



## I D C T E C H N O L O G Y S P O T L I G H T

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# FINRA Regulations Require Technology Innovation to Address Supervision and Monitoring Workload

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*Enterprises are in the midst of a juggling act and many are struggling to keep all the balls in the air. Business leaders are balancing demands for greater collaboration and productivity, while at the same time, trying to keep pace with the ever evolving and tightening regulatory environment governing their business practices. This is particularly true for financial services institutions that manage millions of transactions, are privy to significant volumes of highly valuable and confidential information, and must deal with the increase in regulatory complexity and heightened scrutiny seen in recent years. Further complicating matters, the IT mission has shifted from systems management and data protection to enabling business processes, democratizing IT, and developing solutions that automate regulatory and legal compliance. This IDC Technology Spotlight discusses the impact of regulation on the financial services industry and the integral role that technology can play in simplifying and automating compliance initiatives. This paper will also describe Proofpoint's Intelligent Supervision software and its ability to address the challenges financial services firms face in monitoring corporate data, reviewing it in an efficient manner, and taking meaningful action.*

### Introduction

Financial services institutions are required to abide by numerous policies mandated by a variety of regulatory bodies. Among others, global banks may be regulated by the Financial Industry Regulatory Authority (FINRA) as well as the Securities and Exchange Commission (SEC) in the United States, the UK Financial Conduct Authority (FCA), or the Investment Industry's Regulatory Organization of Canada (IIROC).

Mandates are complex, comprehensive, and strictly enforced. FINRA's supervision rules (3110 and 3120), for instance, require each firm to create and maintain a supervisory system for monitoring employees, investors, and customers to ensure that business activities and communications are in compliance with securities laws and regulations designed to prevent fraud and increase marketplace fairness. This can be a daunting task. Certain technology trends, such as the pervasiveness of distributed sharing and communication platforms along with data growth, create the need for compliance initiatives to cast wide nets.

Without a comprehensive approach and the right technology, financial institutions can quickly find themselves losing their grip on the volumes of data and data sources they are obligated to monitor. What's more, institutions that fail to show progress toward building a culture of compliance through the implementation of reasonable supervisory policies and controls are at risk of being dinged by

large financial penalties or falling under additional scrutiny. In just the last few years, several of the world's largest financial institutions have been fined millions of dollars for not having sufficient supervisory processes and procedures in place. As a result, financial institutions now increasingly demand excellence from both the IT and compliance functions.

## **Key Industry Trends**

Nearly every organization struggles with data. There is no one universal reason as to why. Instead, there's a web of interrelated business outcomes, technology trends, and regulatory pressures constantly feeding an information machine that has seen data swell to the point where systems are bursting at the seams. This scenario rings especially true for highly regulated verticals, like financial services and banking, whose challenges expand well beyond storage and information protection to developing actionable compliance insights derived from real-time data. Below are a few key data and compliance trends affecting the financial services industry.

### ***Rising Regulatory Pressure***

In the United States, there are over 600 regulatory authorities churning out laws, rules, and standards to which businesses must comply. Single regulations can be hundreds of pages in length and, increasingly, new and updated regulations take direct aim at technology innovation. These regulations leave businesses with the unenviable task of interpreting regulation and adjusting processes and technology in an effort to comply. Increasingly, non-compliance carries harsh penalties.

FINRA has taken some of the guess work out of compliance. FINRA's annual Regulatory and Examination Priorities Letter for 2016, calls out supervision, risk management, and control systems as the year's top priorities. It says that upcoming assessments will focus on five key cultural behaviors that demonstrate supervisory capacity: "whether control functions are valued within the organization; whether policy or control breaches are tolerated; whether the organization proactively seeks to identify risk and compliance events; whether supervisors are effective role models of firm culture; and whether sub-cultures (e.g. at a branch office, a trading desk or an investment banking department) that may not conform to overall corporate culture are identified and addressed".

Supervision rules, of course, primarily concern the management of conflicts of interest, the use of technology and data governance, the outsourcing of various business processes, and Anti-Money-Laundering (AML) efforts. This should serve as a staunch warning given that FINRA penalties have reached around \$100 million in consecutive years. Recently, in fact, the authority issued a \$900,000 fine to a financial management company that lacked adequate supervision and monitoring tools.

### ***Cloud Adoption and Business Process Development***

IT functions no longer have the latitude to prescribe one-size-fits-all enterprise grade solutions. Instead, IT has become democratized. Lines of business are leaning on cloud-based and social technologies, handpicking and investing in specific applications that thoughtfully move processes incrementally forward. As a result, modern business processes have begun to resemble interwoven strings of layered applications moving data around the four walls of an enterprise, into the cloud, across the Internet, and into the hands of global workforces and consumers.

The shift is partially driven by consumer expectation for access to real-time information and individualized service. Consumers demand more and line-of-business executives expect enterprise applications to enable access, convenience, and flexibility. These expectations have big implications for communication. Modern collaborative applications allow employees to seamlessly start and pick up conversations from any number of platforms without skipping a beat.

Within investment banking, a typical scenario might involve an initial phone call from an investor, followed up by additional questions via an instant messaging application, and finally completed via an email with additional documents attached. The ease at which communications take place sits in stark contrast to the difficulty IT and compliance professionals face in attempting to capture and reconstruct these disparate communications to meet supervisory requirements.

### ***Content Types and Data Storage***

The way that business processes are developing is shaping trends in data growth and storage. In its most recent digital universe study, IDC predicted that the world's data would grow to approximately 44ZB by 2020 compared to just 4.4ZB of data in 2013. This means that data is doubling every two years.

There are two factors contributing to data growth: higher volumes of data are being created and, as a result, more data is being stored. As it relates to creation, data is no longer limited to simple text documents and spreadsheets. Third Platform and cloud technologies have changed the way that we interact. Today's data consists of a wide array of structured, unstructured, and semi-structured content including social, chat, voice, and documents. Business objectives and regulatory schemes require that the bulk of this data be stored for some time in order to unlock its potential or identify risk. This situation has created enterprise storage architectures that are growing in number, growing in volume, and are highly distributed.

### ***Financial Institution Regulation, Distributed Data, and FINRA***

While the entire process of aligning data management strategies can be daunting, transforming processes to proactively monitor data in an attempt to prevent non-compliance can seem insurmountable. Unfortunately, that's exactly what Federal Banking regulations require. The financial services industry is no stranger to regulation. AML and know-your-customer regulations have been around for some time. Both, of course, have been emphasized since the 9/11 terrorist attacks in an attempt to stem the flow of illegal monies being used to support terror campaigns.

In recent years, AML in particular has gained a level of infamy for the hefty fines levied against financial service organizations involving systemic AML process failures. The 2008 financial crisis added yet another layer of scrutiny as regulators intervened to ensure that lenders closely monitor portfolio risk and execute fair and transparent lending practices.

These regulations, however, create slightly different challenges from those presented by the consolidated FINRA broker/dealer insider trading rules. Here's why: AML rules have developed around deposit transactions that allow banks to comb through structured data sets that typically reside in single repositories or single systems. Know-your-customer (KYC) and lending regulations require a review of unstructured data but the data is generally presented for review during a fairly structured workflow that has little need for absolute immediacy. Supervision and monitoring, on the other hand, requires a view of many disparate unstructured data repositories and systems and a need for immediate action.

Consolidated FINRA rules on supervision and monitoring 3110 (Supervision) and 3120 (Supervisory Control System) dictate:

- Requirements for review of certain internal communications; and
- Obligations to actively monitor for insider trading, including the duty to conduct internal investigations.

## Technology Benefits

With the proliferation of data and shifting regulatory imperatives, developments have taken off in cognitive computing and content analytics. Advancements in these technologies present novel ways to organize, analyze, and access unstructured information and provide platforms capable of applying complex workflow and decision making to glean real value from monstrous repositories of unstructured data.

Machine learning and natural language processing (NLP) are two of the primary concepts underlying technologies in this space. Broadly speaking, machine learning refers to a set of statistical techniques used to identify some aspect of data in order to apply consistent data treatment or leverage the data to perform a given function. NLP refers to the study and development of advancement in machines' ability to interpret language in its natural written and spoken form including colloquialism. Combined, these practices have come together in order to form powerful technology that allows process and workflow to be accomplished through technology like never before. These developments are paramount when it comes to monitoring communications in real-time.

There are too many systems, too much data, and far too many transactions for teams of supervisory professionals to actively and accurately monitor for potential FINRA violations. In order to keep pace, technology must play an integral role in supervisory procedures and practices. For this reason, solutions that utilize machine learning and NLP are considered invaluable assets in the war against fraud and financial crime. Technology can now be used to monitor a myriad of communication channels and data sharing methods and identify anomalies that could constitute potential policy violations.

Key to these technologies, however is usability. Supervision and monitoring tools must be capable of limiting the number of false positives presented to compliance or IT personnel for review while retaining enough sensitivity to detect even the most discrete cases of fraud or innocent mistakes. A tool that is effective at capturing anomalous behavior, but is not easily used or understood does no one any good. Flexible workflows and configurable controls along with a user-centric design focused on visual monitoring and analysis are necessary features for ensuring adoption and data accuracy. Finally, real-time, robust reporting capabilities are critical in providing evidence of an organization's state of compliance for audits, investigations, and legal matters.

## Considering Proofpoint Intelligent Supervision

Proofpoint is a next-generation security and compliance company that provides cloud-based solutions for comprehensive threat protection, incident response, secure communications, social media and mobile security, compliance, archiving and governance. Proofpoint products protect against phishing, malware and spam, while safeguarding privacy, encrypting sensitive information, and archiving and governing messages and critical enterprise information.

Proofpoint Intelligent Supervision is a cloud-based supervisory platform designed for large and complex financial services firms. The next-generation platform helps identify, review, address and maintain audit trails for incoming, outgoing and internal correspondence. It is designed to help companies comply with all SEC, FINRA, and IIROC rules more efficiently than legacy supervision systems or manual tools. The product natively supports the following:

- Email
- Bloomberg Messaging
- Instant messaging platforms
- Various social media and enterprise collaboration platforms

By delivering secure, software-as-a-service solutions, Proofpoint is helping financial services institutions and other large organizations competing in highly regulated markets protect sensitive information and deal with the increasingly complex regulatory environment. Intelligent Supervision software provides capabilities for advanced supervisory review, direct integration with data archiving tools, and visibility into the multitude of enterprise communication and social media tools utilized across the enterprise for greater productivity and control.

Proofpoint's solution allows IT and compliance officers to easily review, control, monitor, analyze and report on a company's state of compliance at any point in time. Among others, the Proofpoint solution offers the following benefits:

- **Reduction in review time.** Today, review teams spend too much time sifting through messages to determine if they contain violations, often reading through a queue of low risk content or items incorrectly tagged as violations by the system. Intelligent Supervision is designed to create less "noise" for review teams to sift through, allowing teams to pinpoint compliance violations faster and more accurately.
- **Flexibility.** Real-time visibility and flexible workflows are designed to provide greater control and reduce risk. Workflows can be customized to meet the evolving needs of large and complex firms.
- **Immediate response.** Poor visibility in the supervision process can slow regulatory response. Intelligent Supervision provides real-time dashboards and reports designed to manage the review process, identify bottlenecks and respond to regulatory audit requests. With more analytics, dashboards and collaboration features, firms can simplify and optimize supervision as data volumes grow.

## **Challenges**

Perhaps the greatest challenge for Proofpoint and other vendors participating in the information governance and compliance space is the continual need to incorporate new data sources or integrations. The strength of overarching governance platforms is their flexibility and ability to provide insight across any number of data repositories and sharing platforms.

To remain relevant, these products must continually evolve tracking trends in new technology and user behavior to be able to deliver new product integrations in a timely manner. The democratization of IT makes that challenge increasingly difficult. The same challenge requires a level of cooperation from line-of-business leaders and knowledge workers. Without business support, IT and compliance professionals risk losing visibility as business processes adapt and leverage the hottest new technologies.

## **Conclusion**

FINRA and other regulatory agencies have delivered a clear message to regulated institutions. Systematic compliance failures are intolerable and hefty penalties await the ill-prepared. As a result, IDC expects regulating agencies to continue to tighten their grip on business monitoring activities. Business leaders need to find a healthy balance between offering flexible business solutions and their ability to monitor data effectively and reduce risk.

As the regulatory environment continues to evolve and corporate data stores continue to expand, Proofpoint has an opportunity to help organizations protect and govern their sensitive information to help mitigate risk and manage costs more effectively and confidently. To the extent that the company can address the challenges described in this paper, IDC believes that their product is well-positioned for success.

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