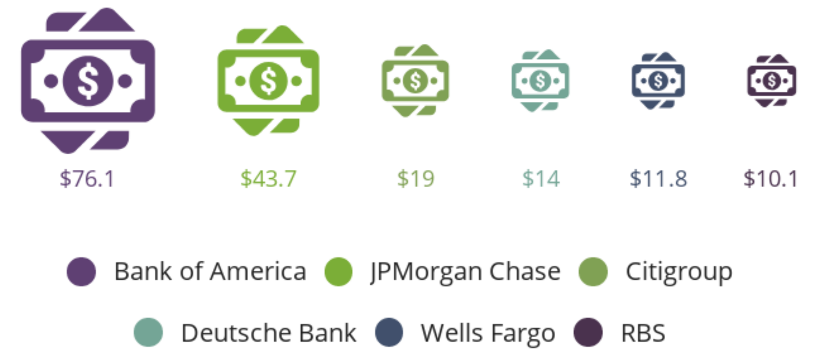
A subset of Fintech that focuses on technologies that may facilitate the delivery of regulatory requirements more efficiently and effectively than existing capabilities.[1]

The appeal of Regtech is that with some investment, FIs (Financial Institutions) can utilise new and disruptive technologies, such as AI (Artificial Intelligence), Big Data analytics, biometrics, blockchain and chatbots to reduce their overall spending on compliance by unlocking more efficient practices. This is particularly important considering the extremely complicated regulatory framework in place globally and how this landscape is evolving over time.

The regulatory burden faced by FIs is very heavy and getting heavier still. The financial crisis of 2008 was a shock to many regulators; meaning that even given the time that has passed since 2008, regulations are still being enacted and altered. Even without the impact of the financial crisis, regulations will always need updating and revising to reflect social, cultural, political and technological changes. This means that keeping up with regulatory change is onerous, let alone ensuring compliance.

The scale of the challenge is clear when regulatory fines since the financial crisis are analysed, as in Figure 1.

Figure 1: US Regulatory Fines Over $10 Billion Imposed Since the 2008 Financial Crisis

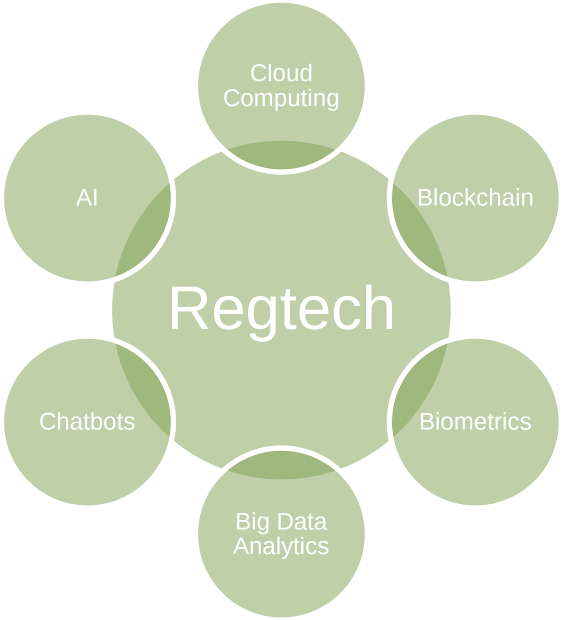


Source: Juniper Research

1.2 Regtech Technological Approaches

Regtech is an extremely varied and broad segment, which is not limited to one approach or one technology being utilised. It is instead a collection of disparate technological approaches that are united by the common goal of improving the regulatory burden that FIs and other heavily regulated businesses face.

Figure 2: Technological Ecosystem for Regtech



Source: Juniper Research

- AI: This can be leveraged in Regtech to automate data processing and derive insight from existing data, as well as to process KYC validation.

- Big Data Analytics: This can be used to make sense of the extraordinarily large amount of data that companies process related to compliance. This is particularly important in terms of transaction monitoring.

- Biometrics: Biometrics has the potential to be hugely important for banks and other businesses in verifying customer identity, which is essential to KYC/AML (Know Your Customer/Anti Money Laundering) regulations.

- Blockchain: Blockchain is being touted as a solution to many kinds of issues across sectors, but it does have genuine applications in the regulatory space. Distributed ledgers can be used to share data, such as AML/KYC data, which can enable FIs to operate more efficiently in a connected way.

- Chatbots: Chatbots have the potential to be used by compliance officers as a way to obtain data about new regulations, or to take KYC data from clients. This can automate existing experiences.

- Cloud Computing: While cloud computing is much better established than others on this list, it still has a transformative ability in the space. Banks in particular have been moving towards cloud deployment in a big way to simplify their regulatory challenges.

1.3 Key Regtech Trends & Constraints

As with any newly developing market, there are a number of both trends and constraints that are operating on the Regtech market and shaping its development. These are examined in detail below.

1.3.1 Key Trends

i. Involvement of Technology Companies in Regtech

Regtech is similar to the blockchain sector, in that traditional technology vendors are becoming increasingly involved in the space. This includes the involvement of IBM, which is leveraging its Watson AI platform, which it refers to as ‘cognitive computing’, to create solutions in the Regtech space. This move is understandable, given that regulatory compliance issues are mostly complex data processing tasks. Technology vendors will already possess the technological capabilities to execute these tasks effectively, meaning that the regulatory compliance area is one that they can get involved in fairly easily. As large multinationals themselves, they will likely have experience of regulatory compliance as well, which will further assist them in the space.

In this context, Juniper anticipates further involvement in the space by major tech players, likely to be in the form of automated compliance tools which can be integrated into Cloud platforms, such as AWS, Google Cloud Platform or Azure.

ii. KYC Checks the Most Popular Area

In the Regtech space, KYC checks are undoubtedly the most popular area for start-up activity. This is understandable, given the scale of the issue surrounding KYC activity. In most developed nations, every single account opening requires a thorough check of documentation, which can be very expensive for FIs. As such, a focus on allowing businesses to process these activities in a more efficient way is an obvious way to appeal to FIs as a potential user base.

The other consideration is that this area is fairly simple to disrupt with existing technological approaches. For example, Trulioo’s KYC solution is a large database of individual information, informed by sanctions lists and other data. While the data itself is not new, the manner by which it is brought together is. Therefore, KYC solutions, while advanced, do not necessarily require a complicated technical approach. This explains the groundswell of activity in this area.

1.3.2 Key Constraints

i. Normalisation Since Financial Crisis

Following the financial crisis of 2008, there was a concerted effort to tighten up financial regulations and eliminate systemic risk, across both developed and developing markets. The current stringent regulatory framework is a direct result of this.

However, there are signs that the market is becoming progressively normalised. Monetary policy has been moving to a more liberal position and it looks like this is set to be the case in regulation as well. This has been a priority for the Trump Administration in the US, which has set out clear policy objectives to reduce the regulatory burden, particularly in the financial services industry. Any removal of regulation in this area will threaten the appeal of Regtech by reducing the regulatory challenge. However, regulators are unlikely to remove fundamental aspects of financial regulation such as KYC/AML and consumer protection, as these have become established practices for valid reasons. Regtech vendors will want to see certainty on regulation, so they can build the correct solutions in time for regulatory rollouts and revisions.

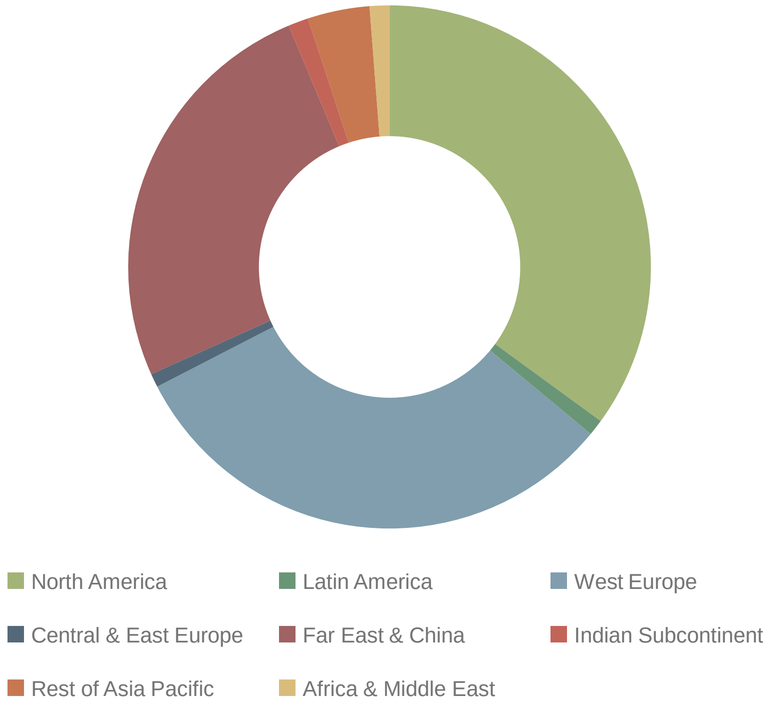
ii. Lack of Expertise

Regulatory compliance is undoubtedly an extremely complicated proposition. The reason that FIs have such large and well-paid teams of compliance experts is that compliance requires a level of expertise that is difficult to obtain. As such, for Regtech vendors to create solutions that appeal to the market, they need to understand the regulatory compliance market at least as well as these experienced internal teams. This is a big challenge. There will likely be a credibility gap with Regtech vendors in the short term, where FIs believe that their own credentials in regulatory compliance are superior, which will in turn restrict investment. In the longer term, as deployments occur, vendors will establish a track record of performance which will be highly beneficial to future revenue generating capabilities.

1.4 Forecast Summary

- **Juniper forecasts that spending on Regtech will exceed $115 billion by 2023, up from an estimated $18 billion in 2018. The research found that increased regulatory pressures, as demonstrated by the recent GDPR (General Data Protection Regulation) are driving businesses towards Regtech to meet greater compliance challenges.**
- This growth is significant, given the much slower rate of overall compliance spending, forecast at a CAGR (compound annual growth rate) of just 16.6% between 2018 and 2023, compared with 45.1% for Regtech. Any heavily regulated business not planning Regtech adoption must make this an immediate priority, or risk damaging fines from regulators for failing to keep pace with regulatory change.
- Juniper also found that KYC checks for anti-money laundering are ripe for disruption by AI systems, due to the inefficiency of traditional, paper-based systems. Juniper forecasts that across banking and property sales, the annual gross cost savings from AI introduction for KYC will exceed $700 million by 2023, a nine-fold increase over 2018.

Figure 3: Total Regtech Spending ($m) Split by 8 Key Regions 2023: $115.9 Billion



Source: Juniper Research