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DIGITAL BANKING FUNDAMENTALS SERIES

The 3 Cs of Regtech

What is RegTech?

Regtech (regulatory technology) is the management of regulatory processes within the financial industry through technology. It involves start-ups, financial institutions (FIs) and regulators which all equally benefit from it. The main functions of regtech include regulatory monitoring, reporting, and compliance and regtech companies use cloud computing technology through software-as-a-service (SaaS) in order to help businesses, comply with regulations efficiently and affordably.

Regtech does not only apply to financial services, however it finds its most evident use-cases in the context of financial services for now. Why? Because the financial services industry is spending the most on audit and compliance with a focus on meeting regulators requirements. Regtech in finance is step one in regtech in any other industry.

Rise of RegTech

Years of 1989, 2000 and 2009 showed us how untethered finance can have a detrimental impact on the real economy. Fintech (financial technology) started in 2007 as a reaction to the financial crisis and regulators have been increasingly encroaching in the territory of FIs to ensure that compliance is respected. One of the most effective ways of doing this is by adding personal and criminal liability to an FI in case of a breach. However, this change in regulations has come at high cost for the financial service industry. The money you put in compliance is money you don't put in customer centricity, competition, or efficiency. It means diverting money from another department to compliance and it's not necessarily working.

Regtech allows for a real time and proportionate regulation that identifies risk and enables more efficient compliance.[1]

Regtech came later in the game and is more of a reform of the financial services industry. It became prominent in the last couple of years because it either didn't have the talent or the certainty that allowed the automation of processes in the earlier years. Regtech presents opportunities to amend existing systems and to build the necessary infrastructure to balance market integrity, financial inclusion, and economic growth, while at the same time meeting commitments satisfying the international financial standards.[2]

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[1] Janos Barberis

[2] Arner, Douglas W. and Zetzsche, Dirk Andreas and Buckley, Ross P. and Barberis, Janos Nathan, The Identity Challenge in Finance: From Analogue Identity to Digitized Identification to Digital KYC Utilities (September 25, 2018). European Business Organization Law Review, Forthcoming; UNSW Law Research Paper No. 18-45;

Regtech (unlike fintech) benefits an entire ecosystem:

- It benefits regulators as technology allows them to have better understanding and view of the firm they supervise.
- It benefits financial institutions by decreasing the compliance cost and still meeting the regulatory objectives.
- It creates a new financial infrastructure for reporting.

In order to have a solid digital financial ecosystem, digital identity is key.[3]

REGTECH MARKET, BY REGION (USD BILLION)
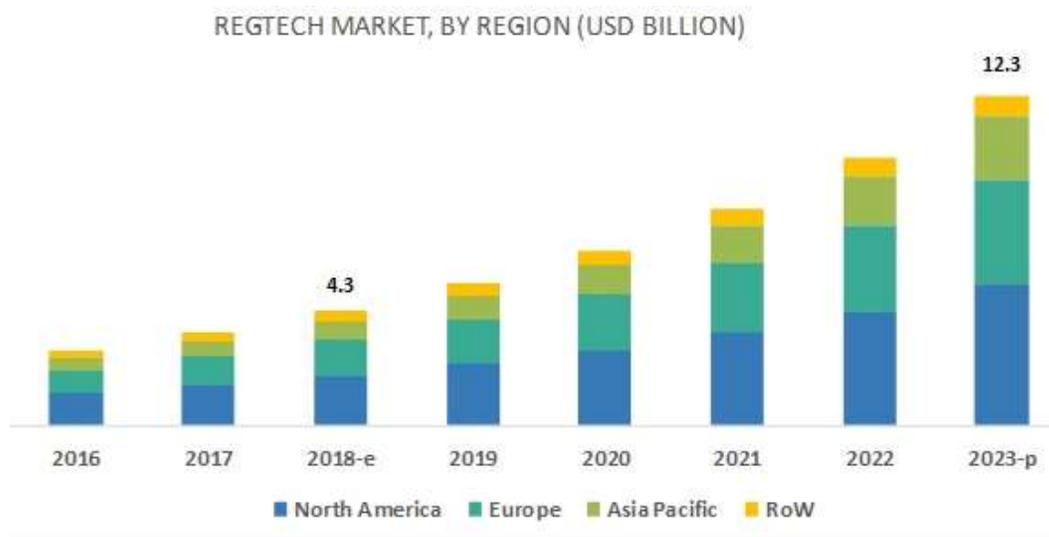
Source: MarketsandMarkets Analysis

Digital Identity

Identity is fundamental in finance.

Verifying customer identity and carrying out know-your-customer (KYC) due diligence in the on-boarding process and on an ongoing basis are essential to market integrity. Knowledge and understanding of clients' identities are basics to protect against fraud and crime, as well as being crucial for providing quality services.

European Banking Institute Working Paper Series 2018 No. 28; University of Luxembourg Law Working Paper No. 2018-008; University of Hong Kong Faculty of Law Research Paper No. 2019/029. Available at SSRN: https://ssrn.com/abstract=3224115 or http://dx.doi.org/10.2139/ssrn.3224115
[3] Janos Barberis

At the same time, these requirements can be major barriers in accessing financial services, especially for individuals and SMEs, and need to be balanced against the objectives of financial inclusion and economic growth.

Technology provides us with an opportunity to fix this challenge through the development of digital identity infrastructure. Setting up digital or electronic identification requires solving design questions such as registration methods, data availability and cross jurisdiction recognitions. Still, it is important to achieve balance between flow-through efficiency and cyber-security so that the objectives of financial inclusion and market integrity are not achieved at the detriment of financial stability. Therefore, we could say that digital identity is somewhat of a cornerstone of regtech.

Can Compliance Be Attractive?

The three Cs (customer centric compliance) is becoming a more prominent strategy and the FIs are starting to realise its importance. The better the customer experience, the bigger satisfaction for both regulators and customers. Customer experience is becoming essential for improving compliance which, done right, doesn't need to be a burden, especially if it can be done in a digital way. That way it removes the friction that otherwise exists in paper-based compliance.

Let's take an example: it takes a person or SME from 3 days to 6 weeks to open a bank account in a traditional way. This means, from the client's perspective, that for that period of time they are unbanked. From the FIs perspective it means that the more time they spend on performing a KYC check on a client, the more expensive acquiring that account will be, which places them in the competitive disadvantage. The longer it takes to make a compliance verification check, the more expensive and harder it will be to get the return of investment (ROI) on that client relationship. On the other hand, the client might choose another FI where the onboarding process is shorter and more seamless. Regtech aids this situation by shortening the process significantly, saving time (and money) for both parties.

About Oradian

Oradian is a financial inclusion company serving financial institutions in remote, hard-to-reach communities. Using insights from our community of customers, Oradian builds a cloud-based core banking system that financial institutions plug into to access best practice and efficiency. Their global community is made up of over 80 financial institutions in 12 countries serving over 4 million end-clients. Feel free to contact them at knowledge@oradian.com.