A holistic approach to regulatory watch

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A recent Deloitte survey revealed that most financial institutions have now realized the importance of the regulatory watch function for remaining ahead of regulatory challenges. With a holistic approach that combines regulatory watch, compliance, legal, and business functions, it does not have to be more complicated than it already is.

Why do we focus now on regulatory watch?

Following the global financial crisis that started to emerge in 2007, the political, regulatory, and supervisory responses have had major implications for the financial services industry.

1. **Regulatory landscape**
   The unprecedented regulatory weight has forced financial institutions to develop and broaden the full range of skills and tools necessary to address technical matters and to keep up with an evermore complex regulatory landscape.

2. **Costs of regulatory transgressions**
   Penalties for non-compliance have reached unprecedented levels. According to the *Financial Times*[1], Wall Street banks and their foreign counterparts have paid out US$100 billion in U.S. legal settlements since the financial turmoil. If one believes that regulatory compliance has become too expensive, non-compliance would certainly be far more costly. While some institutions—usually smaller institutions with limited resources—have been tempted to adopt a risk-based approach toward regulatory compliance, this is nowadays a very risky decision.

1 *Financial Times (25/03/2014): "Banks pay out $100bn in US fines" (R. McGregor and A. Stanley)*

3. Tighter scrutiny from supervisory bodies
   Supervisory authorities have not only become increasingly demanding in terms of reporting and liquidity and capital requirements, but they also pay more attention to the strategies and business models chosen by their supervised entities. Board members and senior management are also being increasingly held accountable for the consequences of their decisions or lack of action. Financial institutions that are most likely to thrive in this environment will be those that understand what an adequate or sustainable strategy and business model look like from a supervisory perspective. To satisfy the increasingly demanding supervisors, they would also need to have the vision to extract the maximum possible benefits from the investments they make.

4. Multiple sources of regulatory information
   The demand for greater scrutiny has been accompanied by an emergence of new supervisory entities (e.g., the new European Supervisory Authorities) as well as an increase in staff members.

   With each supervisory entity publishing its own publications (e.g., guidelines and consultation papers), financial institutions have become overwhelmed with regulatory updates. In addition, law firms, consulting firms, global custodians, and industry associations also publish newsletters and alerts.

5. Generic vs. specific information
   Despite the high volume of publications available, the majority tend to contain rather generic information that is not specific to organizations. The challenge for financial institutions consists in figuring out which publications are really important and which will enable them to anticipate the specific business impacts.

In a nutshell, what should an efficient regulatory watch consist of?

1. Set up of the function
   First of all, businesses need to define the organization of the regulatory watch function. This includes determining the ownership of the function (e.g., compliance, legal, strategy, etc.) as well as the roles and responsibilities of all stakeholders involved, namely the watchers and business experts.

2. Screening and monitoring of changes
   In the second step, sources that will provide the relevant information in line with the activities and services of the institution should be identified. If the institution has an international footprint, it should also ensure that the scope of the watch covers both local and cross-border needs. This phase is key to ensure that the relevance, scope, and volume of information are well-suited to the organization.

   Watchers can then start screening the pre-selected sources and monitor existing topics, capture new ones, and prioritize them for further action. In parallel to the screening, the institution should set up means of storage and communication to transfer information to business stakeholders.

3. Pre-assessment of impacts
   To enhance the use of the regulatory watch input, a pre-analysis should be performed and its results shared with business stakeholders at the right moment. Keeping business units informed on a regular basis about upcoming regulatory changes will foster anticipation and facilitate project implementation. Bespoke information about regulatory updates should also be shared with the different compliance stakeholders such as the board and local entities.

4. **Detailed business impacts**
   Based on the pre-analysis, the organization may decide to conduct in-depth impact analysis. To coordinate horizontal impacts, it is recommended to involve every stakeholder from the beginning—not only compliance but also the executives, legal, IT, risk, and business units. This is the essence of the holistic approach to regulatory compliance.

5. **Gap analysis**
   Following the business impacts, a gap assessment clearly identifies what needs to be changed in the organization. It is a prerequisite for the implementation project that actions mitigating these gaps are planned and the required resources are identified (i.e., volume and type).

6. **Implementation**
   Finally, once the appropriate resources of those involved in the Business as Usual (BAU) are mobilized, the Project Management Office (PMO) can coordinate the implementation and post-mortem implications.

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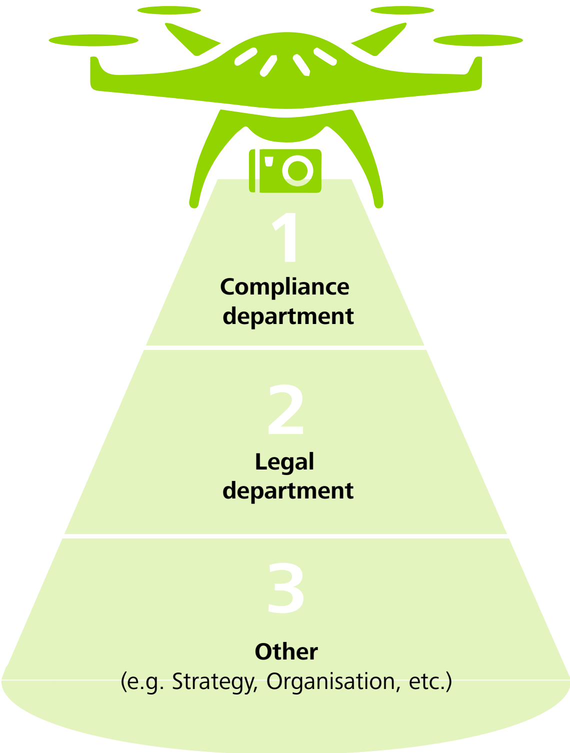
Deloitte survey

In light of the regulatory burden that has fallen upon financial institutions, Deloitte decided to conduct a survey on the organization of the regulatory watch function. The survey aimed primarily to better understand how financial institutions collect, examine, and manage information on current regulatory developments, and how it is embedded in their organizations.



1. General overview of the survey respondents

The survey covers financial institutions, particularly those active in the pan-European market. The majority of the respondents are institutions whose primary business is in private banking, investment banking, or universal banking. The remaining participants are actors operating in the investment fund industry (e.g., custodians, management companies, and fund administrators).

With regard to their geographical footprint, half of the survey respondents are local Luxembourg institutions with limited foreign implementations. However, a quarter of respondents are global institutions with six or more branches or subsidiaries abroad.

2. Ownership of the function

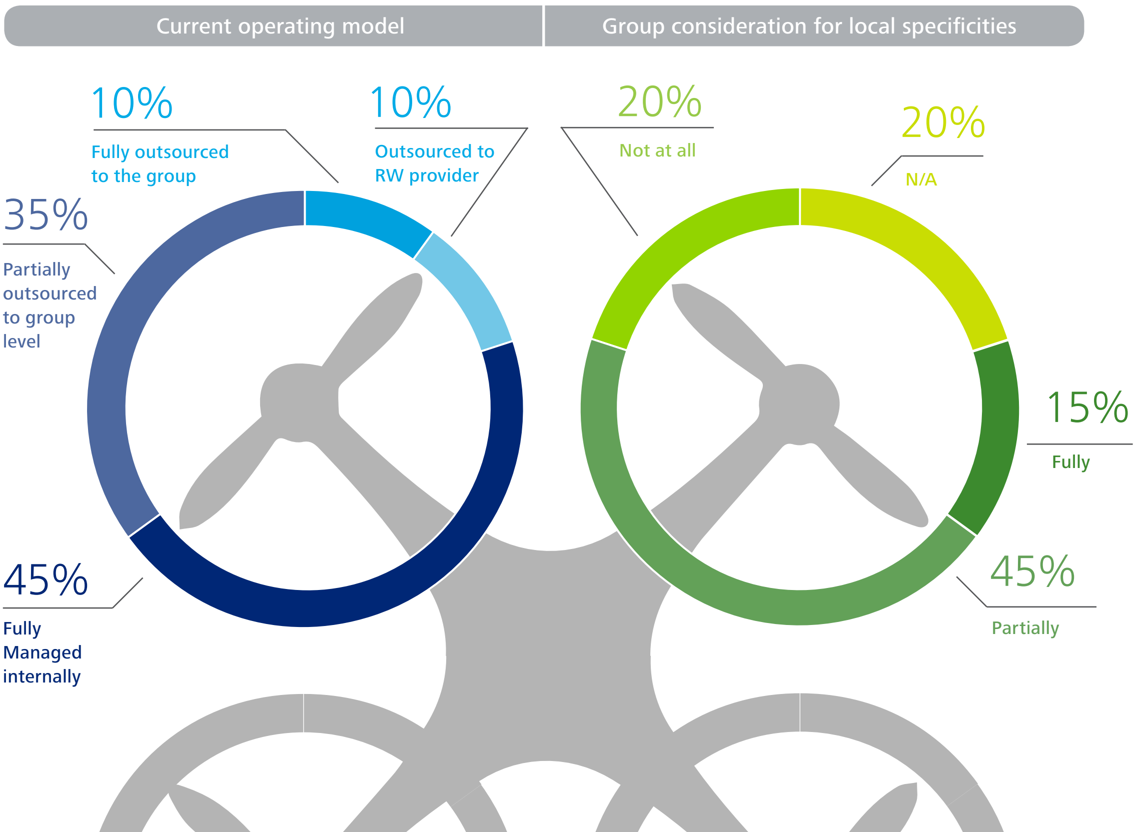
Results of the survey show that the regulatory watch function is generally a duty of the Compliance Department, and in some cases part of the Legal Department. Nonetheless, a minority of respondents are conducting this function within other specific departments such as organization or strategy.

Moreover, the way that organizations view the function largely varies across institutions. 40 percent of the survey respondents view regulatory watch and monitoring as a silo-driven activity (e.g., a sub-part of the Compliance or Legal Department), while 35 percent of the survey respondents consider it a combined function embedded in the compliance and business function. Only a minority of institutions adopt a holistic approach where the regulatory watch and monitoring blends legal, compliance, strategy, business, and operational aspects into one.

3. Set up of the regulatory watch function

For most survey respondents, the regulatory source screening function is generally performed internally, either fully or partially at the local level. 45 percent of respondents have indicated that they delegate the function to the group (35 percent partially, 10 percent fully), and only a minority have outsourced the function to an external provider such as a regulatory watch and monitoring provider.

Out of the respondents who have outsourced partially or fully the source screening function to the group level, 45 percent of them have indicated that their local specificities are only taken partially into account by the group. One in five even state that the group does not take into account their local specificities at all. This reflects how difficult it is for any group to follow the regulatory status in each country where it operates.



4. **Identification of the sources for screening**

The results of the survey highlight the fact that most institutions only follow a limited number of sources, generally less than 10.

Group entities or companies with international practices are nonetheless required to follow additional sources to cover the entire scope of their activities. The vast majority of survey respondents follow a combination of sources and information channels. Newsletters and alerts prepared by the competent authorities or industry associations are the most common information institutions to which they subscribe. Information provided by law and consulting firms is also used by many. The survey suggests that respondents generally prefer to follow information already selected and pre-analyzed by experts rather than raw data from official websites.

95%	Newsletters/alerts from official website
90%	Newsletters from industry associations
83%	Newsletters from law and consulting firms
70%	Manual scrutiny directly on official websites
35%	Conferences and external trainings

5. **Number of resources required**

The conduct of the regulatory watch function may require a significant number of resources as many respondents employ one to two full time employee(s) (FTE) solely as regulatory watchers. However, this figure must be analyzed with the size of the institution in perspective. For examples, larger institutions with 200+ employees—representing 46 percent of the survey respondents—can more easily afford to allocate one to two FTE as watchers, compared to smaller institutions with less than 50 staff members. In fact, the results of the survey reveal that duties of the regulatory watch are also commonly delegated to part-time employees.

Figures among respondents vary with the number of sources being watched, but the majority of the survey respondents indicate that on average one FTE could manage up to 10 different sources.

Firms that may lack the capacity to monitor more than 10 regulatory sources may be missing out on critical information. Let's not forget that local regulatory specificities can be make-or-break.

6. **Automation and frequency**

The results of the survey highlight the fact that most institutions perform the regulatory screening manually, and some respondents have outsourced this process to providers that have automated the regulatory screening with the support of a web-based tool.

With regard to the frequency of the watch function, the majority of the respondents are performing their regulatory watch on a weekly basis. This is in contrast to a quarter of the respondents who are performing their screening on a monthly basis and only a minority who perform it daily.

7. **Reporting of regulatory updates**
Only 20 percent of the survey respondents use a central repository as a tool for storing and sharing regulatory updates. In that context, most institutions use emails or arrange meetings to discuss regulatory changes. A combination of traditional communication channels are used by almost half of the survey respondents.

8. **External service providers**
In a resource-constrained environment, where it is difficult to deprioritize any compliance-related task, freeing up time by using a regulatory watch service provider can be invaluable.

In that sense, 75 percent of the survey respondents consider regulatory watch services valuable, while the remaining respondents would consider it depending on the scope and bespoke service. Moreover, the majority of the respondents have also expressed their interest in a tax watch and monitoring service, often to complement the regulatory watch function.

In fact, the increase in proactivity toward addressing negative regulatory changes is seen by many as the most important aspect of a regulatory watch and monitoring service.

Conclusion

A combined approach of compliance, regulatory watch, and business functions is essential to fully grasp the implications of upcoming regulations, mitigate risks, and prevent what might otherwise be huge compliance challenges.

When looking at the market, the survey has highlighted that only a minority of businesses currently employ a holistic approach to regulatory watch. However, the survey respondents have recognized its importance and are now considering a similar approach. In that regard, regulatory services providers can certainly provide valuable support to institutions overwhelmed with regulatory changes.

Only time will tell which institutions have successfully managed that transition and have turned regulations into competitive advantages.

To the point

- We have witnessed an unprecedented regulatory weight on financial institutions that have tried their best to cope with regulatory updates
- A flexible, efficient, holistic, and proactive approach to regulation can make changes more manageable. But one should keep in mind that one size does not fit all
- Deloitte’s survey reveals that most firms perform the source screening manually and do not use any tool or support from external parties
- The use of a global repository to share and store regulatory updates and analysis offers some great advantages
- Regulatory watch service providers can be invaluable for freeing up time and resources, allowing organisations to refocus on core compliance issues