Regulatory Technology Services (RegTech)

Preparing your financial institution for the future
Global CEO concerns

85% Of CEOS are concerned about

Having to consider the integration of basic automated business processes… with artificial intelligence and cognitive processes

86% Of CEOS are concerned about

How the millennials and their differing needs will change their business
The financial services industry is facing rapidly evolving customer preferences, competition from new business models, complex regulations and macroeconomic uncertainty. Risk and compliance functions, even as mid-office functions, are directly impacted by these external forces. They are expected to be more real-time and agile while being cost-efficient at the same time. Proliferation of new technologies, FINTECHs and REGTECHs, may well be the silver bullet that risk and compliance functions of the future need.

**Trends shaping the future risk and compliance functions**

- The rise of internet connectivity, mobile and social media is rapidly changing customer preferences. This will force financial institutions to be faster than ever with decisions on issues like credit and client onboarding.
- Complex and continuously evolving regulations increase overheads and simultaneously increase the pressure to be “lean”.
- Erosion of trust in financial institutions.
- Increased emphasis on fostering the right conduct and culture, along with consumer protection.
- Slow global growth and macroeconomic uncertainty.
- Explosion of data and proliferation of new technologies, like:

  **Blockchain:** It is a distributed digital ledger of all transactions or information shared across a peer-to-peer network verified by all. Whether it is used for payments, over-the-counter (OTC) derivatives (smart contracts) or know-your-customer (KYC) and anti-money laundering (AML) checks, it has the potential to reduce settlement risk, counterparty risk, financial crime risk and more.

  **Digital Labour:** It is robotic process automation (RPA) systems and natural language processing systems which enable the automation of activities like risk monitoring, reporting, data reconciliation or processing unstructured information.

  **Cognitive Machine / Artificial Intelligence (AI):** It is deep learning algorithms that automate the process of extracting insights from structured and unstructured data. It can reduce the burden of building and maintaining models, and hence be more cost effective.

  **Big Data:** Social media and Internet of Things (IoT) have led to an explosion of data which are highly relevant for risk and compliance functions. Establishing a framework of data sources, distributed computing and Big Data Analytics tools will help in harnessing power of Big Data.

  **Cloud Based Service:** With regulators warming up to cloud computing, it enables banks to set up utilities that will deliver complex risk and compliance activities on a managed service model. E.g. stress testing, reporting.

  **Real-Time Compliance (RTC):** It utilises systems to effectively alert a company to non-compliance ‘triggers’. It can enable corrective action before events build to a significant impact in scale.
The future of risk and compliance in banks

The risk and compliance functions of the future will be powered by near real time information and smart machines to make sense of complex patterns in data and hence better able to foresee risks and compliance failures. They will be able to act and respond faster by adopting disruptive technologies such as blockchain and cloud-based computing. They will be operationally ‘leaner’ with automated business as usual activities. In summary, they will be more adept at being an effective business partner and navigator while simultaneously playing the role of an internal regulator.

Current State

- Manual document processing
- Limited data sources to assess credit worthiness
- Static credit scoring models that do not keep pace with evolving economic cycle and consumer behavior
- Human bias

- Manual document processing
- Huge operational overheads and inefficiencies

- Very high proportion of false positives
- Poor quality of voice data
- Manual sampling and surveillance of data
- Huge operational overhead and inefficiencies

- Manual processes & procedures
- Data quality challenges
- Siloed / disintegrated systems
- Time consuming

- Models that are unable to detect complex patterns in large volumes of data
- Models that do not keep pace with ever changing economic cycle, consumer behaviour and market behavior

Underwriting

<table>
<thead>
<tr>
<th>Document processing</th>
<th>Credit scoring</th>
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<tr>
<td>Powered by Cognitive Machines, Natural Language processing, Robotic Process Automation (RPA), Big Data</td>
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Client Onboarding

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<tr>
<th>KYC</th>
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<td>Powered by Natural Language Processing, Big Data and Blockchain</td>
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Monitoring/ Surveillance

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<td>Powered by Cognitive Machines, Real Time Compliance</td>
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Risk Operations

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Risk Analytics

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<th>Stress Testing</th>
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<td>Powered by Cognitive Machines, Big Data and Cloud Based Services</td>
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## Future State

- Automated document processing leading to faster credit processing.
- Self-learning and continuously evolving models
- More accurate assessment of credit worthiness
- Lower bad rates resulting in lower provisions
- Limited model maintenance and overheads

- Common identity for individuals and organisations on Blockchain
- Digital KYC and due diligence
- Automated document processing

- Reduced false positives
- Integrated voice and data monitoring
- Operational efficiency
- Proactive surveillance

- End to End automation of reporting and reconciliation.
- Improved data quality control
- Integrated data and systems architecture
- Faster reporting

- More accurate risk forecasting
- Pro-active fraud detection
- Self-learning and continuously evolving models
- Limited model maintenance and overhead

### Based Services

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<th>Change Management</th>
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<td><strong>Fraud Analytics</strong></td>
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KPMG has developed a host of RegTech solutions, both in-house and in collaboration with select technology partners. Our deep risk, regulatory and process expertise within our Advisory practice and the specialised technology capabilities within KPMG’s Digital + Innovation team enable us to provide full lifecycle support through your RegTech transformation journey:

1. Ideation
2. Market Needs Validation
3. Business Case Development
4.Prototyping
5. Target Operating Model Design
6. Integration of Systems & Operations
7. Ongoing Managed Service
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<td>• Cognitive machine</td>
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<td>• Collections analytics</td>
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<td>Compliance</td>
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<td>• Trade surveillance</td>
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<td>Regulatory</td>
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<td>• FATCA</td>
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<td>• Common reporting standard (CRS)</td>
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Case studies of KPMG’s RegTech Solutions

Credit Scoring

| Client | ASEAN’s premier consumer banking group  
|        | • Over 1,000 branches in Malaysia and across ASEAN  
|        | • Over 13 million customers across various customer segments |
| Challenge | Develop an application scorecard for their credit card portfolio (using a sample of 31,680 credit card applications from Jan 2013 to Jun 2015) and benchmark the estimated default rate with observed default rate  
|          | KPMG, working with ADATOS, used cognitive machine to perform:  
|          | • Rapid data assessment  
|          | • Build Training Data  
|          | • Built application scorecard using deep learning neural network |
| Results | Significant reduction on bad loan rate from 1.29% to 0.93%  
|          | Translates to US$3.5 million savings on provision per year |

Voice Monitoring

| Client | A bank requested a diagnosis to evaluate and report on the quality of a limited set of call recordings on a sub-set of its Sydney-based traders. |
| Challenge | Bank provided a USB device containing meta-data and speaker and handset recordings for five traders captured over a three-month period (Feb to Apr 2016)  
|          | Only a narrow view of the call recording landscape was available prior to the processing. |
| Results | From the analyses of the meta-data and audio recording files, a number of general and specific observations regarding the quality of the data have been provided, to assist in the development of the surveillance and monitoring programme.  
|          | A total of 5,769 hours of recordings were provided. 47 hours contained usable content. Only 0.8% of recordings were useful. |
KPMG offers a range of deployment models to suit your business requirements.

The key models are outlined below:

1. KPMG’s Managed Service Model – this Cloud based service will deliver KPMG’s customised insights and best practice methodologies coupled with our RegTech approach. This allows us to deliver more value at a lower cost.

2. On-premise model - which enables the business to have direct control over the solution

**KPMG’s Managed Service Model**

- **Bank**
  - Source Systems
  - Internal Data
  - Secure Data Pipe
- **KPMG Cloud**
  - Risk Analytics
  - Trader Surveillance
- **Output**
  - Credit score
  - Fraud analytics
  - Voice Quality / Voice Content

**On-premise model**

- **Bank Infrastructure**
  - Source Systems
  - Internal Data
  - External Data
- **Output**
  - Credit score
  - Fraud analytics
  - Voice Quality / Voice Content
Technology was the biggest factor contributing to company growth, after global economic factors.
CEOs identified new technology as a key enabler to accelerate their transformative strategies.
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Contact Us

Chia Tek Yew  
Head, Financial Services Advisory  
T: +65 6213 3726  
E: tekyewchia@kpmg.com

Gary Chia  
Head, Financial Services Regulatory Compliance  
T: +65 6411 8288  
E: garydanielchia@kpmg.com.sg

Craig Davis  
Asia Pacific Head, Financial Risk Management  
T: +65 6411 8533  
E: craigdavis1@kpmg.com.sg

Nanda Thiruvengadam  
Associate Director, Financial Risk Management  
T: +65 6411 8212  
E: nandathiruvengadam@kpmg.com.sg