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CP Insights

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Is the Age Of Robo-Compliance-Advisors Arriving?

A Discussion on the concept of using robo-advisors in the area of compliance.

Background

Since the financial crisis, the crackdown by regulators has led to more than USD 150 billion in litigation and charges. Financial institutions have incurred increasing costs to comply with stringent regulations. Accenture estimated in 2016 that the cost of compliance has risen 50% in the past three years as new rules and regulations continually come into effect around the world. As Citigroup estimated in 2017, the largest banks across the globe, including JPMorgan and HSBC, have doubled the number of employees to handle compliance and regulation functions.

Firms, especially financial institutions, start to make use of technology to deal with regulations in order to lower their costs and further boost their bottom-line. Regulation is one of a number of services to receive the "Tech" treatment in recent times. Richard Lumb, Head of Financial Services at Accenture, recently predicted that thousands of roles in the banks' internal policing branches could be replaced by automated systems such as robot compliance advisor or robotic process automation or regulatory technology ("regtech"), all of which apply artificial intelligence ("AI") to compliance areas like anti-money laundering ("AML"). In fact, Credit Suisse AG has recently deployed 20 robots to help answering simple and basic compliance questions, which can potentially reduce the incoming call of compliance department by 50%. This year, HSBC also started to partner with AI startup to automate and streamline its AML investigating and reporting processes. This trend is expected to continue in the future.

Necessity to have Robo-Compliance-Advisors?

In the post-subprime mortgage crisis era, regulators around the world tightened the grip on credit controls. Along with the rise of extreme terrorism, more regulations have been imposed and enforced to prevent the financial sector from serving the wrong-doers. To be exact, the global regulatory activity level has increased by more than two-fold from 2011 to 2013, indicating the determination of the global financial regulators on strengthening compliance control. Different international committees and organizations such as the Basel Committee on Banking Supervision are still reviewing the existing banking framework in an attempt to forestall potential financial disaster. It is anticipated that the market would undergo a significant reform and financial institutions would have to adapt to the new regime by all means.

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Given that the regulatory environment is projected to be rather volatile in the near future, financial institutions should be prepared for the unexpected policies and have in place robust plans for non-ordinary scenarios so as to maintain their stability and ensure efficiency. Developing a Robo-Compliance-Advisor might not be the ultimate solution but would definitely be salutary in dealing with the challenging regulatory environment.

Advantages of using AI-based systems in compliance

1. Improve accuracy

Most of the financial institutions today use rules-based transaction monitoring by employees and KYC systems to fight against money laundering. Such traditional method tends to produce a high rate of false positives where customers are falsely deemed to be laundering money by the system. With the use of AI-based systems, such problem can be well addressed. AI-based systems make use of the sophisticated algorithms and hence produce fewer false positives when compared to the conventional rule-based transaction monitoring approach.

2. Improve speed and cost effectiveness

The costs of compliance in recent years have risen sharply. The use of technology in regulatory compliance helps boost operational efficiencies and increase cost effectiveness. The use of automated process in compliance helps streamline the routine compliance monitoring through robotic mapping of regulatory and compliance risks to major business processes. Also, complex and intertwined data can be decoupled and organised through Extract-Transform-Load ("ETL") technologies. Data results and reports can be configured and generated in a shorter timeframe as well. All these will reduce the need of manual checking and the workload of compliance officer, which in turn drive down the costs of compliance. The capital saved can then be used for other income-generating purposes.

Limitations of AI-based systems in compliance

1. Competence and Personal Liability

Across the globe, governments have been implementing policies and laws to ensure that financial institutions are duly performing their compliance and reporting duties to help prevent and combat money laundering and terrorist financing activities. Personal liability has been imposed on Compliance Officers and Money Laundering Reporting Officers ("MLROs") for their negligence and failure to implement proper AML controls and reporting procedures. For example, UK MLROs can face a two-year imprisonment if the firm is found negligent in its AML procedures. As such, MLROs, on top of the current requirement for their legal, regulatory and financial knowledge, will need IT and programming knowledge to fulfill their responsibilities in ensuring that the firm has duly fulfilled its reporting duties via AI-based systems in compliance. This would create great difficulty to financial institutions in search of competent and suitable candidates in the market to take up the position.

2. Limited judgement

Algorithm has gradually become very efficient in processing basic and routine tasks. However, it still has many limitations when handling complex decision-making tasks. The outcome can only be as good as the input provided to them, i.e. "Garbage in, Garbage out". Therefore, it is important for human beings to get involved in the compliance process to conduct cross check and make essential judgements, especially in unanticipated and multidisciplinary scenarios. Moreover, regulatory compliance is not about numbers alone. In monitoring fraudulent trading activities, the context of activities or behavior is important in assessing the intention of infringement. Data alone is not sufficient to detect behavioral anomalies, relationship discrepancies and misconduct in communication. Furthermore, many regulations are principles-based that it is impossible to turn into rigid computer code. The inherent subjectivity of interpretation means automation is unlikely and human involvement is requisite.

3. Privacy concern

Documents stored in the Compliance Department are often of confidential nature and contain sensitive personal information such as ID, transaction records, disciplinary actions and investigations histories. While different Regtech companies may have their own algorithms and areas of expertise, they all require a database of information, records and scenarios to "learn" and perform. It is inevitable that privacy concerns may be raised when financial institutions share their sensitive clients' personal information with these external service providers. For instance, when Indonesian government opened its country's ID database to financial institutions for their KYC purposes in 2016, privacy concerns were raised by the general public.

<u>Conclusion</u>

The development of robo-advice in compliance is promising in the sense that robo-advisor in compliance can help firms to automate the fundamental compliance tasks and reduce the reporting errors that associate with the compliance obligation. Yet, it is obvious that the use of AI and automation in compliance is not a panacea for all the compliance challenges. Given that the problems aforementioned, companies should be vigilant when adopting robo-compliance. At the current stage, solely relying on robo-compliance is unrealistic and dangerous because of immature technology. Therefore, while technology can eliminate time consuming tasks of data analysis and enhance the productivity of Compliance Analysts, it is no substitute for decision-making abilities of human advisors.

If you have any further questions regarding this issue of CP insights or have any topic you would like us to cover, please submit your response here https://goo.gl/forms/gDLVThTmxGvMl4r12.

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we are trusted advisors helping clients to navigate a challenging and changing regulatory environment.

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