



Impact of RegTech

New technology-enabled financial services are born one after another. Traditional financial institutions are struggling with emerging FinTech players. Will RegTech be the chance for them to gain the upper hand over emerging FinTech players?

Regulation tightened quickly

People must follow the rules - Implementing this commonplace has become a major issue for the financial industry in recent years. Nevertheless, the industry is not neglecting efforts. In recent years, regulations are being tightened at a very fast speed.

The beginning of the matter is Financial Crisis in 2008. At that time in the middle of the housing bubble, mortgage increased in the absence of sufficient confirmation of borrower's repayment ability and risk hedging. To make matters worse, the claims have been securitized and spread to

many companies and people. As a result, when the housing bubble burst, they became bad debts. And it caused bankruptcy of Lehman Brothers and global economic downturn. In response to this situation, it was imposed on financial institutions not only to improve the capital adequacy ratio of banks but also to acquire and manage wide and deep customers and market information in order to analyze and grasp lessees' credit worth more accurately

Furthermore, terrorist organizations are becoming active in recent years. In order to prevent funds from such criminal organizations, strengthening countermeasures to deter money laundering is an urgent task for financial institutions. There are 8



Special Requests on Terrorist Financing that was formulated in 2001 by FATF (Financial Activity Working Group, to which 35 countries including G7 countries and 2 regional organizations are members) as an international standard for anti-money laundering measures. However, in 2014 Japan is pointed out that it does not adequately meet this standard. A survey of FATF is scheduled again in 2019, and if Japan cannot obtain sufficient appraisal it may even be ordered to stop overseas remittance and settlement agency services. It is a matter that needs to be resolved quickly.

It is natural that regulations and rules are strict in the financial industry that governs the economy, which is a fluid social infrastructure. However, it is not so easy to thoroughly manage and monitor them. According to Thomson Reuters, the number of new regulations including updates has been doubled in the last three years. Bain & Company also announced that major financial institutions are allocating 15 to 20% of the annual average business operation cost to these regulations and compliance responses.

RegTech is the technology for cost effective and adequate compliance. It is a coined word combining Regulation and Technology. We researched RegTech's application areas, growing companies, and future prospects.

Why RegTech now?

Response required of financial institutions

Ten years have passed since the Lehman shock triggered the stricter regulation. As mentioned above, what is the background behind RegTech's attention now? It is not only the increase in regulatory compliance costs borne by financial institutions but also the advancement of technology has reached the level to achieve regulatory compliance. For example, the finding of money laundering is nearly impossible with only one financial institution, and its detection rate is said to be only 2%. Even if only one institution finds a huge or irregular transaction, it is not enough as a basis for judging whether the deal is due to a criminal organization. However, if such transactions continued across multiple

institutions, it would be worth investigating the transaction. In other words, the key to preventing money laundering is "monitoring transactions across multiple financial institutions".

Until now, disclosure and sharing of data did not proceed smoothly from the viewpoint of protecting personal information and risk of data falsification. However, by utilizing the block chain technology that is being developed in recent years, it is possible to suppress such risk and to possess and manage common data among multiple financial institutions. Besides that, we should also pay attention to efficiency improvement of customer information management using block chains and risk analysis of products by AI.

Reg Tech's application area

Where exactly is the application area of Reg Tech? We think that there are two main areas.

- ① Better communication between government / ministries that design and manage regulations and banks / companies that adhere to them
- ② Refinement and efficiency improvement of operations for company compliance

① Response required of financial institutions

Large-scale enterprises such as mega-banks have been the center of the financial industry so far, but many FinTech ventures have been born recently, and application companies also began offering Pay service.

In addition to the increase in regulation management items, the number of companies to be monitored is also increasing. Effort such as announcing regulation, monitoring compliance status, and reporting management from companies are enormous.

In response to such challenges, Vizor Software from Ireland is renowned as a Web-based solution that unifies the monitoring services of the Financial Services Agency and Central Bank. In addition to issuing and managing business licenses and calculating taxes related to them, the solution

enables KRI (Key Risk indicators) analysis using a framework developed by the company for private companies. Also, private companies enter the necessary information on the website, or upload the Excel file, the report to the ministry is completed automatically. In the regulatory and tax related businesses for a long time in the world, paper processing still remains, and the data format and the system are not unified. As an example they had to integrate 13 systems and 87 data sets across 3 organizations in their projects.

Functions and technologies are not so brand new, but it shows that the time has come for change in the old mechanisms of government and financial institutions. This solution has already been deployed in 25 countries and received the "Global RegTech Provider of the year" in 2018.

② Refinement and efficiency improvement of enterprise regulatory compliance operation

Especially because there are many investments and startup companies, the more attractive RegTech domain is for enterprises. Companies are required to respond to regulations compliance in recent years in three major ways;

- A Acquisition and real-time management of wide KYC (Know Your Customer) data
- B Detection of financial crime including money laundering
- C Monitoring of employee's compliance status

A) Accurate and real-time management of customer information

Since the 2008 financial crisis, the area where regulation has become stricter is collection and management of customer information. A more detailed assessment of current and future repayment capabilities of lessees and customers is required.

However, there is concern that customer information held by financial institutions is actually low in freshness. For example, a bank records information such as an address at the time of opening an account, but after that, even if the

customer moves, data is not updated unless he/she contacts the bank him/herself. Also, especially in Japan, registration of biometric information is not yet common, so it is difficult to contact the customer in case of emergency. In addition, GDPR (EU General Data Protection Rules) obliges to acquire consent from customers at the time of data acquisition. However, man-hours for obtaining consent and updating information are burdens of financial institutions and customers. For example, people with multiple banks or trading accounts have to agree on the use and renewal of personal information with all financial institutions.

Trunomi in the UK is an emerging company that has a service to efficiently acquire and maintenance such troublesome customer information. Using their Consent Management function, users can authorize financial institutions to use his/her personal data. If allowed, information on that user can be managed by multiple systems and financial institutions. For example, when there is a difference in information recorded among affiliated financial institutions, the database is automatically updated to the latest information. In other words, if you inform Trunomi about the information you want to register or change, it will notify all relevant organizations.

Next, Onfido of the UK provides a service that performs automatic background check (career check) using machine learning. If information on name, address and date of birth are available at the time of registering a service and opening a new account, it will automatically inquire the database of each public institution and investigate the criminal record and creditworthiness. In addition, the company also provides identity verification services to prevent spoofing. Their face authentication technology matches the registrant's Selfie (self-taken image) with a certificate with a face photo. CEO Husayn says, "Many services are now on-line, but registry work is often offline." They are planning to shift from certification support in digital services to deployment to financial business.

B) How to detect complicated financial crime

As mentioned earlier, many financial institutions are troubled by detection of money laundering.



In recent years virtual currency has also appeared, the flow of transactions is getting more complex. Therefore, a block chain is essential to reliably track transaction history. Tradle in the United States is a startup that won the European Blockchain Company of the Year in 2017. CEO Gene said, "It is now not necessary to simply move financial assets, but to move credit." In addition to tracking transaction data through block chains, they are trying to increase the transparency of trading by strengthening KYC. The acquisition and management cost of KYC is a problem for many financial institutions. By sharing such KYC functions among banks, they aim to increase the detection rate of financial crime.

C) How to enforce regulatory compliance to employees

It is not possible to respond to regulations by introducing the system only. Naturally, it is necessary to train each employee so that they can comply with regulations. However, it is not easy for mega-banks and major securities companies with many employees and branches all over the world to educate every employee and ensure quality. Even more today, as rules to protect are changing frequently.

Behavox of the United Kingdom provides services to support such employee regulatory compliance. Founded by former Goldman Sachs analyst, the company uses speech recognition and natural language recognition technology to check whether there are problematic statements from in-house chat, e-mail or phone history. Also, it is surprisingly possible for the company to try to increase the degree of intimacy with the opponent from the frequency of people laughing at the phone entrance and slang (slang). If an excessively intimate relationship is predicted, risks such as insider trading are foreseen.

In the financial industry the rule to protect is not easy to understand like "Do not kill people". Therefore, there are cases in which the persons are unaware. On the other hand, there are many traders who deliberately run gray zones, which is an industry issue. While some readers may be surprised that traders are being monitored for the phone, it may be necessary to have such a third party to aim for fairness.

The future that RegTech brings

Be careful about the dependency of RegTech players

The above-mentioned companies will increase the efficiency of operations. However, outsourcing the management of customer information to RegTech companies easily has a big risk. It is natural that financial institutions without goods raise their competitive advantage by using information on customers and transactions. What is the risk scenario by passing such information to RegTech companies?

Who will win using customer data

If the RegTech companies are responsible for identifying customers and assessing creditworthiness, basic information is retained and managed by technology such as block chains.

Once that happens, information that only financial institutions possess is getting less. Meanwhile, RegTech companies can also become responsible for customer authentication and transaction tracking, which are services close to consumers. For example, when start-up companies such as Uber of ride-sharing expand business to food delivery, shopping agency, even real estate investment etc., they will have data that leads to consumer's purchasing power, creditworthiness and holding assets. Become. In other words, the amount of data held by RegTech companies will increase, and it will be high-quality data reflecting the current situation of consumers. Later, if RegTech companies begin to deal with financial instruments, they may be able to build more attractive financial products based on rich data. RegTech companies can become competitors for financial institutions in the future although there is a barrier as to whether licensing of financial business is issued.

RegTech companies also regulated

In the future, RegTech companies may also be subject to regulation. The service using excessive data, like being derided as "Weapons of Math Destruction", may unconsciously give

unfair treatment due to race, place of birth or residence. As an example, there is a concern that in some areas the crime rate is high, and services cannot be received regardless of the person's personality. In other words, RegTech companies themselves will be required to deal with regulations, such as increasing transparency, to show the fairness of services using their data.

How does the financial industry associate with RegTech

How should the current "financial industry" face RegTech? First of all, we think that finance industry should pursue knowledge as a regulatory specialist, and aim for the position to control regulation with government in the future. Grab, Southeast Asia's Uber, began offering payment services. In this way, companies outside the financial industry will enter the financial services in the future. As mentioned above, RegTech companies themselves may embark on the financial industry. When these emerging companies become murmuring, institutions that take control are absolutely necessary.

Financial institutions will be able to make use of "brands" that they have cultivated in the financial industry for many years in each country. The creditworthiness that guarantees the publicity is largely dependent on the history and company size. Due to technological innovation, financial institutions are being hit by sudden changes. However, it is a stage that should be taken offensive, taking these as new business opportunities. It is vital that you walk with these partner strategies, not just vendor relationships with such RegTech companies.

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