Colaborating on RegTech

By STEPHEN SCOTT

MAY 17, 2021

"So what is the future of supervision in this changing world, and what can we learn from the current crisis?", asked BCBS chairman Pablo Hernández de Cos, addressing the 21st International Conference of Banking Supervisors in an October 2020 speech.[1]

starling

The implications of these developments for supervisors are threefold. First, proactive supervision must be the primary response to these changes, as the traditional regulatory framework may not be sufficient. Second, greater consideration should be given to the regulatory perimeter to ensure that the oft-cited mantra of 'same activities, same risks, same rules;' is actually operationalised. And third, cooperation among different authorities—spanning both monetary and regulatory authorities—will be even more important.

Regulators and central bankers are now working closely—through cross-border initiatives such as the Global Financial Innovation Network[2] and the Bank for International Settlements (BIS) Innovation Hub[3]—so they might learn from one another's experiences in bringing new technologies to bear amidst today's manifold challenges. July saw the launch of a Digital Regulation Cooperation Forum in the UK, for instance.[4] The BIS announced broad expansion of its Innovation Hub, with new centers planned for London, New York (in partnership with the NY Fed), Toronto, Stockholm, Frankfurt and Paris.[5]

The European Banking Authority (EBA) issued a Consultation Paper in August last year indicating that it is looking at "mapping and understanding existing RegTech solutions, identifying barriers and risks relating to the use of RegTech and analyzing how to facilitate the application of RegTech across the EU."[6] "While fintech is an essential part of the UK financial ecosystem, it's important to remember that RegTech companies have also played a crucial role in helping firms navigate the challenges posed by COVID-19," said William Russell, Lord Mayor of London, in a speech last month. "Innovative technologies provided by the RegTech industry can help financial services to better meet their regulatory obligations, enabling real time surveillance of the financial markets and even predicting where risks and problems will emerge."[7]

"Innovative technologies provided by the RegTech industry can help financial services to better meet their regulatory obligations, enabling real time surveillance of the financial markets and even predicting where risks and problems will emerge."

"The benefits and opportunities of regtech and suptech for regulated entities and supervisory authorities to improve efficiency, reduce manual processes and make effective use of data are enormous," said BIS Innovation Hub head Benoît Cœuré, during an August 2020 speech.[8] "SupTech and RegTech tools could have important benefits for financial stability," wrote the FSB in an October report.[9] "For authorities, the use of SupTech could improve oversight, surveillance and analytical capabilities, and generate real-time indicators of risk to support forward looking, judgement based, supervision and policymaking," the report noted, adding that "For regulated institutions, the use of RegTech could improve compliance outcomes, enhance risk management capabilities, and generate new insights into the business for improved decision-making. For both authorities and regulated institutions, the efficiency and effectiveness gains, and possible improvement in quality arising from automation of previously manual processes, is a significant consideration.[10]"

Partly driven by strains arising from the COVID-pandemic, the past year has seen a continuation and expansion in these collaborative undertakings, giving a marked boost to the adoption of Regtech offerings.[11] The leak of the FinCEN files triggered greater collaboration around anti-money laundering and other financial risks,[12] and the collapse of Wirecard, may have boosted demand for technologies that address operational and other non-financial risks.[13]

An Australian Senate Select Committee on Financial Technology and Regulatory Technology issued an Interim Report[14] on learnings it has gained through more than 200 submissions from an array of industry participants. The Select Committee has shown interest in developing an informed appreciation of barriers to uptake of these new technologies and recently changed its name to the Select Committee on Australia as a Technology and Financial Centre. “This is the ideal time to widen our scope and explore new opportunities for Australia as a technology and finance centre arising from the COVID-19 pandemic,” proclaimed Senator Andrew Bragg, Committee chair. “I fully expect the committee to focus on removing more barriers to Australian growth as a technology and a finance centre,” he added.[15]

Increasingly, regulators are acting to catalyze technology innovation.[16] Australia’s ASIC has called upon the financial industry for greater collaboration towards achieving better regulation.[17] “We consider that regulatory technology (regtech) has significant potential to help businesses enhance their risk management and compliance activities,” ASIC indicated in a report summarizing the regtech initiatives it undertook during the 2019–20 financial year. “We are committed to the continued promotion of regtech and its use by financial firms. We consider that it can deliver better consumer and market integrity outcomes.”[18]

“The use of technologies that enhance efficiency and/or the effectiveness of risk management and regulatory compliance—presents opportunities to unlock significant benefits for banks, regulators and the wider economy,” the Hong Kong Monetary Authority observed in a report released in November.[19] “The HKMA strongly believes that Hong Kong has the right foundations to support a thriving Regtech ecosystem, and ultimately become a Regtech hub,” said HKMA Deputy Chief Executive Arthur Yuen in a speech coinciding with the report’s launch. “We want to accelerate the adoption of Regtech in Hong Kong. And this will involve us working hand-in-hand with banks and the Regtech community.”[20] At the close of the year, the HKMA outlined a number of regtech use cases that might effectively respond to operational challenges presented by COVID-19 disruptions.[21] And, in January this year, the HKMA issued a report on the use of regtech in connection with AML/CFT obligations.[22] “Regtech adoption will not be an aspiration in 2021,” KPMG argued, “it will be a necessity.”[23]

“The use of technologies that enhance efficiency and/or the effectiveness of risk management and regulatory compliance presents opportunities to unlock significant benefits for banks, regulators and the wider economy”

HONG HONG MONETARY AUTHORITY

Banks have also drawn closer to the fintech and regtech ecosystems in the past year. “By using artificial intelligence, machine learning, and other advanced technologies and practices,” wrote BCG in an April 2020 report, “they can improve bank steering; deliver predictive, real-time insights; and execute faster and more efficiently.” In a September report, McKinsey offered, “Sub-sectors such as digital investments, digital payments, and regtech, which have had tailwinds from crisis-related changes in behavior, appear set to take a greater share of the funding pie.”[24] When the US SEC’s Strategic Hub for Innovation and Financial Technology announced a series of virtual meetups in June, RegTech was the first theme to be covered.[25] The UK FCA asked if the pandemic had helped to usher in a “watershed moment” for the RegTech space.[26]

“Should there be a greater prudential focus on bank conduct, ethics and incentives? Is there scope for greater collaboration among different types of authorities on cross-cutting issues?” asked BCBS chair Hernández de Cos at his October speech cited at the outset here.

The GFC exposed serious deficiencies in these areas. In some instances, misconduct by a few 'rotten apples' in the system threatened to undermine the robustness of the barrel. In response, international bodies and authorities in charge of conduct and market integrity have rightly led the efforts to address these fault lines.

Yet episodes of malpractice and related behaviours have clear prudential implications too. They may point towards broader deficiencies in banks' governance and risk management standards. Conduct-related fines to banks over the past decade totalled hundreds of billions of euros, and proved to be a significant driver of provisions and at times a source of risk to banks' capital strength. And, even more importantly, ongoing misconduct practices erodes trust between the banking system and the public. A moral 'run on the bank' would have significant prudential implications.

Since the financial crisis, regulators and firms alike have emphasized a 'detect and correct' approach to conduct risk governance and supervision. As we move forward, perhaps regtech will permit for a more proactive, 'predict and prevent' capability set.

STEPHEN SCOTT is a globally recognized risk management expert and CEO of Starling, a US-based leader in the RegTech space.

ENDNOTES

1 Pablo Hernández de Cos, "Covid-19 and Banking Supervision: Where Do We Go from Here?" Keynote Speech at the 21st International Conference of Banking Supervisors, Oct. 19, 2020. https://www.bis.org/speeches/sp201019.htm

2 Polly Jean Harrison, "Global Financial Innovation Network Opens Applications for Cross Border Testing," *The Fintech Times*, Nov. 16, 2020. https://thefintechtimes.com/global-financial-innovation-network-opens-applications-for-cross-border-testing/

3 BIS, "BIS Innovation Hub Sets Out Annual Work Programme and Launches Innovation Network," Press Release, Jan. 22, 2021. https://www.bis.org/press/p210122.htm

4 Pinsent Masons, "Digital Regulation Cooperation Forum set up in the UK," Jul. 2, 2020. https://www.pinsentmasons.com/out-law/news/digital-regulation-cooperation-forum-set-up-uk

5 Market Screener, "New BIS Innovation Hub Centre for Global Financial Innovation to Be Set Up Jointly in Frankfurt and Paris," June 30, 2020. https://www.marketscreener.com/news/latest/New-BIS-Innovation-Hub-Centre-for-global-financial-innovation-to-be-set-up-jointly-in-Frankfurt-and--30848255/

6 Shearman & Sterling, "European Authority Seeks to Promote Regtech use," Blog, Aug. 12, 2020. https://finreg.shearman.com/European-Banking-Authority-Seeks-to-Promote-RegTe#page=1

7 William Russell, "Fintech Innovation Will Be at the Heart of London's Recovery," Opinion, *City A.M.*, Apr. 19, 2021. https://www.cityam.com/fintech-innovation-will-be-at-the-heart-of-londons-recovery/

8 Benoît Cœuré, "Leveraging Technology to Support Supervision: Challenges and Collaborative Solutions," Speech at the Peterson Institute for International Finance, Aug. 19, 2020. https://www.bis.org/speeches/sp200819.htm?

9 Financial Stability Board, "FSB Report Highlights Increased Use of RegTech and SupTech," Press Release, Oct. 9, 2020. https://www.fsb.org/2020/10/fsb-report-highlights-increased-use-of-regtech-and-suptech/

10 Randal K. Quarles, Letter to G20 Finance Ministers and Central Bank Governors, Oct. 13, 2020. https://www.fsb.org/wp-content/uploads/P141020-1.pdf

11 Matthew Vincent, "Regulators Speed Up Fintech Plans as Covid Spreads," *Financial Times*, Nov. 2, 2020. https://www.ft.com/content/1f2903b9-0ec8-4489-be3d-9d43fca36edc?shareType=nongift

12 Reuters, "EU ministers Agree to Set Up EU Anti Money Laundering Body," Nov. 4, 2020. https://www.reuters.com/article/eu-economy-ministers-idUSL1N2HQ1YX?edition-redirect=in

13 Tyler Smith, "Regtech Re-Imagined: Innovating Operational Risk After the Pandemic," *The Fintech Times*, Mar. 30, 2020. https://thefintechtimes.com/regtech-re-imagined-innovating-operational-risk-after-the-pandemic/

14 Australian Senate Select Committee on Financial Technology and Regulatory Technology, Interim Report, Sept. 2020. https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Financial_Technology_and_Regulatory_Technology/FinancialRegulatoryTech/Interim_Report
15 Sarah Simpkins, "Senate Fintech Committee Expands Orbit to World Domination," *Investor Daily*, Mar. 19, 2021. https://www.investordaily.com.au/technology/48936-senate-fintech-committee-expands-orbit-to-world-domination
16 Finextra, "How Regulators Have Catalysed Collaborations and Technological Innovations," Apr. 22, 2021. https://www.finextra.com/newsarticle/37917/how-regulators-have-catalysed-collaborations-and-technological-innovations
17 Chris Dastoor, "Industry Needs to Collaborate with Regulators: ASIC," *Money Management*, Apr. 21, 2021. https://www.moneymanagement.com.au/news/policy-regulation/industry-needs-collaborate-regulators-asic
18 Australian Securities and Investments Commission, "ASIC's Regtech Initiatives 2019–20," Jan. 2021. https://download.asic.gov.au/media/5937756/rep685-published-20-january-2021.pdf
19 Hong Kong Monetary Authority & KPMG, "Transforming Risk Management and Compliance: Harnessing the Power of Regtech," Nov. 2020. https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2020/20201102e3a1.pdf
20 Arthur Yuen, "Transforming Risk Management and Compliance: Harnessing the Power of Regtech," Speech at the Hong Kong FinTech week 2020, Nov. 2, 2020. https://www.hkma.gov.hk/eng/news-and-media/speeches/2020/11/20201102-2/
21 Regulation Asia, "HKMA Outlines Regtech Use Cases for Pandemic Environment," Dec. 18, 2020. www.regulationasia.com/hkma-outlines-regtech-use-cases-for-pandemic-environment/
22 Omar Faridi, "Hong Kong Monetary Authority Releases Regtech Adoption Report for Improving AML/CFT Activities," *Crowdfund Insider*, Jan. 22, 2021. https://www.crowdfundinsider.com/2021/01/171479-hong-kong-monetary-authority-releases-regtech-adoption-report-for-improving-aml-cft-activities/
23 Jia Ning Song, "Regtech Adoption Will Not Be an Aspiration in 2021, It Will Be a Necessity," *LinkedIn*, Dec. 9, 2020. https://www.linkedin.com/pulse/regtech-adoption-aspiration-2021-necessity-song-cfa-cpa-frm-caia/
24 Chandana Asif et al., "Detour: An Altered Path to Profit for European Fintechs," *McKinsey & Company*, Sept. 9, 2020. https://www.mckinsey.com/industries/financial-services/our-insights/detour-an-altered-path-to-profit-for-european-fintechs
25 JD Alois, "SEC FinHub Announces Virtual Meetups, First Up is Regtech," *Crowdfund Insider*, June 11, 2020. https://www.crowdfundinsider.com/2020/06/162627-sec-finhub-announces-virtual-meetups-first-up-is-regtech/