

In 2020, the Case for Trade Surveillance Investment Continues

January 17, 2020

Forget trading. Market and trade surveillance technology has proven itself as one of the best appropriators of cutting-edge technology—artificial intelligence (AI), machine learning and big data have all made meaningful impacts in the trade-monitoring world. And for once, innovation in this crucial Regtech function amounts to much more than an over-hyped collection of #buzzwords.

While our Regtech & Risk Practice will be focusing on several compelling developments making noise in the near future, we'd like to provide a sampling of some important trends set to drive evolution and adoption in surveillance technology this year. As a short teaser to upcoming research, we follow up our [*Top 10 Market Structure Trends for 2020*](#) with a countdown of our Top Three Themes in Surveillance Tech for 2020:

Buy-Side Opportunities

Five years ago, the concept of buy-side firms implementing specialized market surveillance platforms for internal use was not “a thing” by any definition. While sell-side investment in this crucial area of regtech was entering the boom phase, the case for buy-side adoption was still gestational at best. Yet, buy-side interest in stocking up surveillance toolkits quickly grew as the industry observed highly publicized market abuse scandals, increasing investor protection mandates, major regulatory implementations, and steady expansion in direct trade execution.

We've even seen tangible growth in adoption rates in the upper tiers of asset management, as forward-thinking compliance officers increasingly recognize the long-term benefits of installing their own line of defense—not only to monitor their own activities but to ensure fair treatment by sell-side partners as well. Despite these compelling use cases and rising demand for buy-side surveillance infrastructure, widespread deployment growth has proven slower than expected, mostly because sticker shock dampened enthusiasm.

The major adoption hurdle has proved to be a greater-than-expected difference in spending tolerance and scalability needs in comparison to sell-side counterparts—the cost structures frequently seen in established vendor platforms are more suitable for the exponentially larger volumes inherent to sell-side trading.

For the buy side, the decision to invest in surveillance technology can often be a matter of finding the right vendor partner to complement the firm's structure and price point limitations. A top-tier asset manager or hedge fund may have the ability to consider investing in established products with formidable sell-side experience, but greater surveillance technology spending growth necessitates accessibility among the lower tiers. While the buy side is clearly a challenging segment for many vendors, some have carved impressive inroads into the space, such as ACA Compliance's Decryptex trade surveillance solution.

Remaining Sell-Side Growth Story

The use case and growth story for specialized surveillance solution adoption by the sell side is well established. Especially for upper-tier market players, the need to fortify this area of regtech has been undeniably compelling during the era of post-financial-crisis regulation and enforcement, as the consequences of skimping on compliance infrastructure proved too big to ignore. Regulatory consequences for lack of proper oversight can be formidable and reputational risk even more so.

Although several indicators are pointing to upcoming budget constriction, growth in surveillance and monitoring technology is far from over (our current estimates project spending growth in this segment to remain steady until at least 2022). A significant portion of this growth will come from new adoption or legacy system replacement by sell-side participants, particularly middle-tier and robust boutique players who have yet to focus on this area of compliance infrastructure. We can also expect to see continuing incremental spending increases on features such as communications surveillance and data fortification from existing solution customers, as many continue to build toward true holistic surveillance coverage.

As we are seeing on the buy side, understanding the best technology investment approach for the firm's needs will be key to continued adoption across firm types. For some firms, the right answer might be as simple as leveraging tools offered by existing analytics providers, such as Bloomberg LP. The lower cost and faster time to market can make the ROI a no-brainer.

Leveraging AI

Last but not least, market participants are increasingly willing to pay up for the latest and greatest enhancements in key fintech functions. Not to be left out of the fray, surveillance technology providers are putting AI to work in some fascinating ways, with alert generation as one of the more notable examples. Leveraging machine-learning capabilities in alert generation algorithms has been a major differentiator in surveillance offerings for several years, but incorporation of deep learning capabilities is now a market reality.

As with any freshly released capability, firms should conscientiously evaluate the use case and implementation plan to ensure the wisest investment decision for individual needs. But there is little doubt that AI processing capabilities will be [high on the consideration list](#) this year (recent Greenwich Associates data heavily supports expectations of a sizeable increase in firms allocating compliance budgets to AI investment).

While not every regtech solution provider can—or should—release an AI-based processing option, AI capabilities are already a live-market reality for some major players in the space. One well-known example here is Nasdaq, whose VP of MarketWatch, Martina Rejsjö, testified to U.S. Congress this past fall regarding the importance of such enhancements (AI processing for U.S. equities in their SMARTS solution went live in October 2019).

Vendor Landscape Preview

Other comprehensive solution providers in this space who are focusing on at least one of these 2020 growth areas include (but are not necessarily limited to) Altair, Bay Street Systems, Eventus, NICE Actimize, OneTick, RIMES, and Trillium.

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