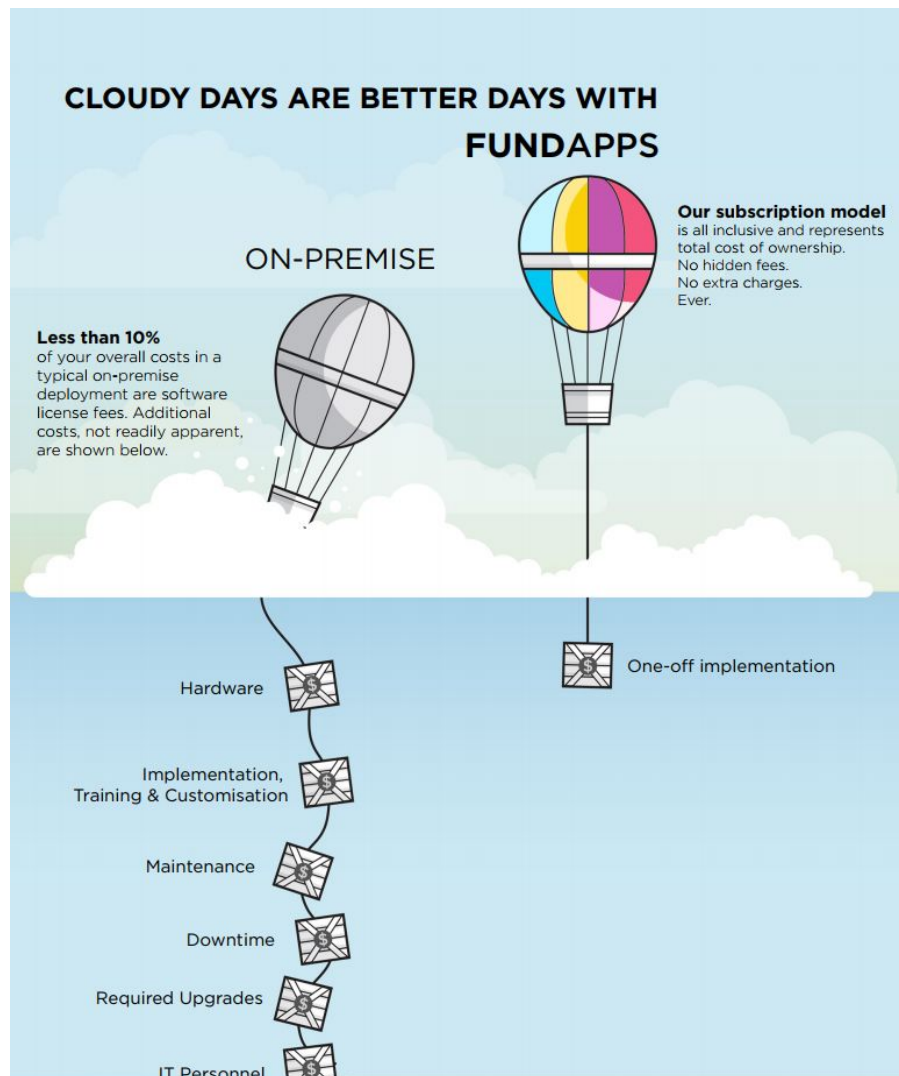


Regulation & The Cloud - A match made in heaven?

The word “Regulation” hangs over the financial sector like the sword of Damocles and is a constant subject for debate within the media. The velocity of change within regulation is ever increasing. When asked what their biggest fear is, over 50% of financial companies respond with “regulatory compliance”¹ or rather, the cost of implementation thereof. Likewise the ephemeral “Cloud” is a red-hot topic in the glacially slow financial services space. Most institutions are still analysing what to do with it and are working out how best to jump on the bandwagon before it’s too late.

These two topics, which at first glance seem to have absolutely nothing in common, are actually a perfect pairing. The Cloud will prove to be a huge cost-reducer, the ultimate enabler for timely, consistent and correct implementation of regulation and the perfect means for providing transparency to investors and regulators alike.

For years, regulation was taboo within financial services and little attention was paid to it. Deregulation was the name of the game - any attempt to rein in the market was seen as big government invasiveness. But slowly, legislators had their way and regulation became prevalent following Lehman. Take mutual fund regulation for example - in the EU the first piece of major legislation was the so called UCITS Directive. It was first conceived in 1985 but by 2001, a 3rd version (imaginatively titled UCITS III), was already required to maintain pace with the industry. By 2009, UCITS IV had reared its ugly head. Fast



¹ <http://cooconnect.com/news/regulatory-compliance-costs-biggest-challenge-boutiques-says-sungardtabb-group-study>

forward to 2014, and managers are faced with the two-fer of UCITS V and VI lined up ready to go. Each wave of regulation brings more complexity and a demand for detail but the implementation period becomes ever shorter. Companies breathe a sigh of relief as one piece of legislation is implemented only to find the next raft of changes looming.

The situation in mutual funds is mirrored in the alternatives industry with the introduction of the AIFM Directive in July 2013. AIFMD fundamentally rewrote how hedge funds et al were able to conduct business within the EU. Across the board, regulation is being introduced and updated on a near constant basis - in fact most regulation names now read like football scores: SSR I - MIFID II, Basel III - CRD IV.

Whereas generally regarded as an odious overhead by managers, the driver behind most regulation - increased investor protection and enhanced transparency - should be welcome. For example UCITS has a remit to protect mutual fund investors and create a level playing field within the EU. Institutions talk about the burden and cost of regulation and how difficult it is to implement, but not about how it makes their business more transparent and investor friendly. Perhaps, the key to understanding why these institutions react so negatively is down to how they have historically managed technology projects.

In the 70s, practically no ready-made software was available. Banks had no other choice but to write proprietary applications to solve business problems. In the process they built up massive IT departments and the Head of IT became one of the most influential people in the business.

During the 90s, off-the-shelf software emerged, solving many standard problems such as accounting, order management, reporting etc. Generally, vendors released new versions of their software packages only yearly and this was by and large OK in a slow moving industry. As the years progressed, it soon became clear that this "old model" of annual releases was no longer adequate.

On the one hand, these upgrades were incredibly prone to failure due to the large number of changes in them. Indeed, the 2012 RBS outage was attributed solely to a software upgrade. Banks feared upgrades like the plague and often put them off multiple times until finally the vendors threatened withdrawal of support. All this complexity entailed cost and software upgrades often exceeded budget by millions. This was made more absurd by the fact that often financial institutions gained little benefit from each new release.

On the other hand, the post-Lehman regulatory tsunami caused vendors innumerable problems. Many of the OMS & accounting software packages had developed rudimentary compliance functionality over the years. Post-2008, this functionality was

no longer fit for purpose nor could it be improved overnight due to the vendor lacking expertise or prioritising other areas. Even when vendors managed to build the required functionality, the banks were not in a position to roll out new versions of the software in time to meet regulatory deadlines. The banks that hadn't bought off-the-shelf software were in an even worse position as they now needed to upskill internal staff and modify their prehistoric systems.

Meanwhile, technology was evolving rapidly and internet based services such as Gmail, Salesforce etc. were gaining popularity and moving people away from their desktops. This nascent technology was just the impetus required to move the financial service industry away from the bad old days of installed software and the legions of IT staff and consultants necessary to maintain the status quo.

In the brave new world, a bank can simply subscribe to a cloud service which provides best-of-breed functionality with zero IT footprint. In the case of a compliance service, this means that not only the software but also the regulation monitoring algorithms will be maintained by the vendor. Changes (whether functional or content) can be implemented and rolled out in a matter of days rather than years. Multiple institutions using the same service ensures everyone is singing from the same hymn sheet. Banks creating bespoke solutions and producing inaccurate results will be a thing of the past. Combine this massive improvement in quality & speed of service with the cost reducing nature of the cloud and you have a winning combination.

Only those institutions which concentrate on their core competencies and move any activities with no tangible strategic advantage to the cloud will flourish in the coming decade. Cloud compliance does indeed have a silver lining.