Streamline compliance with Automated Regulatory Intelligence

Last updated: March 2024

Risk Solutions

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Executive summary

To battle the rising costs associated with compliance as well as non-compliance, coupled with the incessant increase in complexity around the rapidly evolving regulatory guidelines, an efficiently managed compliance risk mitigation function within an organisation can drastically reduce the exposure of an organisation towards financial and non-financial losses.

In most financial institutions, compliance functions are highly fragmented and disintegrated. This paper analyses an emerging set of technological advancements in the compliance management domain, namely Automated Regulatory Intelligence (ARI), that may help the compliance function of a financial organisation understand, anticipate, and implement new changes related to the compliance asks from regulators. Furthermore, this paper also explores whether a sagaciously laid-out and carefully executed compliance management plan can be an instrument to achieve competitive advantage.

Background

Compliance has always played a pivotal role in the economy, be it for regulators, the regulated entities, or the economy itself. Irrespective of industries or sectors, from a regulator's perspective, ensuring compliance has always been a means to secure the interest of customers as well as provide much-needed oversight on the industry participants.

If we take the history of the Indian banking industry into our perspective, economic reforms of the 1990s forced Reserve Bank of India to tighten its grasp on the much-needed regulatory reforms, for as the economy started growing, so did the banks and the possibility of failing in the absence of proper regulatory oversight. From a lack of any standardized guidelines for asset quality management till the mid-1980s to acting on the recommendations of the Committee on the Financial System, RBI came a long way by the end of the 1990s.

As new challenges and risk areas emerged, so did the tightening and evolution of the compliance requirements. Banks may have initially seen this as a burden and a distraction to the expanding branch network or the increasing loan book size. However, timely compliance in identifying worsening assets and provisioning a portion of the bottom line put these banks in a much better position to absorb damages during distressed times.

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Be it the asset-quality-related regulations or the minimum capital requirements, banks that promptly comply to these regulations, at any given point of time, are always better off than the non-compliant ones, although it may seem the other way round at the beginning of the implementation. For example, the compliant banks were, in theory, better equipped to handle the economic tumble brought on by 2008 financial crisis.

Fast forward to the middle of 2010s, the Indian economy, due to years of slow growth and procedural delays, had accumulated substantial amount of stressed assets in public sector banks (PSBs). This forced RBI to require a public sector bank cleanup, an initiative termed as asset quality review (AQR). Back then, this may have provoked a very simple thought that the extant RBI guidelines in the years leading up to AQR, were not devoid of loopholes and were incapable of ensuring proper compliance and robustness in the banking system.

By the onset of COVID-19, most of the PSBs were done with the asset cleanup and, thus, acquired a sturdy position to fight the unexpected economic turmoil. Once again, the years spent catching up to the regulatory needs of the AQR guidelines may have seemed like a burden, but the compliant banks were better off because of them.

In a nutshell, we have gone through some evidence to add weight to the fact that regulatory compliance is an intricate and ever-evolving function that always seems to be playing catch up with the necessities pressed upon by adverse economic events, which force the regulators to take a fresh look at the guidelines and make them stricter.

Current challenges

A forward-looking view can ensure timely compliance while also reducing the regulatory burden on the front lines (branch and salesforce), the second line of defence (operations and compliance risk), as well as the third line of defence (internal audit).

Let us consider a broader perspective by expanding the impact of regulatory compliance beyond the asset quality discipline within banks since they are supervised by various regulatory bodies directly or indirectly. To effectively deal with the profuse, cross-functional, and complex nature of compliance, banks need a well-managed and efficient compliance risk management function that is integrated at an organization level.

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Traditionally, this function has relied mostly on manual efforts in terms of scanning the regulatory horizon, filtering out relevant notifications, analysing the impact on different departments, managing the regulatory change process, departmental collaborations, and finally implementation review. This can easily get out of hand and become too onerous to handle manually as regulations become prolific and complicated.

As per Thomson Reuters' 2022 Cost of Compliance study[1], there were a total of 64,152 global alerts in 2021, averaging almost 176 alerts in a day. The 2023 iteration[2] of the same study found out that among the participants—consisting mostly of compliance or risk team members from more than 350 practitioners, representing global systemically important banks (G-SIBs, other banks, insurers, regulators, asset managers, and more—a staggering 73% of the respondents {other than G-SIBs (59%)} expected an increase in regulatory information published by regulators.

Another fact[3], stated by Global Trade Alert, tells that between 01 Jan 2020 and 04 Aug 2023, a total of 7,480 significant Digital Policy Alerts/events advanced, of which 4,107 were policy or regulatory changes. Digital Policy Alerts forms only a small fraction of the entire regulatory alerts landscape.

As the regulatory alert volumes grow in number as well as intricacy of their impact, manually managing compliance may become increasingly difficult. In most cases, this may lead to an increase in the cost of compliance, assuming that the compliance asks are met timely. In cases involving untimely compliance, it will attract costs of non-compliance in the form of hefty fines, penalties, fees, and other losses originating from reputation damage.

While it may be easier to compute costs associated with compliance and non-compliance, another subset of costs that is hard to objectively quantify involves costs linked to reputational damage. Be it from the perspective of customers, suppliers, partners, employees, or investors, damage to reputation comes with opportunity costs, among others, and eventually leads to loss in potential business.

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As per a 2017 study[4] conducted by Ponemon Institute LLC, the average cost of non-compliance, $14.82 million, was much greater than the average cost of compliance, which was $5.47 million. It may be considered quite reasonable to assume that this cost could possibly have increased since 2017.

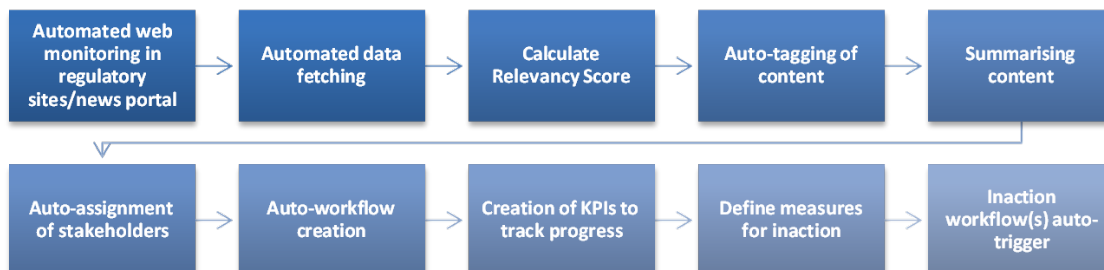
Furthermore, as per Deloitte Banking Alerts5, a total of US$5bn worth of fines related to AML/KYC issues were charged to credit and financial institutions in 2022. It also stated that usually, the fines come years after the infractions have taken place. Thus, the figure stated above may not be indicative of the defaults that occurred in 2022.

Our solution

The absence of such costs in an organisation may be construed as a form of competitive advantage. Not only are there benefits entailing timely compliance, but the processes that help achieve timeliness also impart competitive advantage in the absence of such proficiency in competitor organisation's compliance management systems.

Thus, investing in a solution that has the potential to impart competitive advantage to an organisation is worth the cost of acquisition of such a solution, provided that the cost of acquisition doesn't offset the benefits that it entails. Furthermore, it reduces the regulatory burden (on the compliance team) and the auditory burden (on the internal audit team).

Automated Regulatory Intelligence (ARI) is a sophisticated solution that eases the burden and cost of compliance by automating as well as optimizing processes that form a part of compliance workflows. One example of a non-exhaustive list of steps involved in a compliance workflow aided by an ARI solution is given below.



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Case study: Example of a new KYC notification

If an Indian scheduled commercial bank has put in place an ARI solution to monitor RBI's notifications, and a new notification (hereafter referred to as KYC notification) is published, which mandates that all the new retail customers need to capture spousal details, specifically occupation and income, in the account opening form.

An ARI solution will notice and fetch this KYC notification and start processing it. The processing involves auto-generation of tags, textual summarisation, and calculation of a relevancy score. Being a very relevant notification, it will be sorted at the very top of the alert list and assigned relevant departments as well as users.

Based on the assignment, one or more workflows will be automatically created with consideration of all lines of defences within the organisation. An example of such a workflow is given below.

For each workflow, a set of KPIs will be defined and tracked in order to quantify the completion. These KPIs can also be assigned weights to compute a success score to assess the effectiveness of each regulatory implementation process.

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Conclusion

Automated Regulatory Intelligence streamlines the regulatory compliance workflows by monitoring and consuming updates from multiple regulatory sources, as and when they publish new regulatory alerts, and assessing the impact of such alerts on the organisation. With the rising alert numbers and their complicated impact on compliance function, adopting an intelligent solution to automate compliance processes efficiently may hold the key to reduce costs associated with staying compliant.

The solution in effect will help to ensure all the necessary regulatory asks are met in an efficient manner and the compliance team has a bird's eye view during the compliance process change across the entire organisation.

The adoption of ARI is still at a very nascent stage, especially in the banking and financial services industry in many countries, excluding the United States. While companies explore the viability of such a solution in their respective industries, it will be interesting to explore the ramifications of the competitive advantages such a solution can deliver to the early adopters.

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