Industry Playbook

Banking

CUBE

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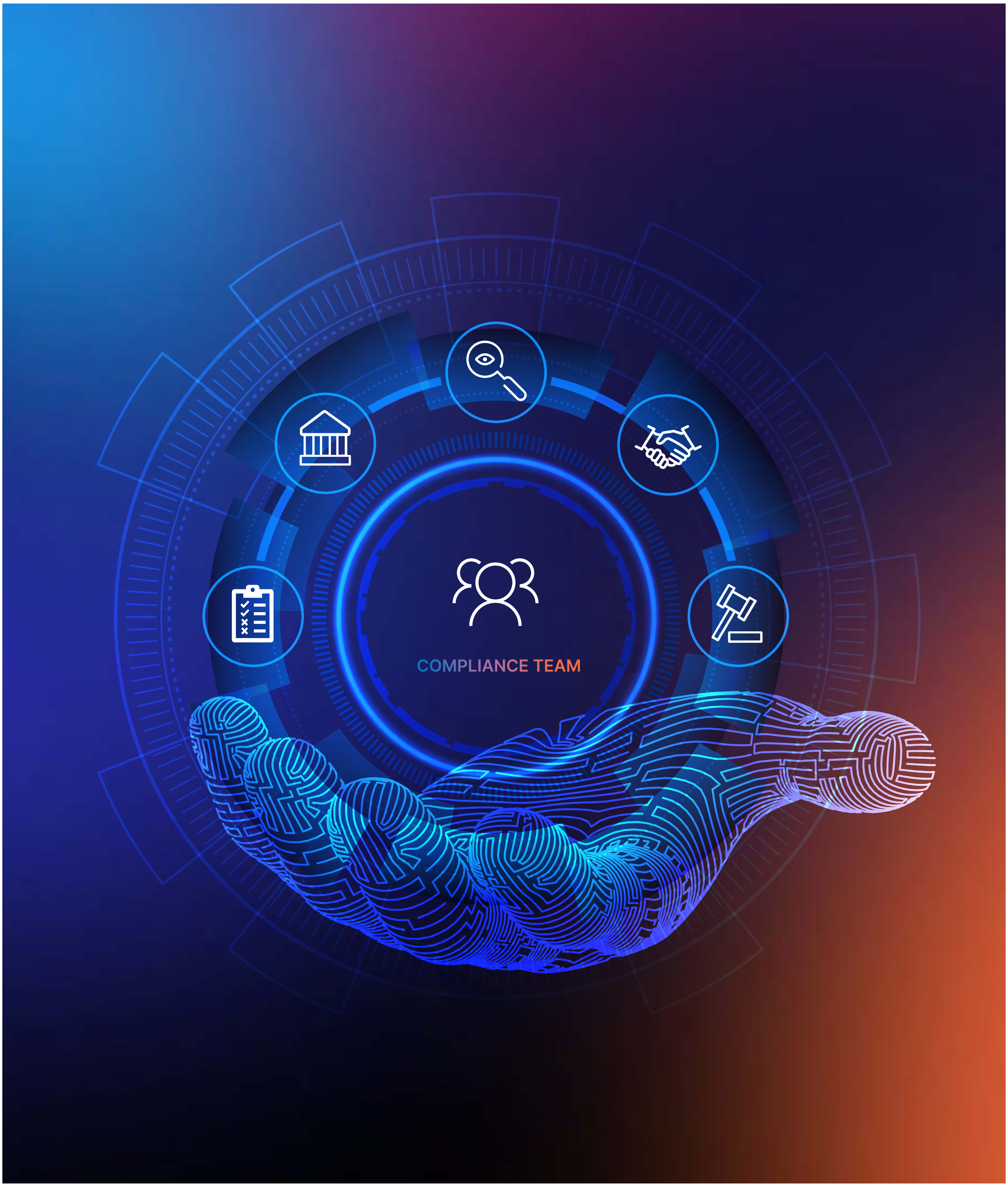
4 Key steps to enhanced compliance with Automated Regulatory Intelligence

EXECUTIVE SUMMARY

Managing regulatory change is one of the most important operations inside any financial services firm, but the challenge is becoming harder as compliance teams face battles on multiple fronts.

Finite resources are being stretched by the pace, complexity, and volume of regulation entering force, while ever-accelerating technological advances drive competition and disruption, both of which can affect the culture of an organisation and its approach towards compliance.



Industry surveys frequently point to the broadening responsibilities and pressures on compliance officers (COs), with no indication the pressure is likely to ease on the individual, their team or organisation.

Long-standing regulatory obligations around anti-money laundering (AML), record-keeping, market abuse, consumer protection and data processing are tightening, while cybersecurity, corporate governance and other operational resilience and risk matters further permeate the function's orbit.

The tipping point where compliance could be maintained by manual supervision and making changes in reaction to events has long since passed thanks to an endless cascade of regulation, complex product offerings and the further digitisation of trading.

To manage expectations, banks are turning to Artificial Intelligence (AI)-powered applications to support front-office functions like onboarding, Know Your Customer (KYC), AML and back-office functions related to transparency and auditability.

There is clear evidence that leveraging Automated Regulatory Intelligence (ARI) inside the compliance function can help banks address the risks on the horizon, keep pace with changing regulatory requirements, expectations, and industry practices, and generate operational efficiencies.

THE LATEST TECHNOLOGICAL SOLUTION IS NOT ALWAYS THE BEST

The solution must fit individual business needs and serve the function rather than try to own it. Equally important is the role of the vendor as a genuine strategic partner committed to ensuring the solution delivers success for the compliance team.

This playbook aims to help financial services firms gain an understanding of how ARI can augment human expertise and deliver proactive and effective compliance.

COs will find actionable intelligence, guidance and best practices that will help them chart the world of regulatory change with newfound clarity.

The insights contained within have been shaped by users, practitioners, and leading thinkers in regulatory change, and are designed to show how the strategic deployment of AI can unlock hidden efficiencies and significantly enhance compliance operations.

STEP 1 Use AI to develop a comprehensive and robust compliance framework

The concept of a robust compliance framework is one COs should be more than familiar with, as the message underlining its importance has been hammered home by regulators consistently over the last 15 years.

It consists of a structure and guidelines within the compliance department that enables it to draw up policies which the organisation must follow and processes to successfully implement legislation.

Understanding the regulatory environment is a vital part of creating the framework and, in an era of heightened risk and scrutiny, staying up to date with the latest regulations and wider supervisory thinking is imperative.

IDENTIFY AND ACT ON RISK SOONER

Regulated businesses should own a list of every piece of legislation applicable to the firm's activities, with COs requiring the knowledge to understand which rules apply, and how the bank can ensure its activities remain within the guidelines.

If a CO is unsure what a particular rule is aiming for, where it applies, and whether there is a chance of being fined (or worse) for non-compliance, accessing the primary source is the best option.

On top of the key pieces of legislation designed specifically to regulate the financial markets, there are myriad laws and rules which compliance teams must be aware of that directly affect their firm's activities.

Many of these laws and rules, like the European Union's General Data Protection Regulation (GDPR), come with heavy financial penalties for breaches. Others, like the UK's Proceeds of Crime Act, threaten imprisonment for senior staff who hold responsibility when a serious problem occurs.

Multinationals also contend with a colossal amount of overseas legislation which, when taken together, is often much greater and more complex than the laws governing their domestic market.

Cross-jurisdictional business brings contrasting regulatory environments, watchdogs, and expectations; the substances of law and approach to their application can change.

Such challenges can be compounded by the corporate structure of the financial institution and its various branches and subsidiaries, teams and reporting lines, which may not guarantee efficient compliance processes.

CUBE's research has tracked more than 40m documents issued by regulators around the world since the 2008 financial crisis, showing the scale of the task compliance have in making sense of the rules.

Identifying legislation of relevance to the firm (and which the compliance team is responsible for) is an exhaustive exercise, particularly given the differences between banks and their activities, and the variances in how much of the same legislation applies.

According to the EY Compliance Risk Survey, however, 63% of organisations consider these essential regulatory mapping protocols a major challenge to achieve.

Some 65% of respondents do not have a centralised repository of applicable regulatory obligations, and 39% of respondents state that no formal training of regulatory obligations is in place.

“Proactive firms who seized the initiative are reaping the rewards of using machine learning to modernise their compliance frameworks,” said CUBE CEO and founder Ben Richmond.

“The early adopters are at the stage where their systems are significantly smarter given the extent of machine training that has taken place, meaning their compliance specialists are able to identify and act on risk much earlier.”

Implementation even of parts of Dodd-Frank, Sarbanes-Oxley, or the second Markets in Financial Instruments Directive (MiFID II) would not have been possible without technological advancements, and the enormous stream of complex regulation and laws banks must contend with has made machine learning an essential extension to regulatory monitoring and management.

ARI tools can provide real-time horizon scanning of regulatory sources, with powerful machine learning engines able to capture, categorise, translate (where necessary) and explain the relevance of the updates in the context of the bank’s compliance framework.

“Moving forward, organisations have the opportunity to leverage technology and improve strategic decision-making through independent compliance functions with a clearly defined framework.” Ahmed Taher, EY MENA Risk Consulting Leader

STEP 2 Develop foresight intelligence with smart horizon scanning

In volatile markets where everyone feels the pressure to deliver, a weak compliance framework could become an existential threat.

Fines for failing to prevent money laundering surged more than 50 percent in the last year, and while the regulatory focus on punishing banks for failing to curb illicit flows of money remains a priority, enforcers are taking an aggressive position on other lapses once deemed relatively minor.

A record-keeping sweep of Wall Street in late 2022 landed every major player with individual fines of $200m (more than $1bn in total) for allowing traders to use personal devices to conduct business.

A follow-on probe of Tier 2 businesses in 2023 yielded a further $289m in penalties, marking a significant escalation of monetary sanctions, given that similar offences several years earlier led to a combined eight lenders paying just $8.25m in total for deleting emails.

No evidence of misconduct was found in any of the cases, merely the fact compliance had failed to effectively implement own-device policies was enough to trigger the largest recorded penalties for such a breach.

In one example, even the individuals responsible for implementing and ensuring compliance with policies and procedures used their personal devices to communicate about the firm's trading, which contributed towards the heavy fine.

At face value the cases underline that, as information technologies develop, banks must continuously adapt their information governance practices and internal controls to ensure they remain relevant. The broader picture, however, is one where regulators are less tolerant than ever of regulatory blind spots.

Punishments for such lapses are no longer immaterial and are indicative of how regulatory expectations are shifting.

“Regulators are relentlessly pursuing what they perceive to be ‘weak links’ within risk programs and coverage,” said Amy Matsuo, Principal and Leader, Regulatory & ESG Insights, KPMG LLP. “Expect increases across supervision, enforcement, and investigations under both old and new regulations.”

Warnings were sent in 2018, prior to the pandemic and the shift towards remote and hybrid working, that monitored employees were not to use their own devices to conduct business, and regulatory issuances on this matter also bubbled back up in 2016.

Progressive firms have adopted ARI horizon scanning to identify these types of regulatory updates. Relevant information is flagged and filtered through for compliance to act on, shore up gaps in coverage and contribute to a strong defence framework.

Deploying AI to scan for regulatory updates which can be categorised, curated and interpreted by machines, frees up COs to better use their time analysing the content and how it can be mapped to the business, helping to further strengthen a culture of trust, business integrity, and accountability.

STEP 3 Win senior buy-in by framing the case for change in numbers

Compliance frameworks live or die on tone from the top.

Despite what some solutions on the market promise about immediate fixes, a healthy culture is a slow build that cannot happen overnight. Environments of trust, business integrity, and accountability are cultivated through senior management buy-in, and the ability of COs to transcend rhetoric and deliver real operational change.

"Winning the 'hearts and minds' battle often means overcoming internal mindsets that compliance is at best a nuisance and at worst a roadblock to be circumvented,' said Rob Fulcher, Chief Sales Officer, CUBE. "Demonstrating the value of automated regulatory change management in ways the C-suite can understand goes a long way to winning support and budget for technological change."

AI-driven compliance functions can have a transformative effect on the two critical aspects of a bank's business model: its strategic and target operating sides.

- The former defines what products, markets, customers and jurisdictions the bank favours depending on its risk appetite.
- The latter covers governance, decision-making, recruiting, technology, human capital, legal structure, and operations.

Banks aim to execute their business strategy with an optimal target operational model, and at the centre of this sits compliance.

Compliance constraints cause the organisation to maximise its risk-adjusted return on capital (RAROC), but as costs around the globe continue to skyrocket, this lowers revenue/costs ratios significantly.

- Broad estimates pin around 30% of a bank's costs on compliance.
- This expenditure slashes return on equity by about six percentage points among GSIFIs (Global Systemically Important Financial Institutions) and DSIFIs (Domestic Systemically Important Financial Institutions).

It has become a critical long-term strategic imperative to reduce compliance overheads without diluting its effect, but without the integration of machine learning and AI tools into the stack, there is little hope of gaining real operational efficiencies.

In the context of globally interconnected finance, it is inconceivable that many compliance requirements can be dealt with manually when machine learning tools can play a defining role.

"Banks that have successfully implemented ARI applications have reported a reduction in compliance spend of more than 40% in some cases, whilst delivering markedly improved results and company cultures," said CUBE's Head of Regulatory Services, Krzysztof Tokarski.

Further cost-saving benefits of a proactive approach to compliance materialise in reduced risks related to breaches, litigation, and other business threats.

Regulators tend to be more lenient of one-off lapses if they witness a strong compliance program in place, whilst conversely, the penalty may be significantly higher than the proportionality to the aspect of non-compliance if the organisational attitude is lacking.

Other damaging outcomes from weaknesses include:

- negative media image hitting share prices and market cap;
- reputational damage repelling customers and impacting both top and bottom line; and
- opportunity costs with resources diverted to deal with investigations, amongst many others.

One of the most harmful costs to businesses is the price paid to remedy any damaging situation. Recruiting costly consultants and specialists or putting the latest technology in as a quick fix may ultimately do more harm than good over the longer term.

The case for implementing ARI solutions can be as simple as understanding that boards respond to numbers.

It is worth noting however that while AI is a very powerful enabler, ownership of extracting what the firm requires from it must stay with the experts inside compliance. Onboarding vendors that offer fantastical tools promising to do every job just as well as people is a common source of (repeated) mistakes.

How the technology performs in a stand-alone situation doesn't hold as much weight as how it can elevate your compliance department and its unique situation when used in conjunction with human expertise.

Choosing the right technology partner is a vital step in the process and can mean the difference between success and failure in compliance, which has broad implications on the rest of the business.

Key takeaway

Successfully implementing ARI applications can reduce compliance spend by more than 40% whilst putting skillsets inside the function to better use.

STEP 4 Unlocking real value with Automated Regulatory Intelligence

Regulators have long accepted the use of AI techniques to assist with the review and production of documents relating to government subpoenas, external investigations and litigation discovery requests, but there is growing recognition that technologies can deliver much more.

The UK's Financial Conduct Authority has gone on record stating it expects AI to better help compliance solve problems, while the US Securities and Exchange Commission has a similar take that only AI can tame the datasets of the modern era, which are rising exponentially.

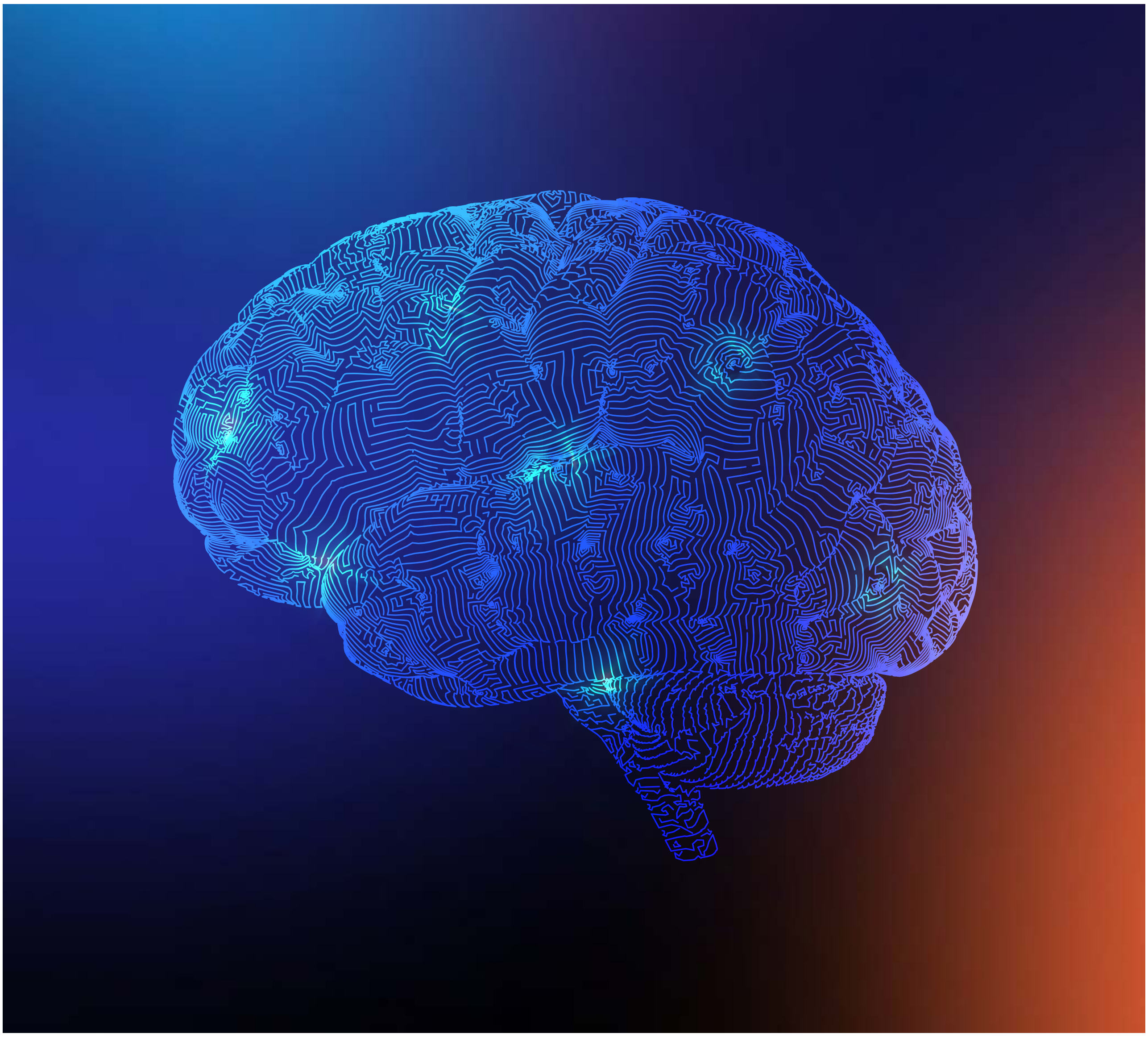
Well-crafted AI tools and data analytics are mining large and diverse regulatory datasets to aid in the identification and mitigation of risks, monitor compliance, and detect patterns and trends too unwieldy for human analysts.

REAL-TIME INSIGHTS INTO REGULATORY THINKING

Deep-learning algorithms and machine learning tools can simplify the complexities of monitoring for multi-jurisdictional and multi-product operations, and automate policy and control mapping – meaning no regulatory issuance slips through the net.

Funnelling and sorting regulatory data into a single place allows for a more complete view of regulatory change. From here, artificial intelligence and natural language processing (NLP) algorithms can identify shifts in regulatory thinking, policy and rulebook updates.

Where ARI truly enhances compliance operations is in the tailoring of regulatory insights and alerts to the organisation's unique profile.



Deploying AI models to vast content databanks in search of relevant proposed and pending regulations, legislative updates, blogs, and speeches can give COs the earliest possible warning that change is or will be required.

Scanning for real-time developments, enforcement activity, fines, blogs, consultations, notices, bulletins, and deadlines will bring vast volumes of constantly updated information, which can be uniquely tagged and classified.

Next-generation ARI solutions can filter the data that matters to the business and ensure compliance and the wider organisation is ahead of change long enough to implement the desired actions.

Recent advances in contextual analysis and natural language processing pioneered by CUBE can provide a connection between insights and other relevant regulatory materials that a narrower scan would miss.

The results are prioritised for the closest matches meaning COs who must also consider data protection, cyber law, or bribery updates would have the results at their fingers in minutes instead of having to take time to scour several other sources.

"Eliminating the need to pore over regulator websites to find changes and then calculate their relevance to the organisation is a significant efficiency gain for COs who can instead move to tasks of higher value such as interpreting regulatory trends or dedicating time to strategy," said CUBE's Head of Product – Digital Experience and Strategy, Tim Ward.

The most effective deployment of AI is synergy of human excellence and machine capabilities. Combined with a cohesive, proactive regulatory capture strategy, compliance teams can cover more ground, better protect the business, and add value as trusted partners to boards and the C-suite.

This is a significant step towards bolstering compliance coverage given the increasing barrage of international and domestic regulations.

Smarter tools can give you control over what to analyse and where, allowing you to prioritise risks and identify the meaningful regulatory change your business needs to respond to.

Key takeaway

Appropriate and effective technology is the best partner to compliance and a strong weapon in the armoury of the business in guarding against risk.

CONCLUSION

- Appropriate and effective technology is the best partner to compliance and a strong weapon in the armoury of the business in guarding against risk.
- Machine learning engines can provide real-time horizon scanning of regulatory sources, capture, categorise, translate where necessary, and explain the relevance of the updates in the context of the bank’s compliance framework.
- Intelligent technology is being used to capture and ingest data from a broad range of regulatory channels, giving compliance departments total vision to help guard from regulatory risks.
- ARI can help perpetuate a culture of trust, business integrity, and accountability across the entire organisation.

Compliance functions are facing unprecedented pressure to meet broadening regulatory expectations, with the penalties for failure rising in both severity and frequency.

Dynamic regulatory landscapes bring constantly evolving laws, amendments and industry trends, and the sheer volume of issuances across multiple jurisdictions can be overwhelming for COs to manually track and interpret.

The net result is greater resources are sucked into compliance, which causes headwinds on the bottom line and may exacerbate risks internally as competition stresses can cause tensions to rise as the business scrambles to improve revenue.

Forward-thinking firms understand the most effective compliance strategy is to get ahead of problems before they escalate, shifting from a reactive approach to a proactive department capable of harnessing AI in ways that will help the business adapt as new regulations and guidance appear.

Intelligent technology is playing a critical role in enabling businesses to build robust and active compliance programs, with AI now a true game-changer in helping banks deal with regulatory change management.

ARI solutions are transforming seemingly impenetrable datasets into sources of insight for senior management, and repositioning COs as a key ally to the business and a valuable strategic asset.

CUBE

CUBE has been the market-leader in RegTech since the business was formed in 2011.
Our unrivalled regulatory change management solutions help the biggest banks on the planet, Fortune 500, FTSE companies and leading names in other highly regulated industries solve complex regulatory challenges.

WHERE CUBE STANDS OUT

- Increased agility and capability to manage regulatory change – make better informed compliance decisions using a complete regulatory inventory.
- Reduce time and costs – save up to 30-40% of compliance costs by freeing up highly qualified individuals from manual tasks to work on valuable operations, analysis, and critical thinking.
- Horizon scanning for compliance – gain oversight over upcoming regulations and plan ahead when it comes to regulatory policies and controls.
- Implement effective, auditable compliance – provide evidence to regulators and internal audit teams across the entire regulatory change process.
- Easy integration into compliance systems and processes – integrate CUBE into your other GRC and risk systems.
- Avoid non-compliance enforcement actions – preserve company reputation and avoid regulatory fines.

ABOUT THIS PLAYBOOK

This intelligent compliance strategy playbook is aimed at compliance and risk professionals responsible for maintaining the integrity of financial services businesses.

Working with our partners, CUBE has developed this guide to support teams considering a move to ARI technology solutions, which we would be happy to facilitate.

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If you would like to discuss this report in more detail or learn more about how we can help you, email hello@cube.global today.