



RegTech: Bringing New Meaning to Compliance and Cloud Technology in Asset Management

The Evolution of the Compliance Function and Disruption of Data Usage with the Cloud

November 2016



Over the past five years, increased regulation and regulatory reporting obligations have put compliance and regulatory teams in the spotlight a little more than they would like. At the same time, compliance failures, highlighted by regulatory scrutiny that lead to fines, have resulted in a huge surge in hiring and expansion of teams.

While additional headcount spreads out the work in the softer areas of research and managing regulatory change projects, it is potentially less effective in the process-driven areas of internal monitoring, compliance testing and overall reporting. These areas are heavily reliant on having a robust and effective compliance program in place – one that includes a methodology that matches both the organisational structure of the team and their working practices.

With the need for more granular types of data to expand compliance testing to encompass an array of investment types and increased machine-readable reporting formats, firms need better and more comprehensive data on a greater frequency basis. Additional headcount does not solve that challenge, but effective data management and technology does.

This whitepaper explores how data management and regulatory technology (RegTech) can support a compliance team and create a better time and cost-efficient way of working.

What is RegTech?

RegTech is a subset of FinTech, introduced by the FCA in 2015, that focuses on technologies proven to facilitate the delivery of regulatory requirements more efficiently and effectively than existing capabilities.

RegTech solutions will often take the form of software applications, technology-enabled processes, or can be found in completely new and disruptive business models.

RegTech is a logical and more recent evolution that complements the broader FinTech space.



Compliance: From a 'Must Have' to an Integral Role in Strategic Business Planning

It has only been a few years since the function of Compliance within a financial services organisation has gained a seat at the C-Suite table. While having a Compliance Officer has been a regulatory necessity for some time now, only recently has this role begun to provide value-add to their firms and is now relied on from a strategic perspective.

That need has been driven by the fact that increasing levels of regulation globally and more challenging regulatory expectations are causing firms significant operational challenges when it comes to understanding, implementing and embedding new regulations and regulatory reform. Understanding the regulatory impact, in particular, has become strategically critical at the senior management level.

Key findings gathered from research by Investit Insights for their paper 'Coping with Regulation - Now and in the Future' June 2015 include:

- 50 percent of firms centralise regulatory interpretation under the Chief Compliance Officer but still rely on other departments or outsource providers for support. Programme Management is centralised for 58 percent of firms under the Chief Operations Officer, yet there is no standard structure for systems analysis and design, and only 33 percent of firms centralise regulatory reporting.
- Many firms have implemented tactical solutions to ensure timely compliance with new regulations. Although viewed as generally effective and reliable, 42 percent of firms question the scalability of the reporting solutions.
- The expected increase in transaction reporting and need for improvements in oversight and controls are major factors impacting scalability. As a result, 67 percent of firms are planning strategic solutions to centralise regulatory reporting in the future.

Striking the right balance to address these challenges is not straightforward. Now, we are seeing a move from the operational need to 'just get it done', to inclusion in the long-term strategic visioning at a senior level, coupled with a renewed interest in investing in software for longer term support. But why the renewed interest in software? For 20 years, compliance software has successfully supported various parts of the compliance process. The answer is in the *Cloud!*

New Dawn of the Tech Savvy Regulator

Regulatory compliance is a complex, time-consuming and expensive task. However, over the last 18 months, regulators have had a realisation that the volume of regulation and the operational costs associated with it are not sustainable for the industry. Regulators are slowly but surely adapting their mind set to pave the way for new, disruptive technologies via Cloud-based platforms and databases. Because of their unique characteristics such as flexibility, speed of integration and deployment, together with robust analytic capabilities, these new technologies can ease the burden of regulatory compliance. The UK's Financial Conduct Authority (FCA) has been leading the way with Project Innovate, an initiative aimed at supporting firms who want to explore new approaches to more effectively and efficiently tackle regulatory challenges in financial services through technology innovation.

In a speech given to bankers at the BBA FinTech Banking Conference in September of 2016, Christopher Woolard, Director of Strategy and Competition at the FCA, confirmed that the regulator plans to "encourage innovation and adoption in technology" by looking at how regulation can be approached in "new and creative ways". Woolard went on to confirm that the FCA "recognises the burden of compliance" and referred to the "billions of pounds and large numbers of staff dedicated to the business of regulation".

Also in September, the Securities and Exchange Commission (SEC) announced its plan to host a public forum on FinTech, in an effort to foster greater collaboration and understanding between the regulator, the regulated and the technology firms. The discussion will examine how the current regulatory environment can most effectively address new technology.ⁱ

Australia has also set up a similar initiative to the UK that will look specifically at how to best manage and internally innovate around the intersection between regulation and technology.ⁱⁱ



RegTech Timeline

FCA launches an initiative called Project Innovate – an advice hub supporting businesses to go-to-market faster with innovative financial products and services.

October 2014

FCA issues a Call For Input to support the development of RegTech and launches a Regulatory Sandbox initiative for testing new product.

November 2015

FCA piloted a two day idea and innovation TechSprint event, aimed at fostering innovation for new FinTech companies.

April 2016

FCA opens its regulatory sandbox to firms, providing a safe space for testing innovative products and services.

May 2016

June 2015

FinTech gains a place on the agenda at the international securities watchdog IOSCO Annual Summit in London. The term RegTech is used during panel discussions.

March 2016

Call For Input participants host regulatory roundtables with FCA to discuss and collaborate

April 2016

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

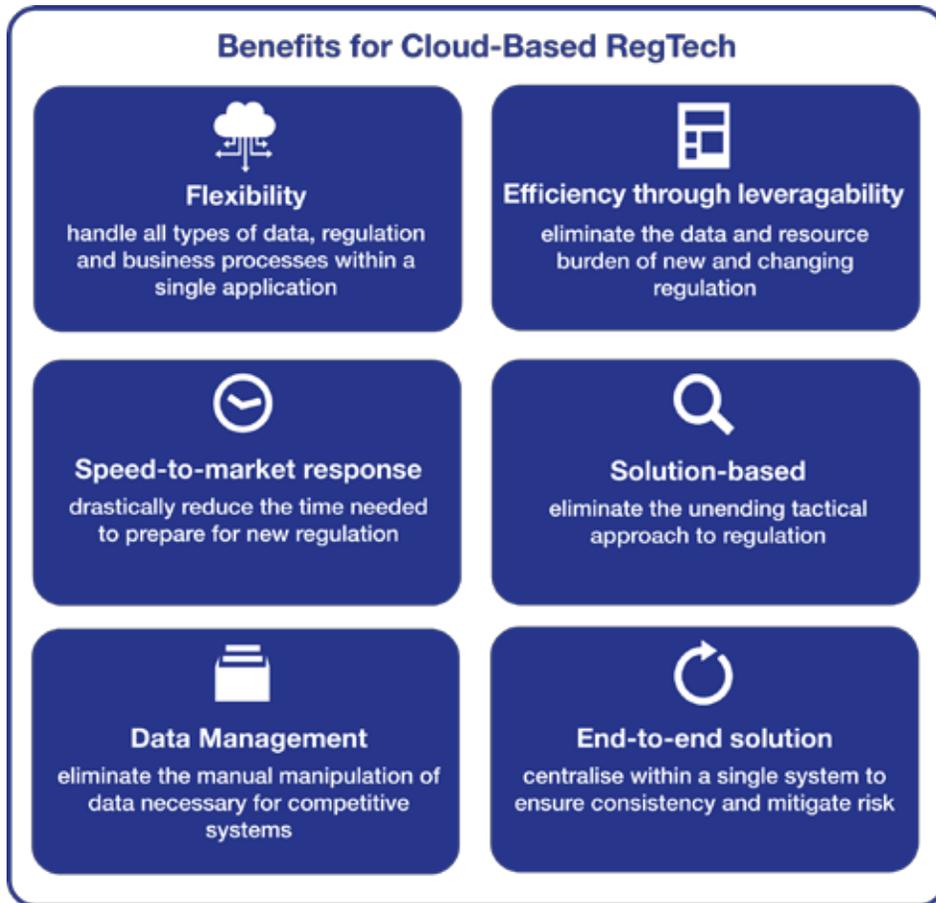
Data Overload and the Cloud Computing Era

Cloud offerings allow for resources (databases, computing power and services) to be delivered via the internet, within a wide range of capabilities and business requirements. It's the inherent flexibility and distribution of this model that is of particular interest for regulatory compliance and reporting. Flexibility and collaboration are key to success in this emerging market.

The requirements of regulators change quite frequently, especially in comparison to other reporting demands. Regulators routinely revise their requirements, release additional FAQs and enact additional regulation. The frequencies of both reporting and change are increasing. Solving for this increase in pace and scale requires a solution founded on flexibility. The agility required to successfully respond must be integrated into all facets of the end-to-end process. That requires flexible processes, applications that can be updated cost effectively and quickly, databases that can model new regulatory demands efficiently, and technologies that can upgrade seamlessly without expensive release processes. Because Cloud-based solutions provide all of these attributes, they are integral to the efficient long-term viability of regulatory processes.

The process of regulatory reporting is distributed across multiple parties, both internal and external, to the filing entity. Multiple and different groups, from sub-advisors to third-party service providers, have to collaborate together on a single disclosure, providing data directly and reviewing content. Preparers and reviewers have to be able to work efficiently in bulk, while having the appropriate details ready to troubleshoot and address concerns, from across the reporting entities. These distributed work streams need the support of a technology solution that matches their complexity. Functionalization of responsibilities is also required as reporting frequency and complexity increases. Cloud solutions facilitate the true operating model of regulatory compliance and reporting – much better, in fact, than the classic draft-based review exchanges via email and other classic methods.





Some additional advantages of Cloud solutions:

- Availability readiness – critical uptime requirements during reporting cycles
- Simplified and outsourced integration with regulators – including National Competent Authorities reports and reporting mechanisms
- Cost reduction and simplicity – simplify the procurement and maintenance processes by including software, technology, hardware and services in one purchase; reduce the cost
- Performance and scalability – the resources that you need
- On-demand elasticity – the resources that you need, when you need them
- Lightweight implementations – turn on reporting with minimal upfront costs and rapid readiness

Cloud Security and Internal Control

While development of Cloud-based technology is certainly a global movement and is disrupting contemporary views of data use and data processing in many industries, there are certain safeguards to be considered when applying this to financial business processes – including the compliance function.

UK financial firms have requested guidance from the FCA over how the term ‘Cloud’ should be defined, how it applies to them, as well as a framework for understanding operational and supply-chain risks.

With this in mind, the FCA has proactively issued recommendations in the form of a guidance noteⁱⁱⁱ that sets out appropriate safeguards for financial businesses when selecting a technology provider and for the effective procurement and monitoring of their Cloud solutions.

The guidelines give financial businesses a provisional green light and framework on how to move to the Cloud.

The FCA insists firms need to review their contracts with their outsourcing providers to ensure that they meet the internal standards. Firms need to ensure their operational risk is not increased by Cloud migration, as well as identify other servicers in the supply chain.

The FCA recommends that firms agree to a data residency policy with their chosen providers and fully understand the data providers' data loss and breach processes. The FCA stresses the importance of continuity planning – asking firms for “appropriate arrangements to ensure that it can continue to function and meets its regulatory obligations in the event of an unforeseen interruption of the outsourced services.” Developing a viable exit strategy is also highly emphasised.

“We see no fundamental reason why cloud services (including public cloud services) cannot be implemented, with appropriate consideration, in a manner that complies with our rules,” says the FCA.^{iv}

Green Light for Regulatory Technology as well as Business Processes

The demand for regulatory and compliance software and serviced solutions is expected to grow at an unprecedented rate. Currently, most financial services firms have not fully recognised or optimised the potential for regulatory compliance software, but that is set to change. The regulators' acceptance of innovation and proactive support for technology start-ups (in the form of a regulatory sandbox) will significantly speed up the 'go-to-market' process.

RegTech in the Cloud enables the solutions to be agile and dynamic and to maintain, manage and back up data in a consistently secure environment. Utilising the characteristics above can significantly cut the cost for clients over the longer term and provide comfort to the client that the solutions will evolve with the constantly-changing regulatory landscape and compliance processing.

“In the short term, RegTech will help firms to automate the more mundane compliance tasks and reduce operational risks associated with meeting compliance and reporting obligations. In the longer term, it will empower compliance functions to make informed risk choices based on data provided insight about the compliance risks it faces and how it mitigates and manages those risks.”

Sean Smith, a partner in Risk Advisory at Deloitte

RegTech enables the compliance function to be efficient and economical. In large part, this is due to the advantages of Cloud technology, which allows firms to leverage existing systems and data to produce regulatory data and reporting in an incredibly cost-effective, flexible and time-efficient manner. In many cases, it also allows them to avoid having to go through expensive and operationally disruptive legacy database upgrades.

Unity NXT™ Regulatory Reporting

Confluence has been the asset management industry's leader in data management for 25 years and has a depth of experience in data management for systemic risk reporting through six years of experience with Form N-MFP, Form PF, Form CPO-PQR, Form NFA-PQR and AIFMD Annex IV. Based on that experience, we have dedicated a significant portion of our research and development budget to improving the sophistication of our data management, form building and filing capabilities. The result of these efforts is Unity NXT Regulatory Reporting, our consolidated regulatory reporting platform.

Unity NXT Regulatory Reporting powered by Synapse™ enables clients to solve their post-trade regulatory filing needs through one platform, giving asset managers and asset servicers the answer to constant regulatory change. With a collaborative environment to minimise review challenges and drive efficiency, clients can reduce the cost of existing reporting obligations and nearly eliminate the challenges and complexity of solving new reporting requirements.

Including support for new and challenging regulations such as the SEC's Form N-PORT, Unity NXT Regulatory Reporting provides a complete solution for data integration, aggregation and reusability for the asset management industry's regulatory reporting needs. By harnessing the power of data through optimisation and reusability, the platform's agile design enables asset managers and asset servicers to rapidly develop new reporting capabilities with minimal cost and complexity as they are mandated by regulatory bodies.

Finally, Confluence has a wide breadth of solutions that share the same data set. Both our financial reporting and regulatory reporting solutions utilise a common system to load, define and relate raw data. This makes Confluence the only provider that offers solutions for financial reporting, Form N-PORT (77% data overlap) and Form CPO-PQR (66% data overlap). As regulators continue to blur the lines between human-viewable and machine-readable output, as with the Form N-PORT and Regulation S-X components of SEC Modernisation, partnering with Confluence to leverage our ability to accommodate all forms of output from a single set of shared data is the best strategic move.

ⁱ <https://www.sec.gov/news/pressrelease/2016-195.html>

ⁱⁱ <http://asic.gov.au/for-business/your-business/innovation-hub/regtech/>

ⁱⁱⁱ <https://www.fca.org.uk/publication/finalised-guidance/fg16-5.pdf>

^{iv} <https://www.fca.org.uk/publication/finalised-guidance/fg16-5.pdf> (section 1.6)

About Confluence

As a global leader in data-driven solutions for efficiency and control, Confluence solves tough data management and automation challenges for the asset management industry, including performance reporting, regulatory reporting, investor communications and fund expense management. Confluence solutions enable asset managers and third-party administrators to consolidate and leverage data across business operations which results in lower costs, reduced risk, decreased reporting turnaround times and the scalability to automate more processes without additional resources. The platform features solutions to support a wide array of fund types – including mutual funds, ETFs, alternative investments, institutional portfolios and UCITS funds. Seven of the top 10 global service providers license Confluence products and eight of the top 10 global asset managers have business processes automated through Confluence.

Headquartered in Pittsburgh, PA, Confluence serves the international fund industry with locations in Brussels, Dublin, Ho Chi Minh City, London, Luxembourg and San Francisco.

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