

Leveraging the stick

Can financial institutions harness the regulatory imperative for improved data management in order to bring wider business benefits? **James Thomas** finds out

"Google could do to banking what Apple did to music, or what Amazon did to print"

This was the striking conclusion of a recent article in *American Banker*¹. Those who believe that such a revolution is imminent point to the importance of data management to the future of banking, marking it out as a key battleground in the struggle between new entrants into the banking space and existing players. And it is generally regarded as an area in which the new arrivals have the edge.

There are two main reasons for this. The first is that these new players, typically younger businesses, lack the baggage of their more established counterparts. Moreover, the fact that new entrants are effectively starting with a "clean slate", instead of managing legacy issues, means that more established players cannot simply replicate their formula for data management success. As Jim Muir, Autorek, puts it: "The challenges that some of the legacy financial services businesses have don't map particularly closely to the the successful Amazons and Googles of this world." Instead, established players may have to look elsewhere for answers.

IN BRIEF

- Legacy data issues affecting financial services companies include: fragmented data landscapes, siloed approaches to data management, and an overemphasis on structured data
- Managing unstructured data is becoming ever more important as regulators are seeking prevention rather than reaction
- Aside from compliance, there are wider business benefits to be gained through effective data management.

The second point is that these new entrants are often more *au fait* with data issues than traditional financial services providers. Indeed, their business models may be centred around data and therefore the importance of managing data enjoys buy in from the very top of the organisation. By contrast, financial institutions have generally been slower to view data management as an opportunity rather than simply a cost. According to independent data management consultant, Nicola Askham: "The likes of Google are embracing cloud computing and Big Data, and they are starting from a much better technology platform,

and even a better mindset. They believe that the data is there to be used and mined, whereas the banks may have ignored it as a potential asset in the past."

However, all that might be changing. And regulatory compliance is providing a catalyst for that change.

The legacy

So what has been the traditional approach to data management in the financial sector? Why is it looking increasingly unfit for purpose? And how is compliance driving change?

As many large financial institutions have grown through acquisition, some have been reticent in consolidating their data systems with those of the companies they have acquired. According to Nicola Askham: "The majority of financial institutions have just collected this ever growing complicated systems landscape." This problem is often compounded for institutions operating in multiple jurisdictions, she adds, as companies may be prohibited from storing data in certain jurisdictions, or sharing data between jurisdictions, resulting in the potential for further fragmentation of that landscape.

Another shortcoming of the traditional approach to data in the financial sector has been a tendency to focus upon structured data (such as transactional records), in part due to the greater cost and complexity of managing unstructured data (such as telephone or email conversations). This is a problem, says Freddie McMahon, Anomaly42, not least because around 90% of the data in financial services is unstructured.

Related to this is a tendency, particularly in the retail world, for businesses (and accordingly business data, processes and systems) to be siloed. Freddie McMahon continues: "From a compliance and risk perspective, you are more likely to have exposures between the silos than within the silos. Interactions are the greatest form of >>

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unstructured data. As these tend to be kept within siloed systems, you can't actually have a holistic view of the customer unless you actually join up all those different systems."

So while Bank A may provide, say, credit card and mortgage products to Customer B, it may not have a joined up approach to managing all of its interactions with that customer. Instead, the records of customer interactions may be held separately by the departments dealing with mortgage lending and cards, respectively. Achieving a single view of the customer will therefore be compromised.

A revolution in thinking

Given these shortcomings, the incentives to improve data management are numerous. But amongst these, regulatory requirements stand out as a primary motivating factor. According to Freddie McMahon: "In every single regulatory fine over the last five years there has been evidence that there was something amiss in the unstructured data element, but it just wasn't picked up early enough." Such failings were highlighted through the recent LIBOR and London Whale scandals, in the abundance of evidence uncovered by regulators, drawn from email correspondence, chatrooms, or telephone conversations.

Moreover, current changes in the regulatory landscape mean that managing unstructured data is assuming even greater importance and there are diminishing returns from managing risk using structured data. In the UK, for example, the Financial Conduct Authority's (FCA) focus on "conduct risk" and its promise of a preventative rather than reactive approach to regulation typify this. According to Freddie McMahon: "Many executives in financial services, let alone compliance people, don't realise that you have to join up nearly all of your data, especially unstructured data, to find anomalies in conduct risk. You cannot achieve compliance with the requirement of treating customers fairly (TCF) unless you are analysing huge amounts of unstructured data. In fact I can't think of any financial organisation that currently delivers proper management information for TCF. How can they if they don't include the automated processing of unstructured data to generate management information?"

This shift from managing structured to unstructured data amounts to a revolution in thinking within the sector. But whereas in the past cost and complexity have been factors prohibiting the management of unstructured data, the automation provided by modern systems now provides a means to do so, quickly and effectively, says Mr McMahon.

From sticks to levers

Although regulatory requirements are a primary driver towards improved data management, other business units should also be interested in the benefits it can bring. Compliance may have a role to play in communicating these benefits to the business.

Good data management may result in anything from efficiency gains through business process improvements, to improved customer attraction, interaction and retention through better customer service or product development. "There is a huge amount of anecdotal evidence of the volume of rework that is currently being done as a result of poor data management," says Nicola Askham. "Then there's the customer service side of it, anything from complaints from customers who don't like having their name misspelled through to the recent cases of banks who have sent out information to the wrong people."

What is key, she argues, is "leveraging the regulatory stick": harnessing the regulatory imperative for improved data management in order to yield business-wide benefits.² "We have to accept regulation is going to be the main reason that the financial sector embraces data," she continues, "but the question is: how can you make more of it instead of just doing a tick-box exercise?"

But how many companies within the financial sector are embracing and implementing this more holistic, enterprise-wide approach to data management? The picture is mixed. On the one hand, there is some evidence that regulation is playing a positive role in raising the profile of data issues. Nicola Askham observes that Solvency II has prompted a number of insurers to initiate data warehouse projects, not as a direct requirement of the regulations but because the focus on data brought about by Solvency II has made firms appreciate that they could be making better use of their data.

On the other hand she also points out that many insurers are still not ready for Solvency II or are doing the bare minimum to comply, in a "tick box" fashion, rather than harnessing the broader business opportunities.³ Mr McMahon concurs, suggesting that we need to "rethink data" because traditionally data warehouses involve structured data and are therefore not the solution to align with the FCA's move from reactive to preventative regulation, which requires new types of intangible measures, such as for TCF outcomes that drive revenue growth and product innovation.

Basel III and Dodd-Frank ought to have a similar effect on banks as Solvency II has had in the insurance sector. But again while there have traditionally been some outliers in banking (according to Nicola Askham it is well reported that when RBS absorbs or merges with another company, they merge their systems and make sure to do so quickly), the retail banking sector as a whole is perhaps behind the curve on grasping the data nettle. According to Freddie McMahon wholesale finance, private banking and wealth management are taking more initiative in this area.

Ironically, as much as regulation is providing an incentive for improved data management, it may also serve as an obstacle. As Jim Muir points out: "There is a genuine desire for better data management across the industry, and from that desire there is some momentum. But there are barriers to progress. For example, the regulatory landscape hasn't been terribly clear to many businesses. The definition around some of the regulation, particularly FATCA, has served to confuse. Some of the larger financial services organisations have found it difficult to prioritise initiatives, even though they have become outline legislation."

This tension is evident in the fact that, while many banks are now appointing Chief Data Officers (which they might not have had in the past) the rate of turnover of such positions is also high. As Nicola Askham explains: "The role of the Chief Data Officer is on the rise, but there is still a lack of clarity on what they are supposed to be accountable for."

Drowning in data?

One thing that is clear is that the challenge of managing data is not going to disappear. Indeed, Freddie McMahon suggests that data volumes in the financial sector are growing by 40% per year, and so the probability of something unexpected happening that might create a compliance issue is expanding accordingly. Good data management, then, should remain firmly on the business and compliance agenda for some time to come. ■

1. <http://www.americanbanker.com/bankthink/google-presents-biggest-threat-to-banking-1059295-1.html>
2. see also: http://www.deloitte.com/view/en_GB/uk/services/audit/enterprise-risk-services/ers-in-industries/financial-services/a82567c5033f6310VgnVCM200001b56f00aRCRD.htm
3. <http://www.moodysanalytics.com/2013SolvencyIISurvey>