

BearingPoint®

Financial supervisors and central banks as a part of Blockchains?

Imagine Future Regulation and Regulatory Reporting.
On Distributed Ledgers.

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Management Summary

We observe that almost every financial institution is using blockchain solutions to make certain financial products easier to trade. In very few networks, regulators are actively involved. Generally, they draw too little benefits from these prototypes for their monitoring tasks. Research shows that it is necessary for regulatory authorities to develop a clear strategy on how they can either become part of DLT platforms or take advantage of the resulting enhanced data streams.

As supervisory authorities remain crucial to allow for innovation in financially regulated industries, they are challenged by the opportunities of new technologies. Besides high cost of current regulatory regimes due to inefficiencies and data quality problems, digitalization increases technological as well as societal pressure to modernize banking supervision and regulatory reporting. Moreover, the steadily increasing number of regulatory duties strengthens the need to accelerate the adoption of new technologies such as distributed ledger technologies (DLT).

Regulatory Reporting Trends

The global banking sector is increasingly focusing on technologically advanced solutions like Blockchain and AI to meet consumer expectations, while preparing themselves best possible for future competition.

Increased granularity, high data quality and live interfaces to banks' data warehouses and trading environments are the key factors that change DLT-based financial market supervision drastically (see Figure 1).

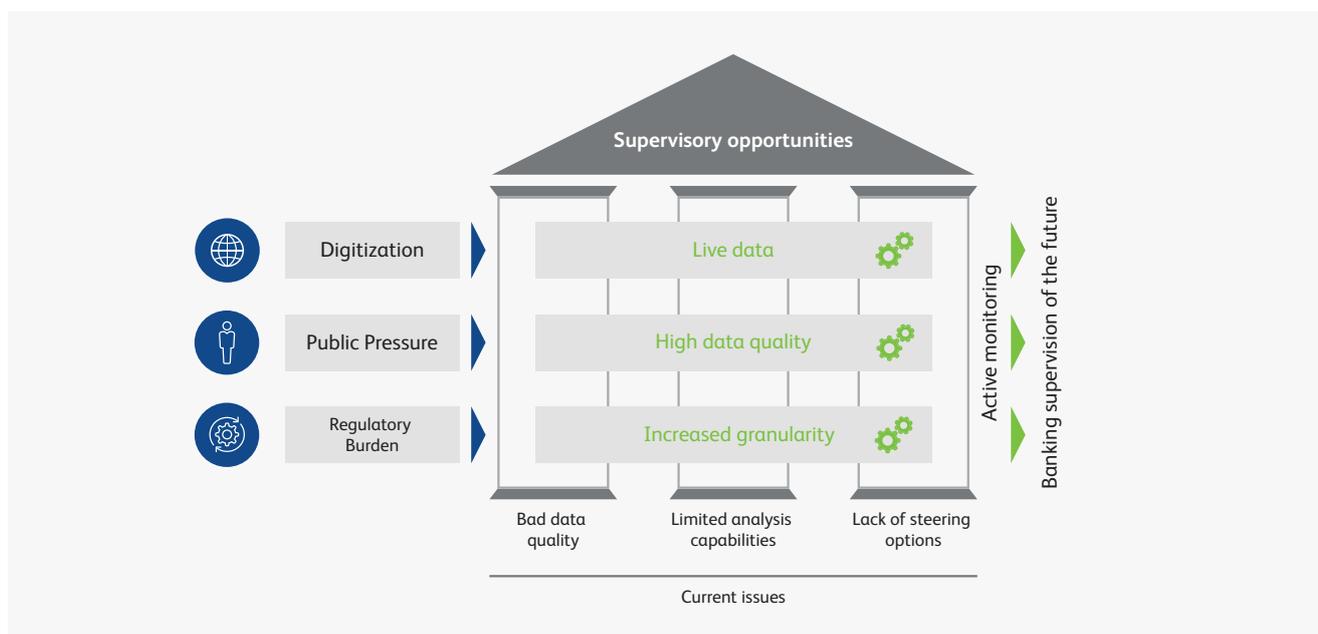


Figure 1: The development towards the regulator of the future

Financial Products on DLT

In the sense of the availability of traditional financial products on DLT-based systems, 2018 was an eventful year. When people talked about blockchain, they often referred to the “crypto winter” and the continuing bear market of cryptocurrencies.

However, distributed ledgers have also been recognized as causing improvements beyond the trust-enhancing feature of trading tokens. DLT was more and more perceived as a decentralized database for financial products that is consensually shared between participants of a network.

Hence, 2018 is clearly more important to mention as a year of inspiration. The financial services industry recognized the capabilities of DLT and started several trials, proofs of concept

and prototypes. Due to benefits such as transparency and traceability of transactions, most industry representatives started to enhance complex processes with DLT for less fungible debt products. As a result, the industry has chosen to use DLT as a standard technology in many occasions. Therefore, regulatory authorities in 2019 need to speed up in developing their DLT strategy.

In addition, figure 2 shows the continuing trend towards using DLT networks as a platform for more fungible assets due to improved scalability. More generally speaking, the numerous successful implementations of prototypes enabled an increase in the availability of decentrally stored digital assets. Many regulators started regulatory sandboxes, allowing financial institutions and FinTechs a safe environment to test possible use cases.

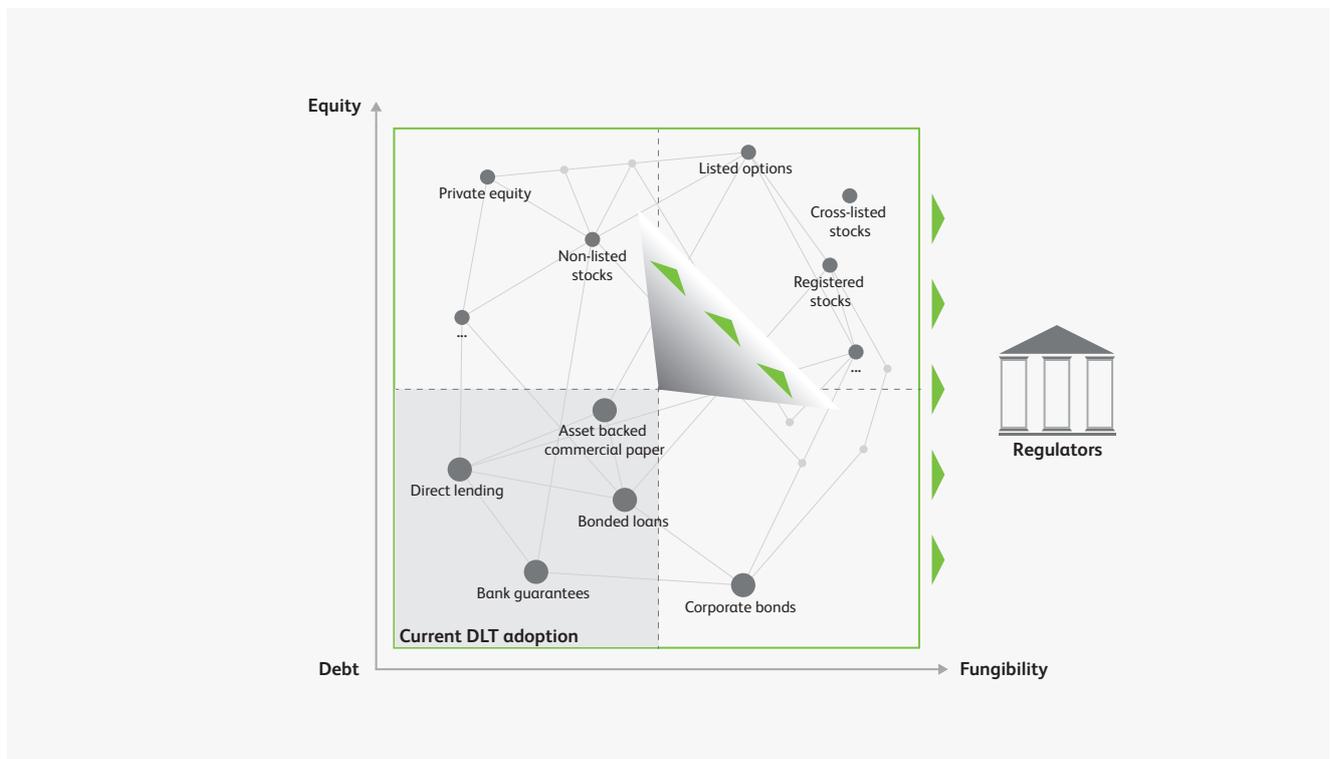


Figure 2: DLT Adoption for financial products

Figure 3 provides an overview of current central banks’ DLT initiatives. Basically, their focus lies on payments and monetary transactions. While other countries still study the potential impacts of blockchain-based payments, some of the central bank digital currency projects have already reached an introductory phase. We note that particularly in some Asian countries far-reaching activities have been undertaken to make the technology broadly applicable. Although most of the projects are concerned with the digitization of central bank money, in some countries far more than just the means of payment is planned to be digitized.

It must not be forgotten that, beyond allowing the industry to make use of DLT, from our point of view, supervisory authorities themselves can tremendously benefit from the technology. An important use case is regulatory reporting. We emphasize that supervisory authorities, regulatory authorities and central banks should use interfaces with DLT-based asset networks to achieve their goals of strongly improving the surveillance of financial markets. This could start with simple reporting features attached to DLT systems of financial products.

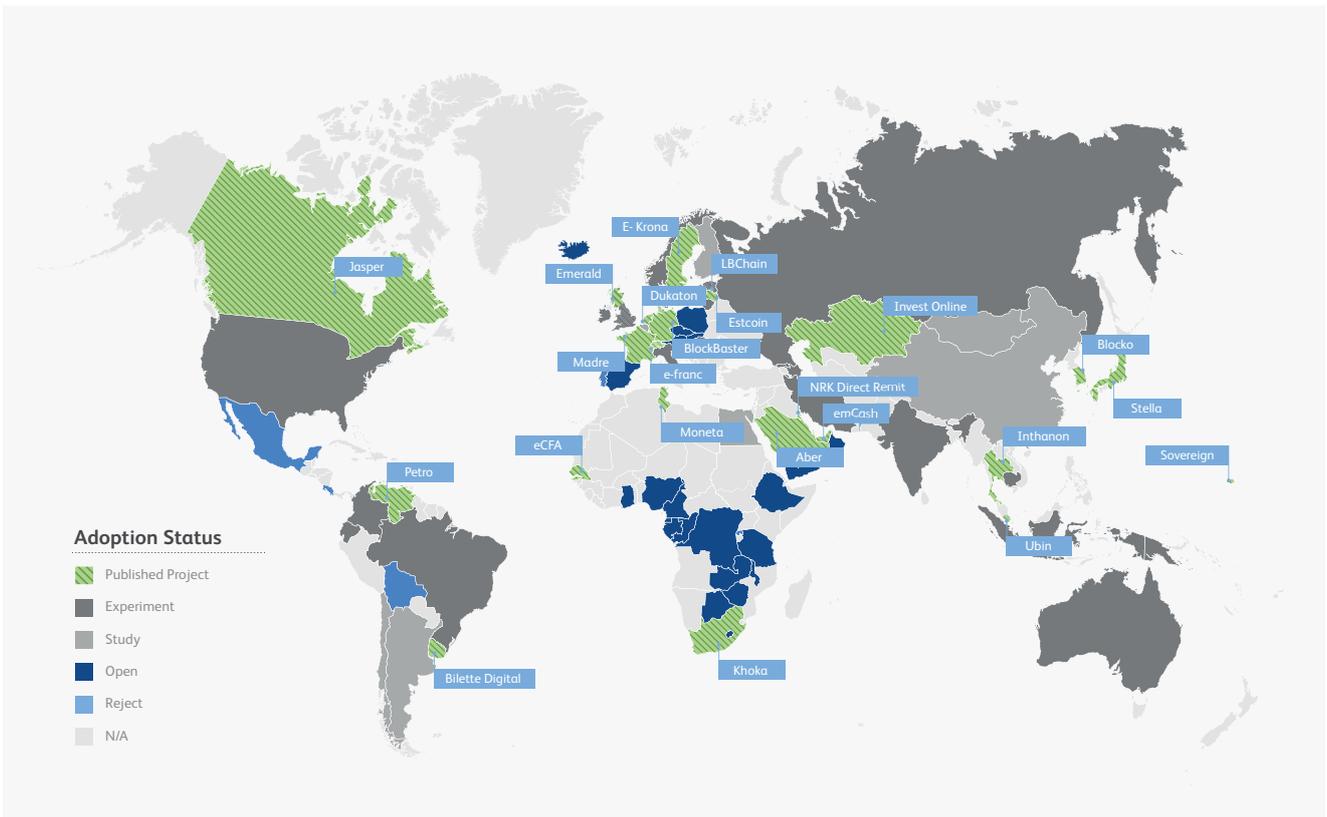


Figure 3: The first wave of central banks' DLT initiatives

BearingPoint's Financial Authority DLT Readiness Assessment

Transaction-based reporting and direct data extraction is only one application for the interfaces to a distributed ledger. More specifically, it is possible to use DLT to automate regulatory reporting by implementing regulatory reporting requirements as preconditions of smart contract execution. As a result, costs

for commercial banks can be reduced, data quality increases and regulatory oversight is improved, because regulators could either become a network participant or participate via an interface. Due to the high granularity and immediate availability of the on-ledger data, for the first time, observers can have live access to financial market events (see Figure 4).

We believe that in certain areas, supervisors could take on a

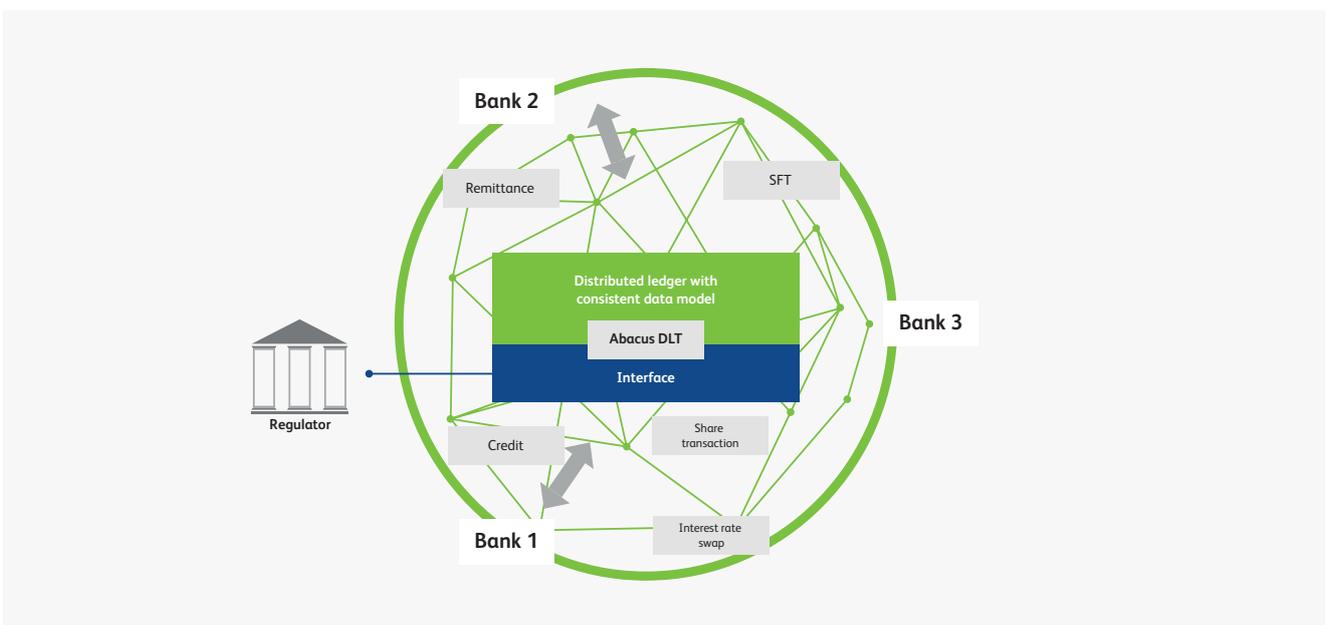


Figure 4: Regulatory Interfaces for Distributed Ledger Networks

proactive steering function instead of just being able to react as they are doing nowadays. To enable all these new opportunities, financial regulators need a defined strategy to their role in blockchain networks. Apparently, there is a broad scope of possible actions that can be taken by supervisors to leverage DLT.

BearingPoint has a broad knowledge on reporting and regulatory pain points. We suggest tackling upcoming strategic DLT issues within a Financial Authority DLT Readiness Assessment (see Figure 5).

Within three different categories and from two alternative angles, we developed distinctive knowledge, in order to help authorities to prepare for DLT-based financial market supervision.

Category A: Governance

Asking whether regulatory authorities would like to actively participate in DLT networks shows the two angles for a potential governance framework.

In general, we consider a regulator’s involvement to be either active & innovation-driving or passive & innovation-perceptive. Elaborating on different scenarios how to interact with DLT networks and being aligned about the regulator’s role, is one target of the governance task force.

Category B: Business

Irrespective of whether they are active or passive, regulatory authorities should examine the organizational and procedural benefits of DLT adoption. In-depth analyses of different reporting processes and the identification of respective efficiency gains are first approaches to determine cost reductions and supervision quality enhancements. The second task force therefore identifies regulatory reporting use cases and innovation focus areas for financial authorities.

Category C: Technology

Even though there is a consensus among all the decision-makers, that DLT networks sufficiently matter for regulators, an analysis of the prevailing IT architecture & potential DLT entry points will be recommended. In order to facilitate a smooth transition to DLT-based reporting solutions, this task force could also include a study on future data handling between financial institutions and the respective regulators.

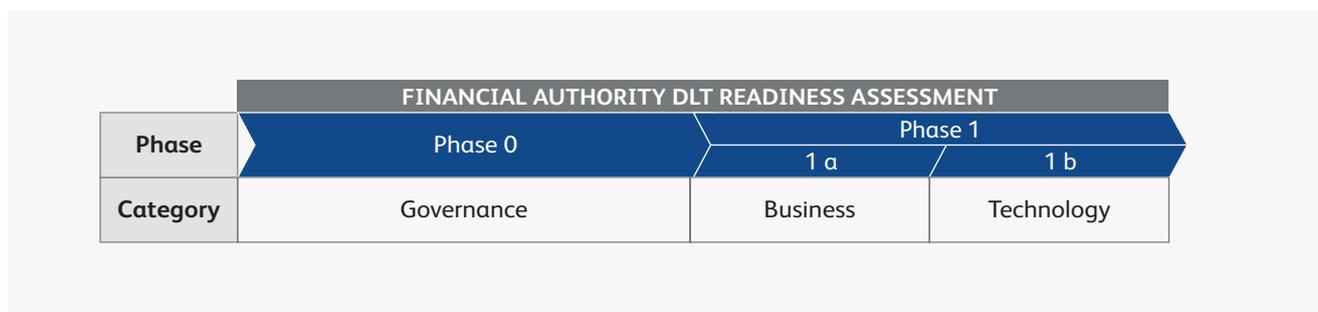


Figure 5: BearingPoint’s Financial Authority DLT Readiness Assessment

Contact us and find out more about how we can support you in the area of distributed ledger technologies.

About BearingPoint RegTech

With its RegTech product unit, BearingPoint is a leading international provider of innovative regulatory and risk technology solutions (RegTech and RiskTech) and services along the Regulatory Value Chain for Financial Services.

Customers representing 6,000 firms worldwide, among them large international banks, a major part of the largest European banks, leading insurance companies as well as supervisory authorities and central banks, trust BearingPoint's RegTech products and services.

We work closely with regulators and, as a member of standardization bodies such as XBRL, we actively contribute to the standard-setting process. We combine our regulatory know-how with our proven, reliable and forward-looking RegTech solution suite, expert consulting capabilities, as well as managed services and training seminars.

For more information, please visit www.reg.tech

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