RT Forum

The RegTech Forum presents:

RegTech for the Buy-side: Increased Regulation, Greater Opportunity

September 2017 – **London**

Contributions from:

liquidnet | CAPITAL GROUP | CORLYTICS

EZE SOFTWARE | OTAS TECHNOLOGIES A LIQUIDNET COMPANY | Solgari

Welcome to the RegTech Forum

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Welcome to the RegTech Forum, a vibrant community of regulators, regulated firms and their technology and service providers. Facilitating discussion, collaboration and insight on the challenges and opportunities within RegTech – and ultimately a marketplace to do business.

Building on the success of our Spring/Summer series, which ran from January to June, we are pleased to launch our Autumn/Winter programme. Through the remainder of 2017 and into 2018 we are planning an exciting programme informed by our community. Future RegTech Forum events will be held in London, Dublin, Frankfurt and Zurich – look out further details on these sessions, digital webinars and complementary publications in the coming weeks.

Our most recent event on September 12th explored the consequences, challenges and opportunities regulation and RegTech offer the Buy-side. Hosted in association with Liquidnet, ***RegTech 2020: A Practical Vision for the Buy-side*** saw a panel of experts laying out a practical vision for Buy-side participants and how technology can generate alpha across their portfolios – further insight and detail from that event is provided in the pages below.

The RegTech Forum, its events and community are part of **RegTech Markets** – a business now well-established as a leading brand in RegTech.

On the 1st of September we closed applications for our **RegTech Directory** – the first curated and researched compilation of service providers, structured by business category. Over-subscribed at every level, our panel of 30 expert judges are now reviewing the companies that submitted to the **Spotlight Awards**. The Directory and Awards will be announced on November 6th, in partnership with ING.

The momentum and traction the RegTech Forum – and RegTech Markets – has gathered would not have been possible without the support of our contributors, sponsors and attendees – thank you. We look forward to welcoming you to our next event.

Executive Summary

Vincent Kelly

Head of Editorial
RegTech Markets

Much of the analysis, thought leadership and opinion circulating around the financial markets relating to RegTech has been one-sided, focusing on the potential challenges and opportunities for Banks and Brokers on the Sell-side. However, these institutions are far outnumbered by the many Hedge Funds, Asset Managers and other participants that are known collectively as the Buy-side.

With global regulators increasingly demanding that Buy-side firms take responsibility for their own compliance, and with the deadline for MiFID II fast approaching, the RegTech Forum was pleased to host an evening dedicated to this pressing issue on September 12th, at Europe's most creative workspace, Second Home.

Working in association with Liquidnet, the global institutional trading network, we curated a panel of acknowledged experts from across the financial services community to share their views on the consequences, challenges and opportunities that regulations and RegTech provide to Buy-side firms. Many thanks to Rebecca Healey of Liquidnet, Simon Steward from The Capital Group, Tom Doris of OTAS Technologies, Eze Software's David Quinlan, John Colgan from Solgari and John Byrne of Corlytics – for sharing their insights at the event, and their contributions to this complementary white paper.

The contributors above have shared their thoughts on a range of topics pertaining to the impact of regulation on the Buy-side, which we present below in the 'Panel Insights' section. The opinions and analysis are fascinating – from the admission that Buy-side firms have historically been 'under-fined' and how that is likely to change, to recommendations on 'best practice' for firms seeking to engage and assess technology solutions.

All-in-all, this white paper is intended to provide a useful, relevant and 'practical' insight into how Buy-side firms can best leverage RegTech solutions to comply with a regulatory burden, the extent of which they may not have experienced before.

I look forward to discussing these ideas with you at our next event.

Liquidnet: Liquidnet is the global institutional trading network where more than 870 of the world's top asset managers and other like-minded investors come to execute their large trades with maximum anonymity and minimum market impact.

Capital Group: Capital Group is one of the most experienced investment management companies in the world.

Corlytics: Corlytics is the world leader in regulatory risk intelligence, delivering world class regulatory risk data and analytics.

Eze Software: Eze Software Group is a premier provider of global investment technology to support the front, middle and back office.

OTAS Technologies: OTAS Technologies - a Liquidnet company - provides pre-trade and intraday analysis and alerts on over 15,000 stocks worldwide for global trading institutions.

Solgari: Solgari provides integrated compliant & Omni-channel cloud communication services –voice, video, chat & SMS – to FinTech & Financial Services customers in 32 countries to date through a cloud software solution.

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Liquidnet Keynote

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The Buy-side's Regulatory Responsibility

Traditionally, technology trends in financial markets have been driven by 'bulge bracket' Sell-side institutions. Today, however, the Buy-side have begun to bring that activity, and their responsibility to comply with regulations, back in-house. Buy-side firms look to their Sell-side counterparties to source liquidity and differentiating trading technology. Certain regulatory requirements, such as Best Execution, have progressed beyond a 'check historically' paradigm. Firms now need to be analysing their execution data almost at the point of trade to go beyond static Transaction Cost Analysis (TCA) to a more holistic Best Execution Analysis (BXA) - – something that Banks today may not be able to offer.

RegTech Generating Alpha

This is partly dictated by MiFID II: its scale; the resource required to interpret requirements, then plan and execute suitable solutions; its global reach. Cost constraints and budgetary planning are another major factor: **recent analysis by IHS Markit & Expand** estimates that MiFID II preparations will "cost firms a total of $2.1bn in 2017" – a staggering number that must be made back as revenue growth.

This is crucial for RegTech and the Buy-side. 'Ticking the compliance box' is not enough – they want to gain actionable intelligence from their solutions, intelligence that can improve trading outcomes and add alpha to portfolios. Solutions that optimise routing logic are a good example of technology generating data for analysis, helping traders make better, more profitable decisions.

Firms want intelligence from their solutions, ***that can improve trading outcomes and add alpha to portfolios***

Working in Partnership

Given the varying size, expertise and capabilities of different Buy-side participants, some larger firms may continue to build in-house solutions – however investing in RegTech solutions will be key for smaller Asset Managers, at a minimum as a way of keeping up with regulatory and technology change. The common requirements and scrutiny facing the Buy-side is encouraging participants to share certain information and form 'consortia'. By identifying common needs, these groups can work in partnership with RegTech vendors to tailor off-the-shelf solutions to their collective requirements.

This can also help Buy-side firms select areas where external collaboration can help, and where solutions should remain in-house. An Asset Manager with a custom Order Management System (OMS), for example, is unlikely to invest in third-party additions to that technology. However, a flexible third-party Best Execution solution could integrate into that system, to contribute to the operational alpha mentioned above.

Growing in Step

Ultimately, the best relationships between RegTech innovators and the Buy-side are likely to be forged over time. Technology providers who can solve a specific pain-point, in a way that can scale across a global organisation, are more likely to progress beyond Procurement scrutiny into on-boarding, and can then grow their understanding of clients' technology estates and business processes – eventually building additional solutions and expanding their deployment across the enterprise.

Making Prudent RegTech Investment

From a resource and cost perspective, smaller firms will need to be selective, and make the right choices. Ultimately, the Buy-side firms that succeed will be those that are willing – and able – to go above and beyond what regulators want. To follow the spirit, not just the letter, of the regulations – and view regulatory change as an opportunity, not a burden.

Panel Insights

Contributors

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Unbundling research and trade execution is key in MiFID II*, requiring a review of brokers, venues, execution & data/ technology use*

We asked each of our contributors to share their thoughts on the key challenges and opportunities facing the Buy-side today. These perspectives are presented below, laying out a practical vision for the Buy-side.

The Impact of Regulatory Change

Rebecca Healey, Head of Market Structure & Strategy EMEA at Liquidnet, characterised the amount of regulatory change about to impact the Buy-side as a "tsunami". In order to navigate this change effectively, she urged firms to spend time understanding the underlying intent of each new piece of regulation. "The regulators' ultimate goal is restoring trust in European capital markets, and increasing transparency and efficiency to strengthen investor protection and confidence in the wake of the financial crisis."

Rebecca went on to say, "Unbundling the payment for research from trade execution is another of the key changes. There can be no correlation between the transaction volumes executed by a broker on behalf of a portfolio manager, and any 'discount' applied to the research material offered to the same portfolio manager. This 'segregation' requires a fundamental re-think of which brokers to engage with, where to trade, what the approach should be for execution methods, and what the optimal use of data and technology should be across asset classes."

John Byrne, Corlytics CEO, agreed that regulatory increase will impact Buy-side firms, pointing to the large financial penalties their Sell-side counterparties have encountered in the past. "It is quite clear that Asset Managers are significantly under-fined compared to other institutions – coupled with the Senior Management Regime in the UK and similar programmes in other jurisdictions, we expect to see an increased focus on the responsible individuals within Buy-side firms."

For David Quinlan, Executive Managing Director at Eze Software, the incoming regulations will only add to the existing pressure many Buy-side firms are experiencing. "Firms are spending more time than ever keeping up with regulatory compliance – at a time when fee pressures have already been eating into many funds' bottom lines. Asset Managers need effective, easy-to-use, reliable technology to help them take care of the day-to-day data gathering, processing, reconciliation and regulatory reporting, in order to make sure they're meeting regulatory requirements without adversely impacting their business."

Digging deeper into some of the operational impact of the new regulations, John Colgan, CEO of Solgari, used communications compliance as an example. "MiFID II instructs the Buy-side to record all customer communications, where a trade is being discussed or transacted, for at least 7 years. This includes all digital communications as well as SMS and chat. Buy-side firms must be able to retrieve the recordings within 72 hours – making them data controllers under GDPR and exposing them to fines of up to £4m or 10% of revenues for serious data breaches. This is a whole new world for the buy side."

However, Tom Doris, CEO at OTAS Technologies, made reference to the opportunity of regulation-driven data discipline. "Buy-side organisations need to have better data sets in order to be MiFID II-compliant. Everyone is now doing this hard work for compliance reasons, but actually at the end of that they're going to have a data-set that can become a tremendously valuable asset."

Panel Insights

Changing Relationships Across the Market

One of the key characteristics of MiFID II is that Buy-side firms now have a proactive role to play in their own compliance – delegating responsibility to their Sell-side brokers and Venues is no longer possible.

As John Byrne explained, "An onus on the understanding of regulatory risk through data-driven approaches, rather than expert opinions, is beginning to drive regulatory intent. The Buy-side will need to become not just compliant, but also to more accurately understand their regulatory exposures with respect to the instruments in which they invest."

David Quinlan agreed, saying that "there is a reconciliation requirement for reports being submitted on your behalf. The reconciliation is often as costly as doing the reporting directly, so managers have started to look at bringing it back in house. Meanwhile, the Buy-side is being pressured by their end investors to account for the fund's expenses and how that might impact fees. This means buy-side firms are spending more time than ever on reporting."

In some regards, however, Buy-side and Sell-side firms will become even more closely linked through the data they hold on each other. As John Colgan said, "Buy-side firms will now be holding sensitive data on their counterparties." While he went on to acknowledge that this "opens up significant data protection reputational risk if not handled correctly", David Quinlan pointed to the fact that possibilities of bringing the markets closer together are being opened up. "There are more opportunities than ever for firms to collaborate. Instead of silos, we are seeing a dynamic ecosystem where everyone plays a crucial role."

Platforms that track rules and reporting requirements – to automatically populate recurring reports whilst optimising trading revenues – ***are a key opportunity for RegTech firms***

The Role of RegTech

With the Buy-side facing increasing scrutiny and pressure from their end investors and margins being squeezed across the market, many firms focussing on their core strengths to generate alpha. Technology therefore has a large role to play in enabling these firms with the functionalities they require to comply. As Tom Doris put it, "One of the great things about the new regulations is that they are explicit. They're talking about specific limits, caps and quantities – observable metrics and data points. Therefore, vendors are well positioned to automate compliance and oversight, allowing traders to focus on what they're good at: trading in interesting market conditions."

Buy-side firms will hold sensitive data on their counterparties – *opening up data protection reputational risk if not handled correctly*

John Byrne agreed, discussing technology's potential for helping firms understand their regulatory risk exposure – and generate profits for their end investors. "Technology that provides an evidence-based approach to understanding regulatory risk provides the buy-side with this important insight, and can also be used as a metric when it comes to making investments on behalf of their clients."

David Quinlan explored the possibilities of a true 'front to back' platform. "A recent AIMA survey found that some 90% of hedge funds spend as much as 20% of their management company dollars on compliance and regulatory reporting. For Rebecca Healey, the opportunity lies in the data that regulations like MiFID II will force Buy-side firms to hold, normalise and examine. "With MiFID II forcing a greater level of transparency and reporting of data, it is hugely important to have the right technologies in place to analyse and visualize that data. Elements of machine learning and artificial intelligence (AI) can sort through this Big Data, and present meaningful information and alerts in plain English that the traders can then act upon."

Panel Insights

A platform that keeps track of rules and reporting requirements can automatically populate recurring reports. The right technology platform can also optimise front-to-middle-to-back office functions, to improve pre-trade compliance and protect from potential violations. All of this could save asset managers weeks of time."

From Rebecca Healey's perspective, technology also has the potential to demonstrate compliance both to regulators and end investors – particularly around Best Execution. "From 3rd January 2018 under MiFID II, Buy-side firms in Europe will have to take 'all sufficient steps' in obtaining Best Execution for clients. While many firms have ad hoc policies in place, these often lack sufficient detail across asset classes or have inadequate governance around implementation and monitoring. They will need technology providers to help them meet this challenge, and ensure that Best Execution Analysis (BXA) is being delivered systematically."

***MiFID II requires firms take 'all sufficient steps' in obtaining Best Execution** – they will need technology providers to help them and deliver Best Execution Analysis (BXA)*

Defining Best Practice for Assessing Potential RegTech Partners

So technology can clearly provide a route to compliance for Buy-side firms – but with so many potential solutions and innovative firms out in the RegTech market, how do Buy-side firms sort the wheat from the chaff and identify the best solution for their specific needs?

For Rebecca Healey, dialogue between Asset Managers and technology providers is critical. "We continually engage with our Buy-side members on our technology roadmap, to ensure that we are not creating solutions 'in a vacuum'. In May 2017, we acquired OTAS Technologies and they had a similar culture of close engagement and iterative development with their existing community – and the success that they have had in building out their pre-trade and in-trade analytics has shown that this is the best approach."

Many of our panel were in agreement that Buy-side scrutiny should extend beyond the technology solution, and into the RegTech provider itself. As John Byrne put it, "the RegTech market is busy, and many firms will fail due to lack of adoption, failed business models etc. – so it is important to assess a firm's viability both from a financial perspective and the management team's track record of achievements."

John Colgan went on to suggest that RegTech firms' data protocols should also bear scrutiny. "A review of the technology provider's data and communication ptorotols, and all related certification around PCI DSS, ISO and SOC II is important. The Buy-side firm needs to be clear on where their data is stored and the impact under regulations such as GDPR and US Patriot Act – particularly as Omni-channel increases the complexity of gaining an integrated view of all client interactions. This is vital as an increasing number of transactions are being completed and modified through these channels."

*It is important to assess RegTech firms from both a financial perspective, **and by the track record of the management team***

Finally, and with Buy-side firms likely to focus on core competencies due to investor scrutiny and revenue pressures, it will be important to select a solution provider that will act as a true strategic partner to the business. "What's needed is a scalable platform that can service different parts of the investment manager's business, powered by consolidated, standardised data streams. It should be able to keep up with regulations, and be able to consolidate, reconcile, and standardise data flowing from various parts of the firm – then feed that information into multiple reports across jurisdictions and reporting mechanisms, through an easy and repeatable process. The platform must be able to impact the very way firms function by bringing together regulatory compliance, execution and reporting into a single, streamlined cycle. The provider should act as an extension of your operations staff."

The Potential of RegTech Solutions Beyond Compliance

With our panel in broad agreement that RegTech solutions should be as broad and functionally-rich as possible, what opportunities do these solutions and the underlying regulations open up across the business – extending beyond the compliance and risk management functions?

For Rebecca Healey, the opportunity lies in the data that regulations like MiFID II will force Buy-side firms to hold, normalise and examine. "With MiFID II forcing a greater level of transparency and reporting, it is hugely important to have the right technologies in place to analyse and visualise that data. Machine learning and artificial intelligence (AI) can sort through this Big Data, and present meaningful information and alerts in plain English that the traders can then act upon."

***Technology should be built for generating alpha and business growth,** with regulatory compliance being a big part of that evolution*

John Byrne agreed that putting compliance / regulatory data in the hands of other teams across the business opened up new opportunities – and that could lead to 'cross-pollenisation' of expertise across functions. "The compliance teams need a view of regulatory risk, and the Op Risk team need to provision for regulatory risk. However, other departments such as the legal teams and the regulatory affairs teams can also gain use from this intelligence to help inform their day-to-day activities."

For David Quinlan, solutions that can scale across the business are a key route towards better business outcomes for Buy-side firms. "Technology should be built for business growth, with regulatory compliance being a big part of that evolution. That means a platform that can optimise operations across the entire investment workflow, from modeling to pre-trade transaction cost analysis, to compliance checks, to execution, reconciliation and reporting. The aim of such a platform is to make the entire business function more efficiently, with fewer breakdowns in communication, fewer repetitive tasks, fewer siloes and fewer chances for mistakes."

A Practical Vision: What Will 2020 Look Like for the Buy-side?

Looking to the future, by 2020 the markets will have evolved – post-MiFID II and post-Brexit. So what did our panel think life would be like for the Buy-side in this brave new world? For Rebecca Healey, data and the use of new technologies will be central. "AI is already being adopted in various forms across the industry, so I imagine it will become commonplace. What is clear is that technology solutions that can analyse and distil meaning from ever-growing amounts of data will be crucial to anyone navigating the markets."

Tom Doris agreed. "There have been many AI break-throughs recently, so naturally people are interested – and also a bit concerned – about the 'threat' of automation. Traders bring uniquely human insights to the table. AI is simply a continuation of an existing trend: traders need better technology to do their job well, making better decisions quickly and accurately."

For John Colgan, firms that fail to stay competitive will likely fall behind. "Seismic market changes caused by regulations will open up ideas for 'smart' firms, and challenge those without proper planning. Asset Managers will likely be using the best technology, making them more efficient and flexible than other participants, who will likely use costly legacy technology to meet compliance needs. This suggests opportunities for Buy-side firms, particularly in Big Data analysis and integrated analysis of all Omni-channel client communication interactions."

In David Quinlan's view, operational efficiency will be key. "Operations will be far more streamlined and centralised – playing a significant role in how profitable firms are. Operational alpha opportunities will grow due to the need for greater regulatory management requirements. Now is a good time for Buy-side firms to examine their operations and consider technological solutions to their pain points."

John Byrne warned that there will likely be a whole new set of challenges facing the financial services industry in 2020. "New regulatory initiatives and political machinations will continue to evolve and, post-2020 with MiFID II and Brexit in the rear-view mirror, what's certain is that these concerns will continue to exercise the minds of the Buy-side with respect to regulatory risk. Indeed, many Buy-side firms will still be concerned with some of the MiFID II themes, both to protect themselves and also from a portfolio exposure perspective. Assessing regulatory risk is coming to the fore and, from a buy-side perspective, will emerge as a key metric – like market risk and credit risk."

***Post-2020 with MiFID II and Brexit in the rear-view mirror**, new regulatory concerns will exercise the minds of the Buy-side*

Panel Insights

In summary, the seven key insights to take away on RegTech 2020: A Practical Vision for the Buyside

1. Unbundling research and trade execution is key in MiFID II, requiring a review of brokers, venues, execution & data/ technology use
2. Buy-side firms will hold sensitive data on their counterparties – opening up data protection reputational risk if not handled correctly
3. Platforms that track rules and reporting requirements – to automatically populate recurring reports whilst optimising trading revenues – are a key opportunity for RegTech firms
4. MiFID II requires firms to take 'all sufficient steps' in obtaining Best Execution for clients – they will need technology providers to help them and deliver Best Execution Analysis (BXA) systematically
5. It is important to assess RegTech firms from both a financial perspective and by the track record of the management team
6. Technology should be built for generating alpha and business growth, with regulatory compliance being a big part of that evolution
7. Post-2020 with MiFID II and Brexit in the rear-view mirror, new regulatory concerns will exercise the minds of the Buy-side

The RegTech Forum events and community will continue to grow, mature and build meaningful connections between innovators, entrepreneurs and venture capitalists in the space. To attend or to contribute towards the next event, please register your interest at www.regtechforum.co