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A user's guide to RegTech: Navigating the challenges and what success looks like

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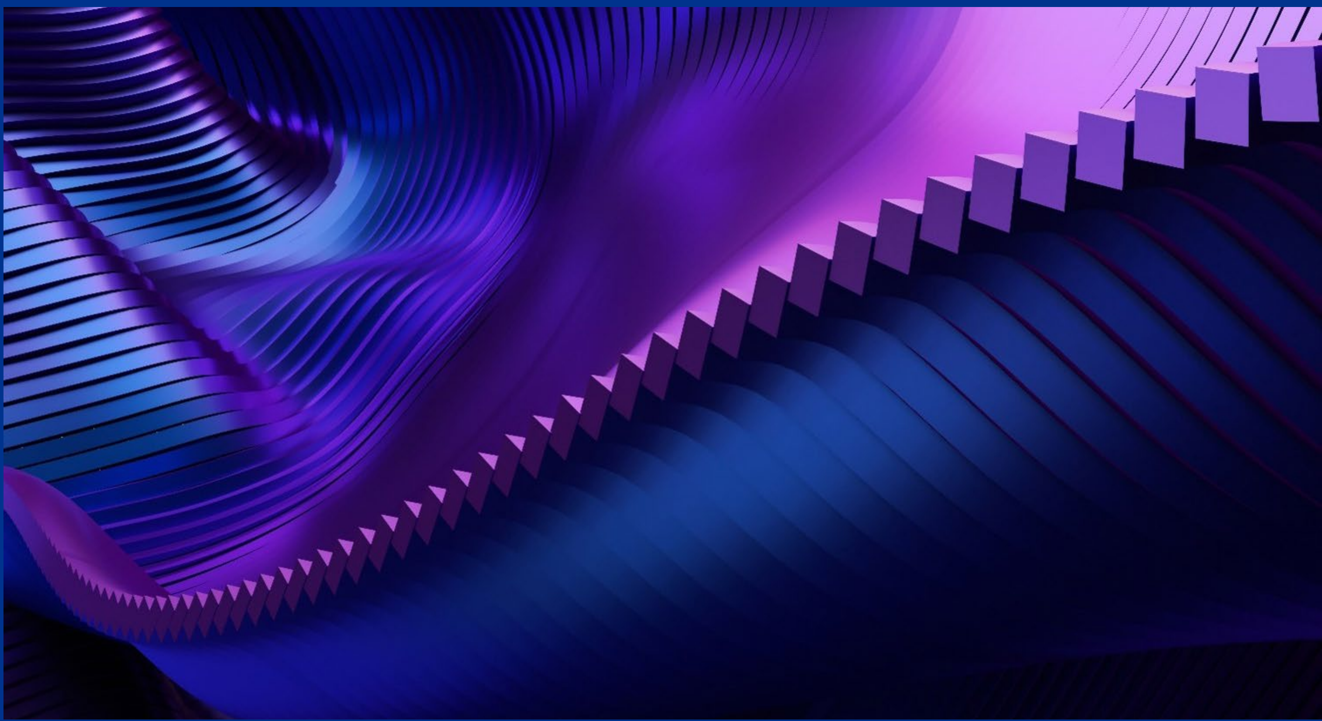


Foreword

RegTech (Regulatory Technology) is a thriving part of UK FinTech. The importance of new technology to help financial services remain compliant and combat bad actors has been underlined by the recent sanctions against Russia. And yet, RegTech has still not gained prominence in the same way that other FinTech verticals have.

According to the City of London's Report 2021: A Critical Year for RegTech , UK RegTech is facing multiple barriers to scale. The report highlights the need to build awareness of the many remarkable RegTech solutions currently offered in the market and the impact they are having on financial services. We think there is already a compelling story to tell, but we recognise the support of cross-industry stakeholders - regulators, government, investors, institutions - will be needed to properly move the needle on the RegTech scaling challenge. We hope this paper will start that process.

Thank you to our fantastic RegTech members and non-member RegTechs for their contributions and time in shaping this paper. Thank you to KPMG for their tremendous support in the creation of this paper and for helping to build our vision to support UK RegTech.

Janine Hirt,
CEO, Innovate Finance

The world is changing fast and so is the use of technology to make risk and compliance more efficient and more effective. There are many factors driving the need to deploy existing and emerging technologies to meet regulatory compliance challenges, including the acceleration of digital transformation, complexity of regulation, and the increasing costs of compliance. Layered on top of these long-standing drivers, the current geopolitical climate has driven further focus into RegTech domains such as identity management and fraud prevention. However, alongside the most mature RegTech domains, solutions are also evolving to meet some of our planet's existential ESG and sustainability challenges.

Together, these factors have contributed to ongoing strong investment in RegTech. In the first half of 2022, RegTech companies globally attracted $5.6bn of investment across 157 deals – a similar level to the whole of 2021 .

KPMG in the UK, as part of the KPMG global network of member firms, are working closely with Innovate Finance, RegTech businesses, legislators, regulators and other actors in the ecosystem to support RegTech adoption and to try to overcome the barriers called out by last year's City of London report.

As Janine notes in the Foreword, several reports have stated awareness of RegTech is lagging behind the fantastic solutions that are being developed. Part of the challenge is the sheer breadth of domains that RegTech businesses can address. In this paper we dive into some specific use cases with the aim of raising awareness of what RegTech is, and what it can offer. We aim to build on the work that has come before and continue to nurture a thriving RegTech community that delivers substantial benefit to the wider economy.

Please get in touch if you want to discuss any aspect of regulation or how your institution could be using RegTech.

Chris Steele,
Partner, KPMG in the UK

[1]City of London and The Global City (in partnership with RegTech Associates), 2021: A critical year for RegTech (theglobalcity.uk)
[2]KPMG, Pulse of Fintech H1'22 (assets.kpmg), September 2022
[3]Bloomberg, RegTech Market size worth $ 87.17 Billion, Globally, by 2028 at 23.92% CAGR: Verified Market Research® - Bloomberg, March 2022

Why is RegTech needed?

Definition

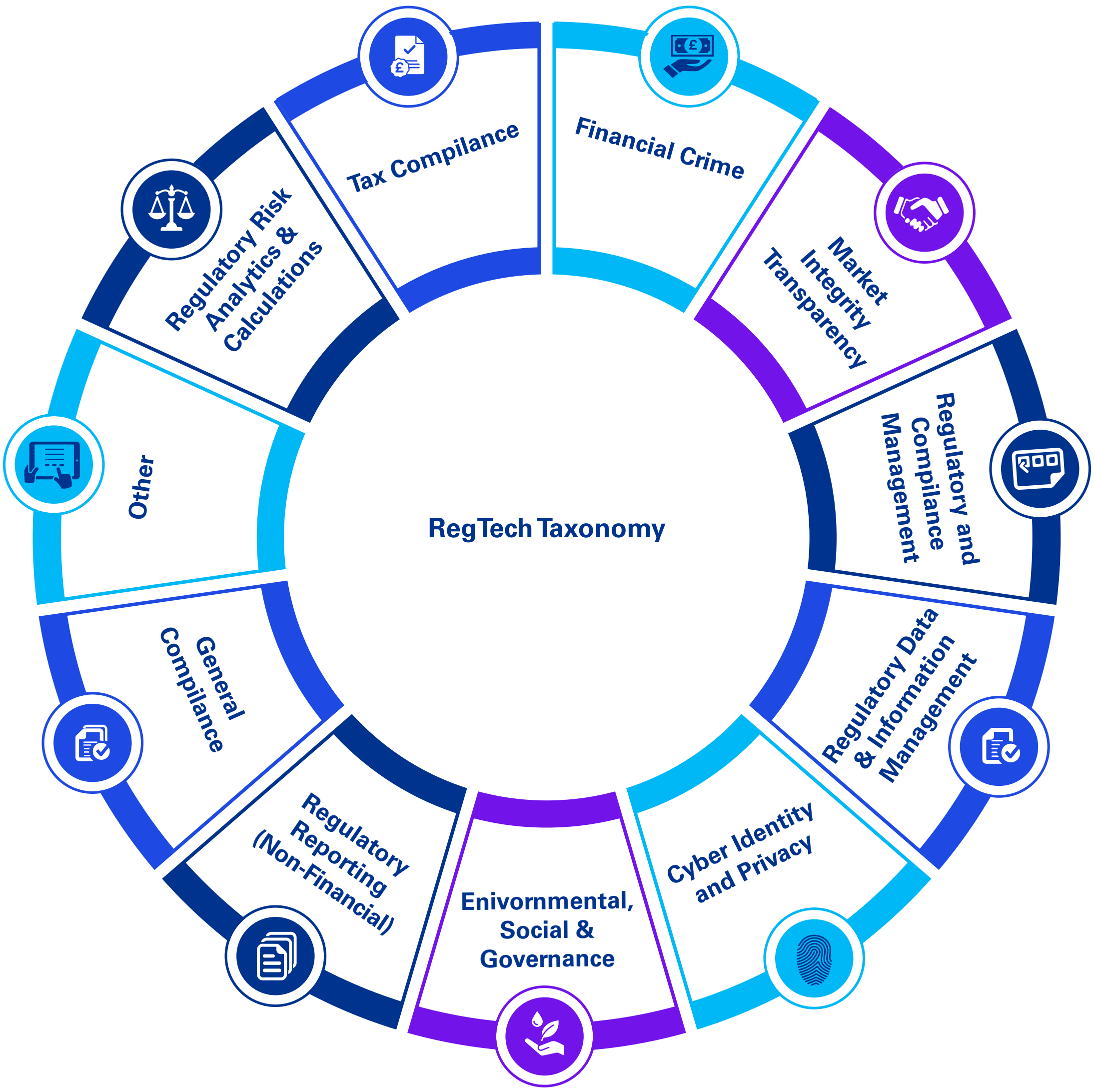
It has been frequently highlighted that a key challenge faced by the RegTech sector is a lack of awareness as to what RegTech is and how it helps firms. This challenge extends to ongoing disagreement around an exact definition.

In the context of this paper, KPMG defines RegTech as technology-driven services to facilitate and streamline compliance with regulations. While RegTech is closely associated with financial services and FinTech, its applicability extends to any regulated industry. As a result, the potential benefits of wide-scale adoption can encompass society as a whole.

In order to elaborate on the wider scope and applicability of RegTech, this paper refers to the below City of London[3] taxonomy of the RegTech market. This taxonomy is expected to evolve with time as RegTechs continue to spread into related areas such as crypto and digital assets and reach enhanced levels of adoption.

Taxonomy

Using the RegTech Taxonomy wheel, Section 4 of this paper sets out four different use cases from the identified domains.



[3]City of London and The Global City (in partnership with RegTech Associates), 2021: A critical year for RegTech (theglobalcity.uk)

The Importance of RegTech

Regulatory compliance is fundamental to ensuring that financial services firms build trust with customers, contribute towards market stability, and improve their service offerings.

New regulatory updates are implemented constantly. As a result, fines for non-compliance are becoming more frequent and more economically material for firms. The UK Financial Conduct Authority (FCA) alone, during the period of 2019 to 2021, imposed fines of £1.1bn. In 2019, the Securities and Exchange Commission (SEC) in the US, issued 862 enforcement actions resulting in fines totalling $4.3bn.

The 2022 Thomson Reuters' Cost of Compliance Report notes that RegTech solutions are having a growing impact on the management of compliance – at both a firm level and at a compliance function level. Within compliance functions RegTech applications are being used for compliance monitoring, regulatory reporting, financial crime, onboarding and know-your-customer processes. In fact, around a third of firms report that RegTech will affect their implementation of regulatory change.

Beyond the case for improved controls and enhanced regulatory compliance, there is an increasing expectation that RegTech can also be used to reduce cost, boost operational efficiency and improve the consumer experience. This shift helps to make the business case for RegTech's positive impact on the bottom line.

The assessment of delivered outcomes is starting to move away from a one-dimensional view, measured in terms of compliance, and towards encompassing a broader range of factors, including stakeholder value, trust and sustainability.

Adoption of RegTech

Highlighted below are some of the long-standing drivers for the adoption of RegTech:

Reduced Cost – Regulatory constraints, pandemics and geopolitical crises mean it remains difficult for financial institutions to generate consistent profit growth. The UK's current cost of living crisis will further require financial institutions to focus on reducing costs. As such, we will continue to see these institutions embrace technology which facilitates increased efficiency in the risk and compliance function. As competition drives down the cost of hardware and software, investment in RegTech will become increasingly more affordable.

Better compliance – As regulators around the world focus on implementing reforms (ranging from systemic risk to data privacy), the compliance burden for firms will continue to grow. There is also a need to improve efficiency in addressing these compliance burdens and RegTech solutions are increasingly focussed on providing solutions that address both complexity and efficiency simultaneously.

Tackling complexity – The financial sector must attempt to navigate new products, services and regulations, in the context of widespread political uncertainty. Layered on top of this, is the complexity created by the data environment, legacy systems and operating models. The common data formats and connectivity options offered by RegTechs can help to reduce some aspects of this complexity.

Improved Consumer Experience – As consumers continue to demand a better and faster experience, regulators are also now placing increasing focus on consumer outcomes (e.g. through implementation of regulations such as the UK's Consumer Duty). This means financial institutions need to either invest in developing their own technology or embrace developed RegTech offerings.

Corporate Experience – Corporations are also a significant stakeholder in their own right and demand RegTech solutions that address cost efficiency as well as improved systems and data integration. These solutions will satisfy both their regulatory requirements and provide positive internal experiences for their staff and customers.

RegTech Emerging Trends

Given the increasing number of gaps that RegTechs fill, it is no surprise how quickly the industry is growing. According to Bloomberg3, if the sector achieves an expected growth rate of ~24% CAGR annually, it could reach a valuation of US$87 billion by 2028.

In particular, the current dominant domains of Cyber, Identity, Privacy and Financial Crime are expected to continue to grow. In addition, driven by new regulatory regimes such as Markets in Crypto-Assets (MiCA) and ESG standards, the emergence of a new wave of Regtechs in some of the relatively less talked about domains such as ESG (Environmental, Social and Governance) and **Digital Assets Compliance** (NFT, Crypto) should also be expected.

Compliance Management Solutions are another domain with predicted strong growth for 2023. Existing trends of complexity and breadth of regulation are likely to continue to drive adoption of Regulatory Change Management solutions. The introduction of wide-ranging regulatory reform, like the FCA's **Consumer Duty** rules aimed at improving the outcomes received by retail customers, lends itself to a range of existing RegTech solutions whose product governance, customer communication monitoring and outcomes testing solutions can be used to address the challenges these new rules create.

Finally with growth in outsourcing of compliance, a significant upward trend in Regtech adoption across the market segments should be expected.

What needs to be true for successful adoption

In order to continue growing the RegTech market at this anticipated growth rate, there are some focus areas that can help achieve successful market adoption. These areas are listed below, as highlighted by the UK RegTech Vendor Survey 2020 and included in the City of London's 2021 A Critical Year for RegTech paper[1]:

Internal success factors for an organisation's adoption of RegTech:

Updating legacy technology processes results in improved integration of RegTech solutions into existing aging IT stacks.

Shortened procurement cycles to avoid long delays in the potential onboarding of RegTech solutions. This will confirm with the short deployment times often required by business to comply with regulatory change.

Increased education and awareness among senior management regarding available RegTech solutions and their comparative benefits vis-a-vis traditional solutions (in particular, the improved security of digital offerings).

Increased boardroom support for RegTech investment, due to increasing confidence in solutions and improved ability to develop quantifiable business cases for adoption (in monetary and reputational terms).

External success factors for an organisation's adoption of RegTech:

Development of common data standards and interoperability between RegTechs. Developing this within the market would ultimately benefit the institutions adopting RegTech within their wider business model and also help to accelerate adoption.

Increased digitisation within the regulatory framework. Regulatory sentiment in the UK and EU are maturing in this field, which can help contribute towards increased RegTech adoption.

A technology-positive stance of regulators. Although it is not the responsibility of regulators to explicitly promote RegTech solutions, positive engagement is likely to reduce lingering scepticism amongst financial institutions with regards to fully-embedding RegTech into their infrastructure.

Increased market awareness around RegTech solutions and the benefits they offer. Many market participants remain unaware of how RegTech can help firms solve their compliance challenges.

Clarity regarding the reliability of smaller RegTechs – specifically their capitalisation and future resilience. This would address any wariness on the part of traditional large-scale financial institutions regarding embedding smaller RegTech companies. their compliance challenges.

Clarity around upcoming regulations would avoid delayed investment decisions for new RegTech solutions.

Progress towards internationally recognised accreditation standards that RegTechs can conform to. The availability of consistent accreditation standards should provide increased comfort to potential users.

RegTech use cases

This section shines a spotlight on four representative use cases from the RegTech Taxonomy wheel to illustrate the potential benefits of RegTech solutions for a prospective client.

Cyber, Identity and Privacy combined with Financial Crime

The first use case is a combination of the Cyber, Identity and Privacy domain and the Financial Crime domain – as the two increasingly go hand-in-hand. By most measures, this area drives the most investment into RegTech.

As multinational companies operate in different regions, and across a variety of verticals, they need to keep abreast of domestic and international laws and regulations to not only ensure that their service offerings are compliant, but that their end-users' privacy and identity are protected. Companies need to also take every step possible to protect their digital headquarters, and safeguard against cyber-attacks and other types of financial crime.

In particular, companies must ensure compliance with the following regulatory programmes: anti-money laundering (AML) and counter financing of terrorism (CFT), anti-bribery and corruption (ABC), Know-Your-Customer (KYC), modern slavery, watchlist monitoring, sanctions screening, and Market Abuse Regulation (MAR).

Compliance with financial crime regulations is made increasingly complex to navigate due to the accountability placed on organisations, especially financial institutions, for their decision-making on personal data processing and privacy. This requires, for example, limits on storage of personal data. By investing in RegTech solutions, these complex rules can be embedded into the software by compliance and risk teams to reduce the time business teams need to spend on considering potential requirement conflicts. As a result, these business teams have their capacity freed up to focus on core activities.

If companies do not invest in RegTech to support these efforts, they run the risk of fines (including loss of licence), media scandals, reputational harm, and loss of revenue caused by business disruption.

RegTechs falling within this domain offer a range of technology-enabled identity verification solutions, including customer onboarding, company structure identification, beneficial ownership and document signing. These technology solutions can empower organisations from a variety of sectors to not only comply with the relevant regulatory programmes but also keep pace with wider market changes.

Some key applications include:

- Ensuring organisations are capable of detecting and stopping cyber-attacks which could result in loss of service and/or loss of confidential client data
- Sanctions monitoring and controls Identifying corporate ownership structures, beneficial owners, directors and persons of significant control across international firms
- Validating individual user identity by cross-checking ID documents and biometric data
- Facilitating enhanced due diligence and detailed risk investigation
- Maintaining accurate, up-to-date, auditable authorised signatory lists
- Driving large-scale digitisation and automation of corporate onboarding processes and on-going monitoring activities
- Automating the retention and deletion of documents and personal data to comply with storage limitation requirements whilst keeping data required for financial crime regulations

These applications bring about wide-scale benefits for firms adopting RegTech within their organisation.

Some key benefits include:

- **Enhanced security** and crime detection – by carrying out real-time ongoing threat assessments
- **Customer retention** via improved user experience and trust
  - Experience is improved as the verification process is swift and low friction compared to a physical branch visit
  - Trust is improved through the demonstration of how RegTech solutions better protect privacy compared to legacy solutions
- The automation often used in RegTech solutions reduces the chance of human error and enhances **cost efficiency**
- **Faster identification of high-risk** customers and firms allows financial institutions to quickly make risk-based decisions as to onboarding that customer or firm
- **Draws on much wider data sources:** wider breadth of data ingestion and processing compared to the manual alternative – with the ability to gather information from the entire indexed internet
- **Improved compliance and risk management**

- **Centralised regulatory filings**
- More effectively **supports remote and hybrid working** practices

Regulatory Reporting (Non-Financial)

Solutions offered by RegTechs in this domain range from secure and encrypted Cloud-based real-time data processing, local licence-based software deployment on client systems through to secure localised remote data processing and monitoring.

This covers companies complying with important non-financial regulatory reporting (NFRR – Broad term used to cover any required regulatory reports covering non-finance related data) obligations such as MiFID II (Markets in Financial Instruments Directive) Transaction Reporting, SFTR (Securities Finance Transaction Regulation), EMIR (European Market Infrastructure Regulation) Transaction Reporting, ASIC (Australian Securities and Investments Commission) Derivatives Transaction reporting, and CFTC (Commodities and Futures Commission) Transaction reporting.

Key applications include:

- Pre-reporting eligibility checks across jurisdictions before trade execution, to ensure enhanced compliance and choice of execution
- Combining data from multiple systems and using customized or off-the-shelf rules to send fully developed and reportable data messages to the regulator performing pre-reporting validation and accuracy checks
- Real-time ability to detect inaccuracies before regulatory submission, thereby limiting the potential for resubmission and / or penalties. A full audit trail also helps to identify changes made to the data during the lifecycle of the submission
- Full traceability around the reportable data message provides confidence that an institution is fully compliant with often lengthy and complex regulations
- Ability to reconcile an institution's regulatory submissions to their front office systems to ensure complete and accurate reporting
- Ability to perform post-submission diagnostic / accuracy checks to determine quality of submitted data

Some key benefits include:

- **Assurance of improved compliance rates** - thereby freeing up the capacity of compliance resources
- **Significantly improved data processing times** (compared to legacy IT infrastructure)
- **Cost savings** that result from having to deploy fewer operational and IT resources to maintain in-house solutions
- Flexibility and scalability - as a result of the **ability to scale-up reporting processes** to accommodate new volumes
- **Confidence that future regulatory changes can be implemented** within required timeframes

Sustainability and ESG

Increasingly, financial institutions and corporates need to report across their portfolio or supply chain on things like climate risk, impact on ESG factors, action plans to mitigate these, and alignment to net zero.

Global financial institutions need to establish a scalable approach to address the growing volume and scope of ESG -related regulatory disclosures, and the growing stakeholder appetite for ESG-related risk insight. At the same time, regulators (notably in the EU, UK and US) have raised the bar regarding disclosure quality. Dealing with both scope and quality challenges requires a scalable, agile and forward-looking approach.

The key applications of this in a RegTech context are varied and wide-reaching. They could include:

- Facilitating values-led investment decisions – by analysing underlying financial assets, or monitoring portfolio risks during the transaction life-cycle
- Performing cost-effective and enhanced due-diligence on supply chains and individual stakeholders
- Ensuring compliance with the increasing number of ESG related laws such as the German Supply Chain Act from 2023, the EU's Corporate Sustainability Due Diligence Directive, the US Slave Free Business Cerification Act or the UK's Modern Slavery Act, amongst others

Traditional due diligence solutions (Politically Exposed Person checks, Sanctions & Watchlist look-ups) are insufficient to help firms properly comply with evolving ESG regulatory frameworks. These traditional solutions provide binary yes/no answers and lists of search results, whereas companies are increasingly required to have a holistic view of risks that are thematic and loosely defined.

It is important to consider that the increasingly wide ramifications of ESG from a regulatory disclosure perspective mean that there is no 'silver bullet' technology solution. The gathering of ESG data continues to evolve and new RegTech solutions are emerging in this area. Organisations should look to integrate these new solutions, while still leveraging their existing technology investments, for the most efficient and effective approach.

Under the Sustainable Finance Disclosure Regulation (SFDR), Financial Market Participants (FMPs) will need to begin disclosing a Principle Adverse Impact (PAI) statement from 2023 relating to the period ending 2022. The PAI statement must include a description of principal adverse sustainability impacts and any related action planned or taken by the FMP. Large firms (with more than 500 employees) can no longer opt out, as the PAI regime applies to all FMPs defined as Investment Firms under the EU MiFID, Alternative Investment Fund managers (AIFMs) (which encompass most private equity firms), and credit institutions.

Reg Tech solutions not only support disclosure requirements like this, but they can also:

- Support gathering the relevant information for clients to meet ongoing regulatory requirements and increase focus on mitigation and / or remediation activity
- Streamline processes by combining with other related areas, such as KYC and anti-financial crime, to save time and expense
- Identify ESG reg flags in possible investment assets
- Allow financial managers to make informed, strategic ESG-related decisions

Regulatory and Compliance Management

The overarching application of this is embedding compliance within business processes to allow institutions to demonstrate regulatory compliance and traceability of requirements to policies, processes and controls. This can come in many shapes and forms – including horizon scanning, policy and control management, implementation, and distribution of controls. As a result, this use case has wide-reaching potential benefits, including:

- The implementation of a holistic and automated approach to embedded compliance allows for **greater standardisation**. As a result, different regulatory regimes can be more easily compared, contrasted and mapped
- Common regulatory requirements and associated compliance risks can be managed with fewer policies and controls, consequently saving the institution time and expense. This can be achieved through the compilation of regulatory obligation and mapping inventories in order to avoid duplication of policies
- The ability to **significantly reduce compliance breaches** – through embedded checks, warnings, insights and the removal of 'human error'
- With increasing regulatory convergence across key regulatory authorities globally, technology-enabled regulatory mapping obligation inventories can store and group common requirements and be linked to regulatory horizon scanning systems. This can enable the improved **identification and triage of regulatory change** to understand its impact on institutions' policies and controls
- Enterprise-wide, technology-enabled inventories can also be used to generate **insights on external regulatory themes and trends**, and inform internal compliance activities (e.g., risk assessments, policy enhancements and control testing)
- The simplification of internal policies and compliance requirements allows management to **accelerate decision-making** and focus on strategic objectives and revenue generation

Adoption success stories

In this final section of the paper, three client adoption success stories are summarised. In each, a RegTech solution has successfully been adopted by an incumbent financial services institution, thereby helping them to achieve multiple beneficial outcomes.

Financial Crime & ESG

The client, which was a private equity firm, needed to carry out cost-effective and swift enhanced due diligence on individuals the firm was considering investing in. In addition, there was a need to analyse organisations when evaluating underlying assets in which they have a large financial exposure.

Regulatory impact and coverage

The solution offered by the RegTech covered anti-money laundering compliance and fraud related risks and ESG compliance.

Operational benefit for client

- The client concluded that the RegTech's solution could cost-effectively deliver on all their enhanced due diligence requirements. The ability to search public information data sources across the entire breadth of the internet (including employee reviews, company reviews, all media) and the ability to tailor this for specific ESG searches proved to be of vital benefit.
- The RegTech's solution went much deeper than traditional due diligence checks by 'spidering out' across the entire internet and the proprietary AI technology helped the client to analyse large quantities of data efficiently. Several deep dive reports were undertaken focusing on a range of ESG red flags for all relevant target assets. These reports alerted the client to the risks of assets they were considering investing in.

The client's Board was forward-thinking and willing to adopt new processes and emerging technologies which facilitate the demonstration of good governance, achieve regulatory compliance and achieve a cost-benefit advantage.

Regulatory and Compliance Management

The client, which was part of a wider banking group, had several problem areas in the management and maintenance of their authorised signatory lists, including:

- No version control across a number of lists
- No easy single view across multiple functions, signatories and locations
- No clear audit of changes made, when they were made, or by whom
- Difficulty determining if only authorised representatives were updating or accessing lists or with whom they were shared

Regulatory impact and coverage

Adopting the RegTech's blockchain solution helped to ensure the client's authorised signatory lists were securely contained in a tamperproof decentralised database. This database prevents misuse, ensures robust governance and confirms compliance to GDPR regulation.

Operational benefit for client

By adopting the RegTech vendor's solution, the client realised the following benefits:

- A 95% reduction in time taken to add and remove people from multiple lists
- A reduced risk of fraud and data errors
- Enhanced regulatory compliance with simplified reporting and automated, immutable audit trail
- Achieved an efficient and secure end-user experience, with easy navigation, that requires minimal maintenance
- Improved corporate governance through facilitating improved adherence to control frameworks

The client has a relatively high maturity index of RegTech adoption. In recent years, they have made a conscious effort to adopt technology to refresh their corporate governance, risk and compliance activities.

Regulatory Reporting (Non-Financial)

A mid-size investment firm approached the RegTech with a complicated, yet not uncommon, scenario. The firm had multiple trade capture systems operating independently of one another and, in some cases, each having its own set of static data. There was no centralised method of capturing client data and, to complicate matters further, a number of IT migration projects meant that, at times, their trade data was duplicated and inconsistent.

Each new trade capture system or methodology unknowingly disturbed processes that ultimately led to undetected reporting issues. In addition, the client also had the following issues:

- Quality Assurance processes were internally viewed only as an "ad-hoc" function
- Budgets and resources were stretched
- In order to meet the MiFID II go-live deadline in 2018, the solution was rushed through to implementation without appropriate compliance oversight
- The client had received warnings from the FCA on the quality of its data reported dating back to start of MiFID II in 2018

Operational benefit for client

By adopting the RegTech vendor's solution the client benefitted from:

- Significantly improved compliance rates
- Substantial costs savings – up to 80% of the costs (excluding notional savings from regulatory penalty) of doing the work in-house
- Rapid access and integration
  - Instant access to a cloud-based solution enabled within one week
  - Integration of the full RegTech into daily operations/tasks/systems/control framework within one month
- The introduction of additional checks after results from the solution flagged historical issues with late report submission (around staff holidays)
- The solution's detailed description of each encountered error allow multiple teams within the client to collaborate and resolve issues
- The prevention of BAU erroneous reporting to the FCA

Call to action

If you think RegTech solutions can help to support and improve your business, please consider getting in touch with a relevant provider. Moreover, firms should look to address the success factors described in this report, to ensure these solutions are adopted successfully.

Acknowledgement

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