



**Hogan
Lovells**

Getting to data nirvana

A legal and compliance guide
to data value creation

Chapter 3 – Regulatory silo-busting
to optimize risk management

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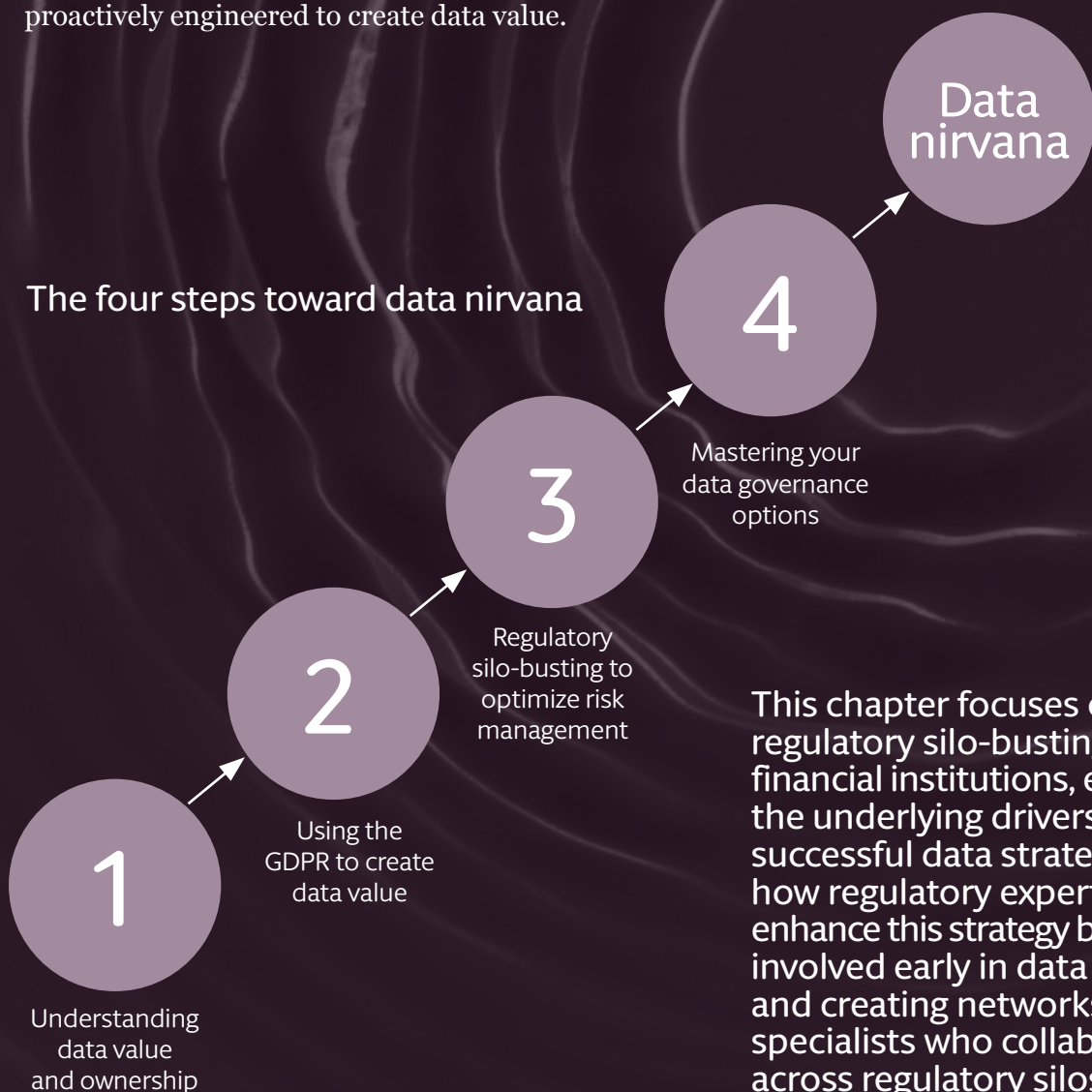
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Introduction

The job of legal and compliance teams is to make sure that their company's data projects don't violate applicable laws. Their task is not easy because laws regulating the processing of data – particularly data that is personal – are multiplying worldwide. However, a focus solely on data compliance can prevent broader thinking about data strategy, and how legal and regulatory teams can contribute to value creation.

Hogan Lovells' "Getting to data nirvana" guide helps open the door to broader thinking about data strategy, by showing how regulatory, contract, IP, competition and litigation strategy can be proactively engineered to create data value.

The four steps toward data nirvana



This chapter focuses on regulatory silo-busting within financial institutions, exploring the underlying drivers for a successful data strategy, and how regulatory experts can enhance this strategy by getting involved early in data strategy, and creating networks of data specialists who collaborate across regulatory silos.

Chapter 3 – Regulatory silo-busting to optimize risk management

The case of financial institution

1. The elements of data strategy for the financial services industry

Business objectives

The FinTech revolution is bringing new data-driven innovation to the financial services industry. The FinTech revolution also creates challenges for incumbent financial services firms with multiple business units, products and legacy systems that operate in silos. To address the challenge, incumbent financial services firms are developing data strategies to help transform their organization into agile, data-centric firms. Financial services firms are sitting on a gold mine of data, but the challenges associated with using that data in new ways are significant.

A data strategy starts from the enterprise's business objectives. For a financial services firm, these objectives typically include:

- making the customer journey as fluid as possible, while still permitting full compliance with KYC and data security obligations;
- using data to facilitate the offering of new services to existing clients. Data analytics may allow the banking needs and requirements of individual customers to be anticipated more precisely and in a more timely fashion. Targeted advertising may even become a possibility. Data can also be used to generate insights into how the online experience of customers can be improved;
- cost savings through the reduction in the number of separate systems that manage data within silos. Data analytics may improve and automate risk management in several areas, including regulatory compliance, fraud prevention, AML, risk control. The effect of this will be to enable banks to reduce risk at the same time as stripping-out costs.



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To fully capture the tremendous value of using big data, organizations need nimble and flexible data architectures able to liberate data that could otherwise remain locked within legacy technologies and organizational processes.

*JRash Gandhi et al., "Look before you leap into the data lake",
BCG perspectives, 2016.*

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To reach these objectives, the data strategy will generally call for data mapping to take stock of existing systems and data. One of the purposes of the data mapping exercise will be to assess the relative value of each data set in terms of their potential to contribute to the overall strategy, and the ease with which the data could be cleaned, shared and used within other applications in the organization. The data strategy may well involve the creation of a data warehouse or data lake, involving the interconnection or combination of the organisation's diverse data sets so that they can be accessed via new applications, including big data analytics. Finally, the data strategy will likely involve the development of new FinTech applications such as mobile banking similar to those offered by pure player FinTech firms.

Defensive and offensive strategies

Data strategies generally have two motivations¹:

- A defensive motivation focused on reducing costs, increasing internal efficiencies, and enhancing compliance,
- An offensive motivation focused on using data to propose new services and compete successfully with digital pure players.

The balance between the defensive and offensive motivations for the data strategy will depend on each individual firm. For financial services firms that are highly regulated, the motivation for the digital strategy will be roughly balanced 50/50 between the defensive and offensive motivation.

The balance between an offensive and defensive strategy will also be reflected in the risk-benefit trade-offs made in legal, regulatory and compliance matters. As explained below, smart risk-benefit trade-offs should not be made silos; they require sophisticated legal risk analysis. A holistic view of regulatory constraints and their direction of travel is necessary to maximize data value. Without this holistic view of regulatory constraints, a data lake can become a data swamp.

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The challenge for CDOs and the rest of the C-suite is to establish the appropriate trade-offs between defense and offense and to ensure the best balance in support of the company's overall strategy.

Leandro DalleMule and Thomas Davenport, "What's Your Data Strategy?" Harvard Business Review, May-June 2017.

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Don't be dazzled by the draw of another favourite industry buzzword, the "data lake." Things aren't as beautifully simple as the image of clear water and mountain springs might conjure. We can't just pour all our data into one system, expecting goodness to result. Your business is unique, and you can't buy unique advantage off the shelf. Care, planning and investment are required; otherwise you're certain to end up with a data swamp, seething with liability, confusion, and rotting bits.

Edd Wilder-James, "Breaking Down Data Silos," HBR.org, December 5, 2016

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2. Regulatory constraints and data strategy

Regulatory teams should be involved at the beginning

An essential component of the digital strategy is the legal, regulatory and compliance aspect of data value, yet these aspects are often added later. Traditionally, legal, regulatory and compliance constraints are viewed as external barriers that inhibit the realization of the data strategy. The legal, regulatory and compliance teams are often not involved in the elaboration of the data strategy itself, and regulatory constraints are rarely viewed as a strategic tool to enhance data value. In this chapter, we argue that legal, regulatory and compliance considerations can and should be integrated into the data strategy at its inception, and that by doing so, financial institutions can increase the value of their data assets.

Regulatory dynamics can create opportunities

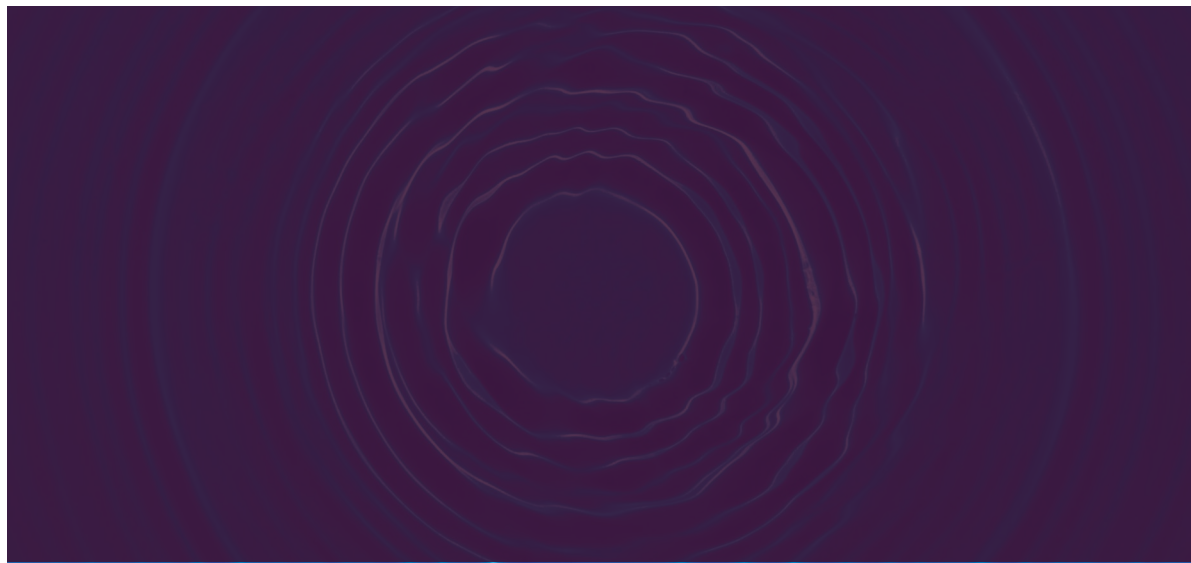
Regulators can be as confused as we are about how to implement regulatory requirements that don't always match up. Each regulator will lack understanding of the regulatory landscape outside his or her own silo, and will generally be curious about, and receptive to, solutions that reach across silos.

To the extent a regulator has flexibility, he or she will generally embrace a solution that:

- reconciles several regulatory requirements at the same time, even if those requirements are not located in the same silo;
- is consistent with the direction of travel for regulation globally.

Both the multi-disciplinary vision of how different regulatory silos interact with each other, and the dynamic vision of where regulation is going, will permit financial institutions to engage in discussions with regulators on pragmatic and creative compliance approaches. Even if these discussions do not result in an immediate change in regulatory approach, they may influence how regulations evolve.





3. Regulatory silo-busting permits smarter risk management

The "push-pull" character of regulations

Regulatory policies, like planets, are in constant motion. They each have a direction of travel, and they each can exert gravitational force on other regulatory policies. Consequently, to make sound judgments on risk-benefit trade-offs in data projects, organisations need to understand where each of the regulatory policies is headed, and the relative strength of the gravitational pulls affecting those policies. The regulatory viewpoints also need to be reconciled with ethics, general customer expectations, and the organisation's commercial objectives. This is best done in a non-siloed way, based on a holistic data governance philosophy.

To illustrate, consider regulations to fight money laundering and terrorist financing (AML), which exert a "push" in the direction of creating data lakes permitting the interconnection and analysis of transaction data throughout the organisation on a single platform. Data protection regulations such as the

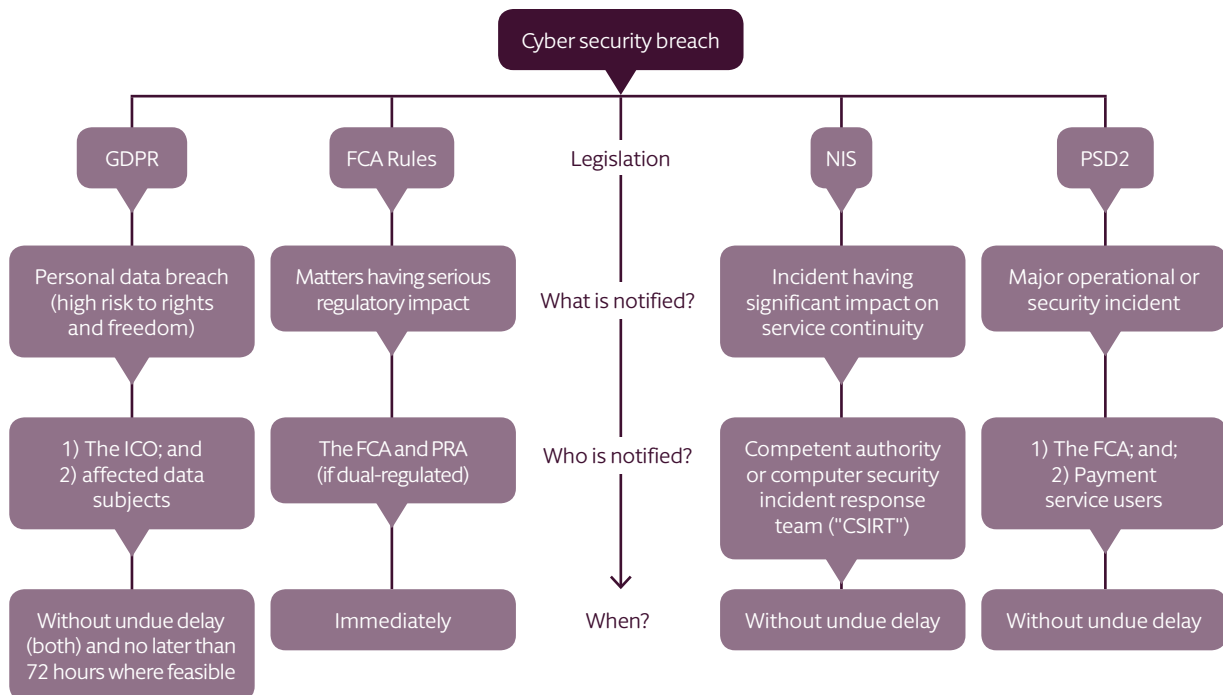
GDPR exert a "pull" in the opposite direction, discouraging interconnection of databases to develop profiles. Similarly, PSD2 creates a "push" in favor of sharing data with competitors, whereas data protection and bank secrecy laws pull in the opposite direction, prohibiting sharing without consent or another strong legal basis.

The push-pull character of regulatory constraints is even visible within the GDPR itself. The GDPR discourages data interconnection, yet creates compliance obligations that can only be satisfied through a 360° view of customer data, so that data subjects can exercise their rights to data portability, access, rectification and erasure with regard to all the data held by the organisation.

Example: four regulations, one obligation

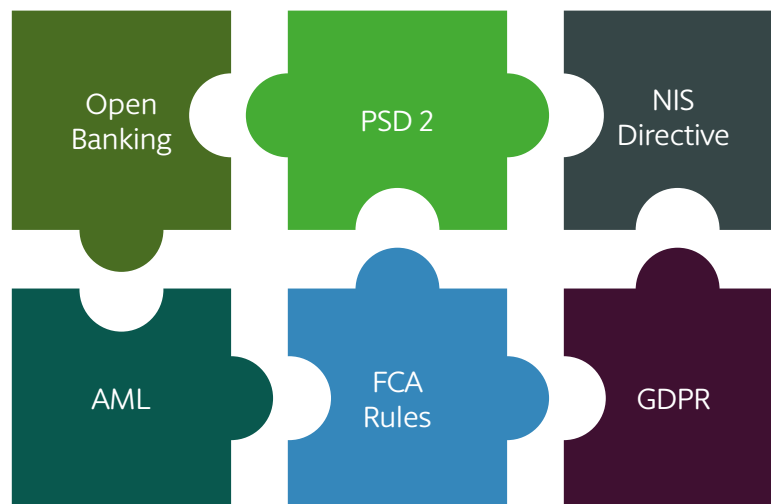
In the field of data breaches, financial institutions are subject to four different breach notification rules flowing from four separate regulatory silos (GDPR, FCA, NIS, PSD2). If viewed separately, these regulations could create four parallel breach reporting processes with slightly different requirements. If considered as a whole, the parallel breach notification requirements can be reconciled and built into a single coherent breach notification process that fits with all four regulatory silos.

Risk – Cyber breach

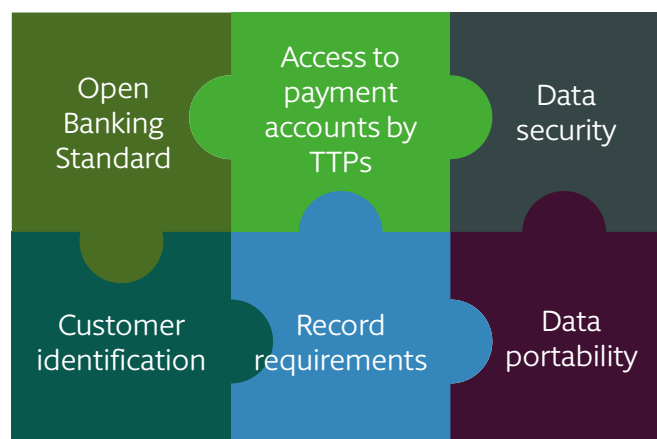


Silo-based regulatory analysis often results in an organization not taking full advantage of shaping regulatory outcomes based on the bigger picture. For example, a simple question such as "what form of customer consent is required?" may yield different answers under data protection law, bank secrecy law, PSD2, or contract and consumer protection law. Similarly, data portability will look different under GDPR and PSD2. A cross-disciplinary approach might lead to a single consent or portability process that represents a reasonable compromise when all the constraints and corresponding risks are looked at as a whole, even if the particular method may not be the one recommended when considered in isolation within a given regulatory silo.

Data Nirvana Navigating the regulatory jigsaw



Data Nirvana Navigating the regulatory jigsaw



4. Governance structures facilitate converged regulatory thinking

Getting the best advice from regulatory and compliance teams requires regular training and workshops. Workshops bring together experts from different jurisdictions and regulatory disciplines to examine common operational problems, such as digital onboarding of new customers, or the creation of customer profiles based on aggregated data.

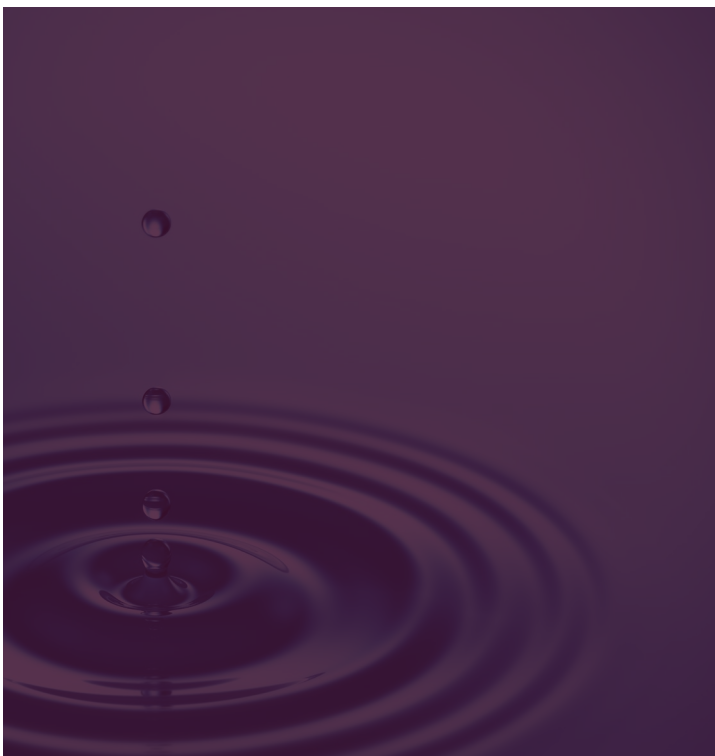
These workshops will facilitate the creation of informal networks of data ambassadors in the legal and compliance functions of the organization. The data ambassadors will exchange best practices and permit broader thinking on data issues.

The internal network of data ambassadors would be reinforced by the creation of a data governance committee at the upper management level.

We discuss these governance options in Chapter 4.

References

1. Leandro DalleMulle and Thomas Davenport, "What's Your Data Strategy," Harvard Business Review, May-June 2017



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