Written By

Urs Bolt, *FinTech & RegTech Expert, Bolt Execution Partners*

# How Can Regtech Make Bank Clients Happy Again? (Regtech Is More than Just the New Fintech)

The financial-services industry is in the middle of a storm and faces pressure from many sides. Expectations and impacts from the following groups become increasingly demanding:

- Customers,
- Regulators,
- Shareholders,
- Human talents,
- Macro-economic conditions,
- Emerging technologies,
- New competitors: e-commerce, big data and fintech firms,
- Increased risks: cyber-attacks and information risks,
- Public perception.

Since the financial crisis, the pace of new regulations has dramatically increased, and new published regulations have tripled. The cost of regulatory fines in the last 10 years is estimated to be $300 billion.

Banks are under attack from two sides. Big-data companies such as Amazon, Google, Facebook and eBay have created new ways of doing business and increasingly integrate basic financial services into their value chains, e.g. payments and commercial loans. Moreover, new financial technology (fintech) players are acting like piranhas nibbling away high margins from profitable businesses.

## How to meet the regulatory challenges and turn them into advantages

Despite new technological and intellectual capabilities, banks are only slowly changing their way of doing business. Why aren't they moving faster? Some reasons are the cultural differences and dominating mind-sets in incumbents' organisations. As seen elsewhere, technology is not the real challenge, but overcoming the resistance to change and changing mind-sets and execution is. This requires a willingness and openness to leave well-trodden paths and even exit or give up control of business lines.

Regulations and compliance topics are boring for many and hated by even more people. Compliance tasks are time-consuming and often done manually by literally completing tick-the-box exercises; they do not improve the service quality and even decrease client satisfaction.

What has made the situation more challenging in recent times is the fact that financial service providers (FSPs) are no longer the technology leaders they once were decades ago. This role is now taken by big e-commerce and social-media companies such as Amazon, Alibaba, eBay, Google and Facebook. They collect massive volumes of data in real-time and on a global scale. Their data-management capabilities require an intelligent workforce who make these skills scarce elsewhere, including amongst the FSPs. Banks are no longer *the* magnet for talents. Young talents search for work with technology companies and startups; also, an increasing number of senior talents are leaving banks to gain back freedom and thrive in an entrepreneurial environment.

## Customer centricity and regulatory compliance

"Finance is the only industry where the legislator orders the operators to know their clients." *(Hamberg, 2017)*

Fintechs focus on customer value by nature; whereas banks, complex organisations with long decision-finding processes, often don't have the client in mind. Their priority is compliance whatever the marketing promises are. Fintech start-ups focus on user-driven applications and deal with regulation in a second step. Banks, given their risk aversion, often don't even get started with innovative new client functions because of perceived risks, potential conflicts with regulatory compliance or unknown territory requiring structural changes. How can customer centricity and compliance be brought together?

Let's look at the example of a digital-wealth advisor. Three conditions need to be met to live up to client expectations:



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1. Suitability check for investment products at the time of decision-making and continued monitoring/adjustments;
2. Multidimensional risk management;
3. A human touch for the social aspects of the client relationship.

Digital processes mean that the client is entering his data by himself. Whenever possible, fintechs allow users to reuse their own data from other platforms, e.g. LinkedIn or Facebook. The output is then created by the software application and can be reviewed by the client and the service provider.

As banks cannot sell their data, they have to use it themselves. Re-using this data could improve client services and satisfaction. Even more, staying one step ahead of their clients by automatically predicting their clients' individual behaviours and needs, they can offer products and services that a client wouldn't typically associate with a bank but rather with a fintech.

> "Banking has to happen wherever the customer is. To win back the client game, banks have to adapt to the new realities."

## Open banking is the new paradigm

The new European Payment Services Directive (PSD2) will allow anyone in the Single Euro Payments Area (SEPA) access to the banking data. Banks that are not ready to improve their client-services risk by being separated from their clients will ultimately lose out. In a disaggregated financial market, banks may offer their "backbone" for new services arranged for specific client groups. A successful collaboration should increase transaction volume and profitability. New coordinating functions including integration technology will be required. Standard interfaces such as Application Programming Interfaces (APIs) enable open banking via an Internet of Things-like approach.

Examples show that a digital transformation is possible. Digital banking matters for several reasons. Digital banks have emerged from nowhere in a relatively short period of time; most are two years old—or younger. Many of the digital banks use innovative technology to confirm the identities of clients and meet Know Your Customer (KYC) requirements. In theory, digital banks could radically transform the financial-services landscapes in the markets in which they operate.

## How can regtech make a difference?

Banking has to happen wherever the customer is. To win back the client game, banks have to adapt to the new realities. Regulatory compliance must become a largely automated and recurring process.

Many new regulations issued in the last 10 years force banks to perform pre-transaction activities, e.g. client and product suitability checks, obtaining an extended range of credit-risk information. This has led to countless new internal procedures and a massive increase in manual and time-consuming efforts, often supported by external service providers. The internal-compliance organisations now dominate "business as usual", and they have become bureaucratic; quite the opposite of what stakeholders expect from a slimmer and more cost-efficient organisation. As a result, client service has not improved, and overall client satisfaction has even decreased.

**Three types of regulation:**

- Non-financial regulation,
- Financial regulation: compliance in trading, risk and capital adequacy, financial and regulatory reporting,
- Competition and market regulation.

After the financial crisis, new laws and rules were mainly non-financial regulations. These are rules regarding conduct, consumer protection, compliance with procedures and laws, including operational risk measures such as employee misconduct and consumer-protection measures. Examples include the European Union's Market Abuse Directive (MAD) and General Data Protection Regulation (GDPR), the United States' Foreign Account Tax Compliance Act (FATCA) and global anti-money laundering (AML) and enhanced Know Your Customer (KYC) regulation.



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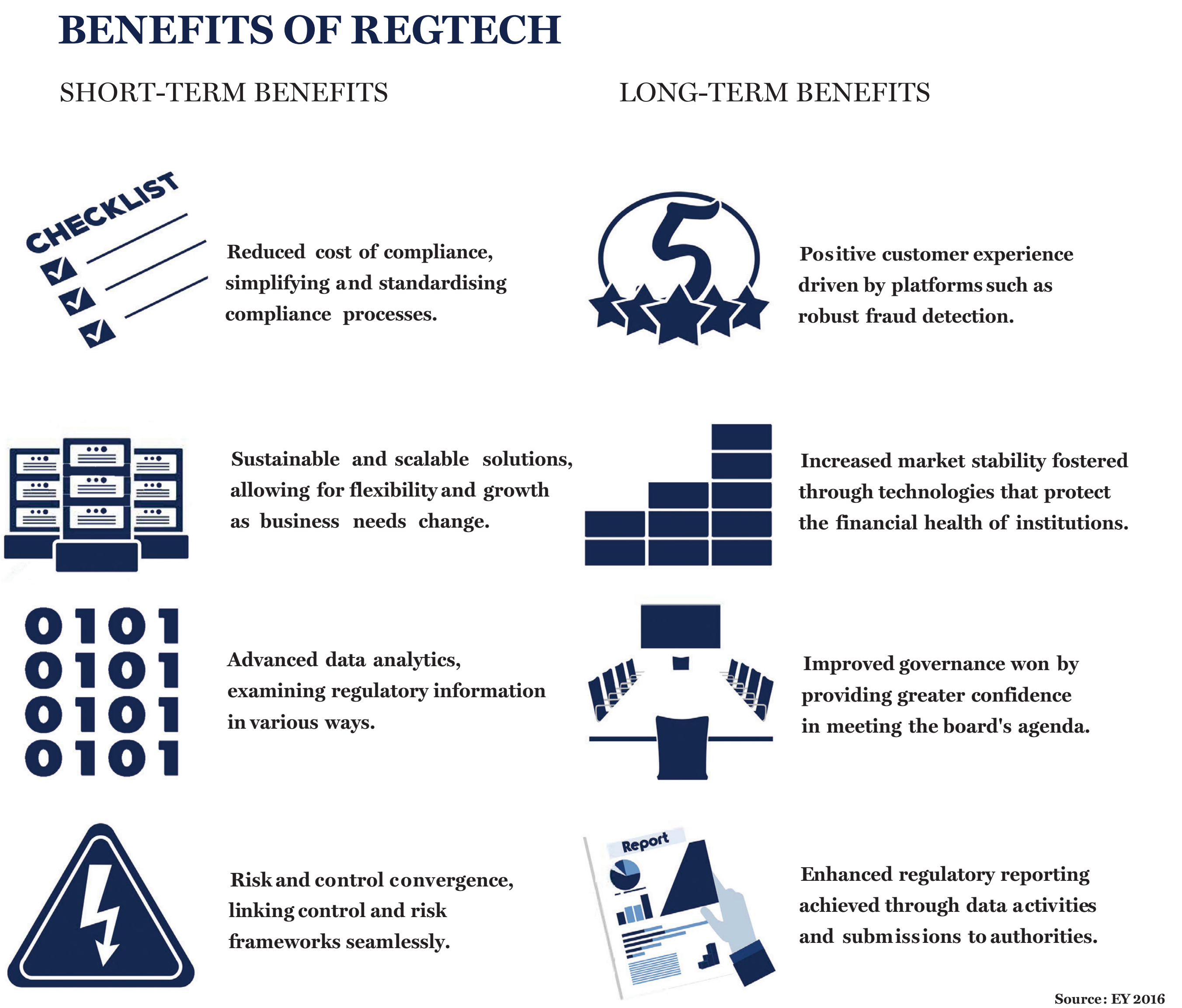


Compared to other industries, the entry barrier into banking is much higher and requires substantial efforts to establish a sustainably profitable business. Observers of the rapidly changing financial-services landscapes can easily see that new entrants are especially successful if they are not overburdened by time-consuming regulatory requirements. This is demonstrated in basic banking services, e.g. payments, current accounts, retail cross-border payments. Incumbents fear that this will create a disadvantage for them.

Many higher-margin businesses, e.g. wealth management and structured finance, require extended and complicated compliance efforts. This is where financial-services providers with their knowhow and experience can make a difference.

## Making it happen

Banks need to radically rethink their service and product strategies. A holistic-solution approach to regain the overview requires the following elements:

- Strategy: service and product roadmap,
- Governance of processes, data, infrastructure, integration,
- Partner strategy: regtechs, fintechs, technology, integration partners.

Banks have to ask their clients what they really want of a digital bank:

- Are clients primarily looking for low-cost solutions and benefits from the branchless nature of digital banks?
- Are customers looking mainly for a user experience that is only possible with cutting-edge technology?

Whatever the answer, the new value propositions for products and services need to integrate compliance requirements as service elements, not just with a compliance but also with a client satisfaction goal in mind. The redefined strategy shall be outlined in an implementation roadmap.



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> “Consumers are willing to allow a company to track their activities if they see a benefit in a more customised experience.”
>
> *Urs Bolt*

**Tips on how to choose a regtech solution:**

- What pain point does the solution solve? How quickly will it bring results?
- Is the technology proven? Just having potential is not enough.
- How easily can it be implemented? The solution must be adaptable and allow a rapid integration into existing workflows.
- How shall the technology be used? As an internal software, or as a web-based service?

The conventional approach of developing and integrating individual or standard software into existing technical and operational environments is not just time-consuming but also continues the way of doing business as before. Traditional FSPs are often in a patchwork of solutions, each one aiming to tackle one specific regulation. Infrastructure challenges (architecture; redundant data; inefficient, manual and/or faulty processes) cannot be solved in the required time to market. This will most certainly lead to increased costs of legacy infrastructure without innovating the client experience.

To implement the new strategy, banks need to take another route by either collaborating with fintech and regtech firms or building new technology following a "green field" approach. As the latter path won't be desired by most banks, the focus will most probably be on collaboration.

## Collaboration is key

For buyers and sellers alike, technology is just an enabler. The requirements and preconditions for successful collaboration of banks with regtech firms are often neglected. There has to be more than just the desire to implement a software solution in a complex technical and organisational environment.

**Examples and proof points of way forward:**

- Electronic identification (eID): The verification of eIDs is seen as one of the most potent and instantly useful services, e.g. for account-opening, KYC and anti-money-laundering purposes.
- Investor risk-profiling as a service can increase client satisfaction and open new ways of doing business. A user-centric model would allow banks to focus on data validation and suitable product offerings.
- Regtech utilities:
  - A KYC registry: an industry utility to share Know Your Customer (KYC) data between institutions would bring big cost-savings potential.
  - Credit-risk data aggregation: The regulator could systematically monitor credit-risk changes across the sector; banks would benefit from a level playing field.
  - Capital and liquidity data aggregation: required reporting and stress testing; currently inhibited by legacy information-technology infrastructure and alignment issues.
- Regulatory Sandboxes: e.g. the Financial Conduct Authority (FCA) and the Monetary Authority of Singapore allow banks and technology companies to test new services.

Fundamentally changing processes is prone to resistance from staff, customers and regulators. Despite obvious rational reasons for and advantages of regtech, there are many soft factors that can easily become "hard" stumbling blocks for technology implementation:

- Mindset for openness and change,
- Innovation-driving leadership,
- Talent support,
- Environment of mutual trust.

Only by combining technology with a change in mindset will banks realise the full potential of regtech.

## Conclusion

Regulatory compliance must become a largely automated and recurring process; collaboration with regtech firms is key—its success, though, depends on various factors. Given that the preconditions are met, they can fulfil the promises and requirements of the regulator and financial-services provider alike.

And, after all, happy customers will help to change the banks' public perception.

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