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4th floor, Ropemaker Place  
25 Ropemaker Street  
London EC2Y 9LY  
United Kingdom

+44 20 7260 2000Phone  
+44 20 7260 2001Fax

[ihsmarkit.com](http://ihsmarkit.com)



Bank for International Settlements,

Centralbahnplatz 2  
4051 Basel  
Switzerland

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## **Sound Practices: Implications of fintech developments for banks and bank supervisors**

Dear Sirs,

IHS Markit welcomes and is pleased to respond to the Basel Committee on Banking Supervision (BCBS) Consultative Document (CD) – *Sound Practices: Implications of fintech developments for banks and bank supervisors*.

IHS Markit (Nasdaq: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide.<sup>1</sup> Our company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to well-informed decisions. We have more than 50,000 key business and government customers, including all G20 governments, 85 percent of the Fortune Global 500 and the world's leading financial institutions. Headquartered in London, IHS Markit is committed to sustainable, profitable growth.

### **Introduction**

We provide data and innovative solutions and services often described as regtech and fintech to most of the world's major banks and financial firms and regulators. Our services often facilitate compliance with regulatory requirements and reduce related costs and risks, lowering barriers to entry and fostering competition in the market place. Our services broadly fall into three categories:

#### **a. Analytics**

We provide a range of data and analytical solutions to the financial sector. For example, we are developing a tool to assist the management of bank capital calculations under the Fundamental Review of the Trading Book (FRTB).<sup>2</sup> The solution aggregates market data provided by its users and from other sources, anonymises it and provides users with powerful tools that enable efficient capital allocation without compromising the effectiveness of the regulation.

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<sup>1</sup>See [www.ihsmarkit.com](http://www.ihsmarkit.com) for more details

<sup>2</sup>[www.markit.com/Product/FRTB-Solution-Suite](http://www.markit.com/Product/FRTB-Solution-Suite).

## **b. Shared solutions**

We are a leading provider of solutions that centralise operational functions and allow users to benefit from mutualised economies of scale and standardisation. This ensures that all users make costs savings compared to building their own system, while the standardisation element mitigates against any 'race to the bottom' on standards. Our suite of shared solutions includes:

- i. The Know Your Customer (KYC) and Know Your Third Party<sup>3</sup> (KY3P) platforms streamline compliance with KYC/AML and critical outsourcing requirements;
- ii. IHS Markit processing platforms<sup>4</sup> provide electronic confirmation, regulatory reporting services and connectivity to clearing houses and trade repositories globally; and
- iii. IHS Markit Outreach 360 platform<sup>5</sup> that offers standardised and auditable outreach for regulatory, due diligence and data gathering purposes.

## **c. Software Solutions**

We also provide a host of scalable software solutions that help firms streamline operations. These serve as a solid foundation for risk management and regulatory compliance and include:

- i. IHS Markit Enterprise Data Management (EDM)<sup>6</sup> allows firms to validate data from different sources, check completeness and manage exceptions to facilitate compliance with various regulatory requirements;
- ii. IHS Markit Digital<sup>7</sup> is a leader in software for interpreting, manipulating and displaying financial information, including being a major provider of robo-guidance systems; and
- iii. IHS Markit thinkFolio<sup>8</sup> is a cross-asset class order and portfolio management system.

Furthermore, we have invested significant resources in innovative techniques such as Deep Learning, Artificial Intelligence (AI) and Distributed Ledger Technology (DLT) solutions. This includes successfully experimenting with DLT applications, particularly in the secondary loans market. IHS Markit supports early stage companies in global capital markets by providing free or low cost data through a number of fintech sandbox and data partnership programs. We are also invested in Illuminate Financial Management's capital markets focused fund.

We believe our broad range of products and our strong relationships, including with major Banks, offers us an important perspective on the fintech debate. In this respect, we broadly welcome BCBS's analysis of fintech and its recommendations. We have outlined our views in more detail in the comments section of this letter, but these our can be summarised as:

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<sup>3</sup> See [www.KYC.com](http://www.KYC.com) and [www.markit.com/product/ky3p](http://www.markit.com/product/ky3p) for more details

<sup>4</sup> See [www.markit.com/product/markitserv](http://www.markit.com/product/markitserv) for more details.

<sup>5</sup> See [www.markit.com/Product/Outreach360](http://www.markit.com/Product/Outreach360) for more details

<sup>6</sup> See [www.markit.com/Product/EDM](http://www.markit.com/Product/EDM) for more details.

<sup>7</sup> See [www.markit.com/Product/Markit-Digital](http://www.markit.com/Product/Markit-Digital) for more details.

<sup>8</sup> See [www.markit.com/Product/ThinkFolio](http://www.markit.com/Product/ThinkFolio) for more details.

1. BCBS should encourage regulators to ensure a thorough analyse of both risks and benefits of innovative services and that they provide as much clarity as possible around when such services can be used. Greater direct engagement with fintech and regtech providers would also help. Furthermore, the BCBS should consider 'shared services' which assist in mutualising of compliance costs and processes as a distinct aspect of regtech;
2. Authorities should consider how they can recognise and endorse regtech products if they want to encourage innovation and its take up. They should also look to adopt such technologies themselves; and
3. To ensure that the industry can benefit from fintech/regtech solutions we believe that the BCBS should advise global supervisors to:
  - a. ensure proportionate regulatory requirements around data and outsourcing solutions provided by fintech/regtech providers;
  - b. consider how to encourage the growth of DLT with clear supervisory expectations, international cooperation and clarity around digital assets.

## Comments

Our comments fall into three broad sections:

### 1. Balancing the risks and opportunities arising from fintech

Recent fintech innovation has presented new challenges for established banks in the form of new risks through the changing nature of banking and new competing services offered by fintech providers. The latest innovation has also coincided with drastic change in the regulatory landscape following the financial crisis. However, opportunities have also been created as fintech has led to potential cost savings and new and more efficient financial services. The benefits of these innovative fintech solutions range from improved risk management and operational processes, to increased financial inclusion, better investor education, and improved, more cost-effective regulatory compliance.

Of course we agree with the BCBS (CD Recommendation 1) on the importance to balance the "safety and soundness of the banking system with minimising the risk of inadvertently inhibiting beneficial innovation". The question is how to strike the right balance. This balance, as with any innovation, must include properly identifying changing risks but also areas where risks are reduced or better managed. We strongly agree with the BCBS that 'regtech' provides opportunities to better manage risks and this should be a focus of policymakers.<sup>9</sup>

The CD categorises regtech solutions into IT, data technologies, identity technologies or new technologies, such as DLT.<sup>10</sup> We believe there should be an additional category of 'shared services.' Shared services can centralise compliance functions which would otherwise be performed separately across many firms, divisions or locations. Shared services allow individual firms to enjoy the benefits of economies of scale by pooling or mutualising the costs of compliance. A group of firms sharing a service would also share the same standards. Therefore, the incentive to engage in a regulatory 'race to the bottom' would reduce as there would be no advantage to be

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<sup>9</sup> For example CD Pg 23-4, Box 5

<sup>10</sup> CD Box 5, pg. 23-24

gained by undercutting other participants. This, and the need to analyse a smaller number of approaches (as supervisors would not need to examine the separate approach of each and every firm), should benefit supervisors. Scalable services also foster competition by reducing barriers to entry for new entrants that would otherwise need to develop their processes from the start.

Our KYC platform (KYC.com) is an example of such a shared solution. Enhanced KYC and Anti Money Laundering (AML) requirements have increased compliance costs and potential liabilities for banks, sometimes to the extent that they might not be willing to transact with certain types of counterparties or counterparties domiciled in certain jurisdictions (increasing costs or potentially excluding clients access to financial services).<sup>11</sup> KYC.com provides market participants with standardised and repeatable processes designed to facilitate client on boarding. By removing the need for firms to perform duplicative, ad-hoc processes, this service has significantly reduced the operational risks associated with KYC and also lowered compliance costs incurred by individual firms and their clients when establishing new counterparty relationships in a timely fashion. The service helps avoid a 'race to the bottom' in compliance competition as all the service users adopt a similar approach to KYC.

Shared hosting services can also radically reduce costs and offer innovative solutions. We would call for a more widespread adoption of fully hosted yet fully bespoke solutions for internal capital models as well as non-model-based compliance. Recent advances in technology enable banks to retain ownership of their internal models and model choices – effectively running custom analytics – while mutualising the infrastructure and, where applicable, the input data. Hosted infrastructures also allow smaller banks to benefit from the improved risk sensitivities. A good example of this is our FRTB product discussed below.

Policymakers, including the BCBS, should take a view of both the risks and benefits of innovative approaches and provide clarity to regulated firms over where and when the use regtech services are acceptable. To do this, more engagement between supervisors and regtech providers is needed in order for supervisors to better understand the services as well as the risks and benefits they bring. They should then be in a better position to communicate what is acceptable to the regulated firms. We would therefore recommend the BCBS encourage supervisors to adopt such approaches.

## **2. Benefits of Regtech and Fintech for banking supervisors**

We agree with BCBS' observation that bank supervisors need to respond to rapid technological change and innovation by continuously assessing and updating their approach to supervision (see CD Observation and Recommendation 7). We believe that greater use of regtech and fintech solutions by regulated firms can help this process. Supervisors should therefore be:

### **a. Be open to, and encourage adoption of, regtech**

Compliance processes in banks are often burdensome and require intensive documentation and reporting. The supervisory audit process may also require banks to replicate certain results to justify approaches to compliance. For example, banks may be required to demonstrate how capital calculations have been generated by complex models. Individual separate approaches would be time consuming and costly for both the bank and the supervisor. We believe that such processes could be made more efficient through standardised approaches that

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<sup>11</sup>See, for example, [www.fiercefinanceit.com/story/deutsche-bank-stops-onboarding-new-clients-highrisk-areas-pending-kycrevi/2015-12-01](http://www.fiercefinanceit.com/story/deutsche-bank-stops-onboarding-new-clients-highrisk-areas-pending-kycrevi/2015-12-01)

would be easy for supervisors to integrate and compare outcomes for different firms relatively easily.

As an example, our modular and scalable FRTB solution suite enables banks to satisfy their market risk requirements from efficient data and risk factor to capital management. It handles both standardised and internal model based approaches, in particular aggregating anonymised data across markets while making the configuration available to users and, potentially, regulators. The solution suite also provides a comprehensive audit trail of input as well as model choices, including scenario, risk factor and capital calculations, and allows users (or potentially regulators) full rerun capability of any calculation at any time. The solution suite also enables banks (or regulators) to run custom analytics on risk factors, catering to diverse IMA requirements as well as running comparisons on benchmark portfolios or challenger models.

Despite the clear benefits, firms can be reluctant to adopt such new approaches as they may not be clear whether the supervisor would accept them. Supervisors should be clear that regtech solutions are tools supervised firms can use. One way to demonstrate this would be for supervisors to lead the way and look to adopt such processes themselves.

### **b. Signalling acceptance by endorsing regtech standards**

As discussed above, regtech could help supervisors meet their objectives and they should consider how they might encourage its take up. It would be extremely helpful if an approach could be found of recognising or endorsing services developed by regtech providers. As stated above, such an approach would mean supervisors would assess and monitor far fewer approaches to compliance than it would if every firm built and adopted its own systems. For firms it would remove uncertainty and inconsistency about whether such solutions were acceptable. This would not mean accepting that the use of a regtech service would mean automatic compliance. Usually regtech solutions are tools that assist in the compliance process and so the risks of appropriate endorsement to the supervisory approach would be limited.

Some form of endorsement could also provide a signal to banks clients that they would be expected to cooperate with regtech services. Currently there is little incentive on the important clients of financial firms to agree to cooperate with regtech providers when accessing financial services. KYC utilities, for example, generally struggle to engage with a bank's clients. Client reluctance can undermine the whole enterprise and its agreed standards as they could refuse to adhere to higher standards and threaten to go elsewhere. Regulatory endorsement, or a similar mechanism, would signal to banks' clients that they should cooperate as lower standards are unlikely to be tolerated elsewhere. Anything that supervisors could do to help incentivise clients use of such regtech approaches would be useful.

## **3. A regulatory framework that encourages adoption of fintech/regtech**

We believe that banking supervisors should ensure that the regulatory framework promotes innovation, part of which is enabling firms to adopt fintech/regtech solutions. In addition to the areas already highlighted, regulators need to pay special attention to the impact of rules and approaches to the use of third parties, outsourcing and the treatment of data.

As has been well discussed, fintech firms are a key driver of innovation in the financial sector but are not typically part of the established banking industry. We have also noted that part of the efficiency third party fintech firms can bring is around services

that create standards shared by each participating firm and pooling the burden of compliance. It is understandable that supervisors are concerned that these third parties are often unregulated, but we would encourage policymakers to adopt approaches to outsourcing and third parties that are risk based, proportionate and facilitate innovation. For example, unclear supervisory expectations around outsourcing and the disproportionate application of material outsourcing requirements, can raise costs significantly for banks and third parties. This can have a chilling effect on innovation and fintech firms.

Data privacy and data sharing is also a key issue for fintech/regtech firms. These providers often receive, transmit and store data, including personal information. Data-privacy laws and data localisation regimes provide significant challenges and discourage banks from using regtech providers. The growth of cloud computing also makes issues of data localisation more difficult. Of course cybersecurity and the proper treatment of personal data are important issues and should be ensured by the regulatory framework. However, fintech providers can often be at the forefront of such protection themselves. We would encourage the BCBS to ensure the regulatory framework does not create disproportionate costs. It might consider circumstances when it would be appropriate to provide safe harbours or clear protocols for the handling of data by fintech/regtech providers.

As set out above, we are actively participating in DLT proof of concepts and pilots, focussing on specific activities where DLT has the greatest potential. We are excited that DLT has the potential to bring about important change in financial services and we welcome the increased interest from regulators. Drawing on our experience, we would recommend that BCBS work with regulators on the following areas to underpin the successful development of DLT:

- **Definition of Digital Assets** – a working legal definition of digital assets does not exist in most legal jurisdictions. Without a standard accepted definition, it remains ambiguous how digital assets (crypto securities, crypto commodities, and crypto currencies) would be separate and distinct from other DLT innovations (particularly smart contracts: digital agreements that manage counterparty obligations, facilitate individual transfers of title and constitute ownership in the court of law). Furthermore, many of the DLT proofs-of-concept will be unable to scale to production-grade systems without a definition that clarifies these uncertainties;
- **Cross border coordination** – In the absence of a legal framework for DLT in most jurisdictions, it is imperative to have a framework for cross-border coordination between industry participants and regulators. DLT networks are likely to be supranational and their success will depend on cross border coordination. We would urge BCBS to encourage regulators globally to cooperate on the development of DLT networks and standards; and
- **Supervisory approach** – BCBS should encourage regulators to clarify where and when DLT systems are acceptable in order to ensure clarity and consistency when firms adopt DLT solutions. This could include endorsement of specific DLT solutions or clear acceptance that DLT solutions can be adopted for specific activities.

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We hope that our above comments are helpful. We would be happy to elaborate or further discuss any of the points addressed above in more detail. If you have any questions, please do not hesitate to contact us.

Yours sincerely,

***David Cook***

Head of European Regulatory Affairs

IHS Markit

[david.cook@ihsmarkit.com](mailto:david.cook@ihsmarkit.com)