

Fintech, RegTech, and the role of compliance in 2023

Thomson Reuters Regulatory Intelligence



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EXECUTIVE SUMMARY

In recent years, financial services firms have, by necessity, adopted technological solutions at speed. Digital transformation is a continuum and while there are myriad benefits to be gained from the successful implementation of technology, there are also challenges which need to be navigated.

The seventh annual Thomson Reuters® Regulatory Intelligence survey and report on fintech, regtech and the role of compliance explores the way in which firms are addressing the deployment and management of fintech applications. As G-SIBs are often seen as a leading indicator of future behaviour, they were asked to identify themselves, to enable comparison with other, smaller, firms. Regional results are also split out where they highlight a particular trend.

Main points

In many ways this year's report gives a contrasting message on the status of the fintech marketplace. On the one hand, respondents identified an increasingly diverse range of uses for fintech and regtech applications ranging from credit risk analysis, where 40% of G-SIBs were using fintech applications, to information security, where 30% of respondents used fintech. Half of respondents (50%) have either implemented a regtech solution fully or in part, up from 38% in 2021.

On the other hand there are signs of a slowdown in the growth of the fintech sector. According to Innovate Finance's 2022 Summer Investment report¹, in H1 2022 the total capital invested in fintech worldwide reached \$59 billion. This was flat year-on-year, with 3,045 deals completed, fewer than the 3,401 deals in H1 2021. An exception to this slowdown was in the UK fintech sector, which continues to grow, with investment reaching \$9.1 billion – a 24% year-on-year increase from H1 2021. The UK remains second worldwide in fintech investment, behind the United States.

The slowdown in the marketplace was echoed in this year's survey, which reflected a sense that enthusiasm in the fintech sector was waning from the buoyance seen in previous years. For example, there was a fall in the number people feeling extremely positive about fintech and regtech. For fintech overall, this year's survey reported that 15% of respondents were extremely positive compared with 31% last year.

There could be many reasons for this decline, from lack of funding to the economic downturn to greater competition. One area, however, may be worth singling out – increased regulatory risk. In 2021 there were some significant regulatory fines for firms. Many were imposed on firms which were potentially using fintech/regtech applications to meet their financial crime requirements. Examples included ABN Amro², 480 million euros and NatWest³, £264 million, both for money laundering failures, and JPMorgan⁴ \$125 million for recordkeeping failures.

Despite these fines, respondents to this year's survey highlighted financial crime as the area where regtech applications were having the greatest impact, no doubt partly to aid firms in their compliance efforts regarding sanctions following Russia's invasion of Ukraine.

In addition to the greater regulatory risk, the survey reported significant challenges when using fintech and regtech applications. Reasons given for not implementing fintech included a lack of investment, lack of in-house skills and poor infrastructure. This mirrors some of the wider challenges that respondents identified when deploying fintech applications, where the availability of skills, data governance and the regulatory approach featured prominently.

¹ <https://www.innovatefinance.com/capital/2022-summer-investment-report>

² <https://www.prosecutionservice.nl/latest/news/2021/04/19/abn-amro-pays-eur-480-million-on-account-of-serious-shortcomings-in-money-laundering-prevention>

³ <https://www.fca.org.uk/news/press-releases/natwest-fined-264.8million-anti-money-laundering-failures>

⁴ <https://www.sec.gov/news/press-release/2021-262>

Regulatory environment

Regulators are also adopting technological solutions to help with their supervisory roles and with the management of enormous quantities of data. The survey sought respondents' views on the hallmarks of "good" regulation.

Respondents said their firms needed more interaction with regulators on fintech and regtech. Among the larger G-SIB firms, 43% of respondents reported having spoken to the regulator about fintech and 43% about regtech. This contrasted with responses from other firms, nearly 60% of which reported that their regulator had not spoken to them about the use of technological solutions.

Looking forward

The slowdown in 2021/22 reported by Innovate Finance seems to have been a transitional period. There remain huge benefits to be gained from the successful deployment of technology, including the development of better risk management tools, the automation of processing, improved tracking of regulatory change as well as the streamlining of data governance, all of which should free up time for more

compliance value-add tasks. Global growth and the perceived "positive attitude" toward fintech applications has plateaued, however.

Predictions about the future of the fintech marketplace remain optimistic, so it may be that 2021/22 is merely a pause in the long-term growth of the sector. Firms should therefore continue to consider investment in technology, and in the supporting IT infrastructure and associated skillsets, although any such investment needs careful planning. Firms need to be certain that fintech and regtech will deliver the stated benefits. A well-resourced, highly skilled compliance function will be invaluable in successfully navigating the optimal use of digital solutions.

To maximise the potential of technological innovation, firms must continually reassess their technological needs and then invest in solutions tailored to the activities of their business.



"Failure to innovate can undermine a bank's competitiveness, posing a threat to safety and soundness just as innovating recklessly can."

Michelle W. Bowman, governor, U.S. Federal Reserve, August 2022

FINTECH AND THE GENERAL MARKETPLACE

The Financial Stability Board (FSB) defines fintech as “technologically enabled innovation in financial services that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services.

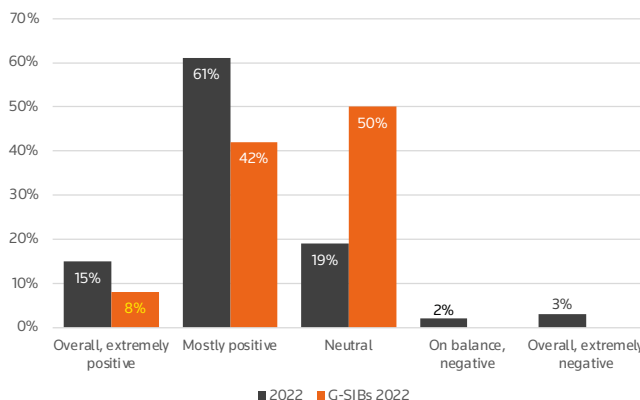
Enthusiasm waning for fintech?

The survey asked respondents how they used fintech and the benefits they derived from doing so. It sought to gauge the mood of respondents and to establish their views on innovation and digital disruption.

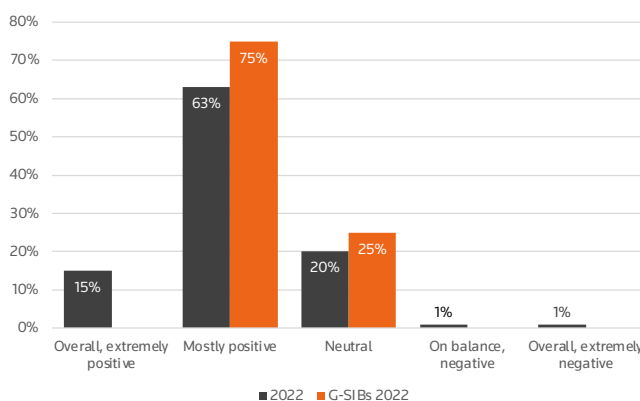
There was a fall in the number people feeling extremely positive about fintech and this was echoed among those feeling extremely positive about regtech. For fintech overall, this year’s survey reported that 15% of respondents were extremely positive, compared with 31% last year. There was an increase in those who felt mostly positive with 61% of respondents replying compared with 51% in 2021. For regtech, 15% of respondents felt extremely positive compared with 26% in 2021. There was an uplift in those who felt mostly positive – 63% – compared with 48% in 2021.

Further analysis of these figures shows that respondents who worked in a G-SIB also reported a waning of enthusiasm for fintech. Only 8% of respondents from G-SIB firms felt extremely positive about fintech and no respondents from G-SIB firms felt extremely positive about regtech. There was an uplift in those who felt mostly positive about regtech – 75% compared with 55%. The biggest change in terms of fintech, however, was for respondents from G-SIB firms feeling neutral – around 50% this year compared with 14% in 2021.

Fintech: What is your view of innovation and digital disruption?



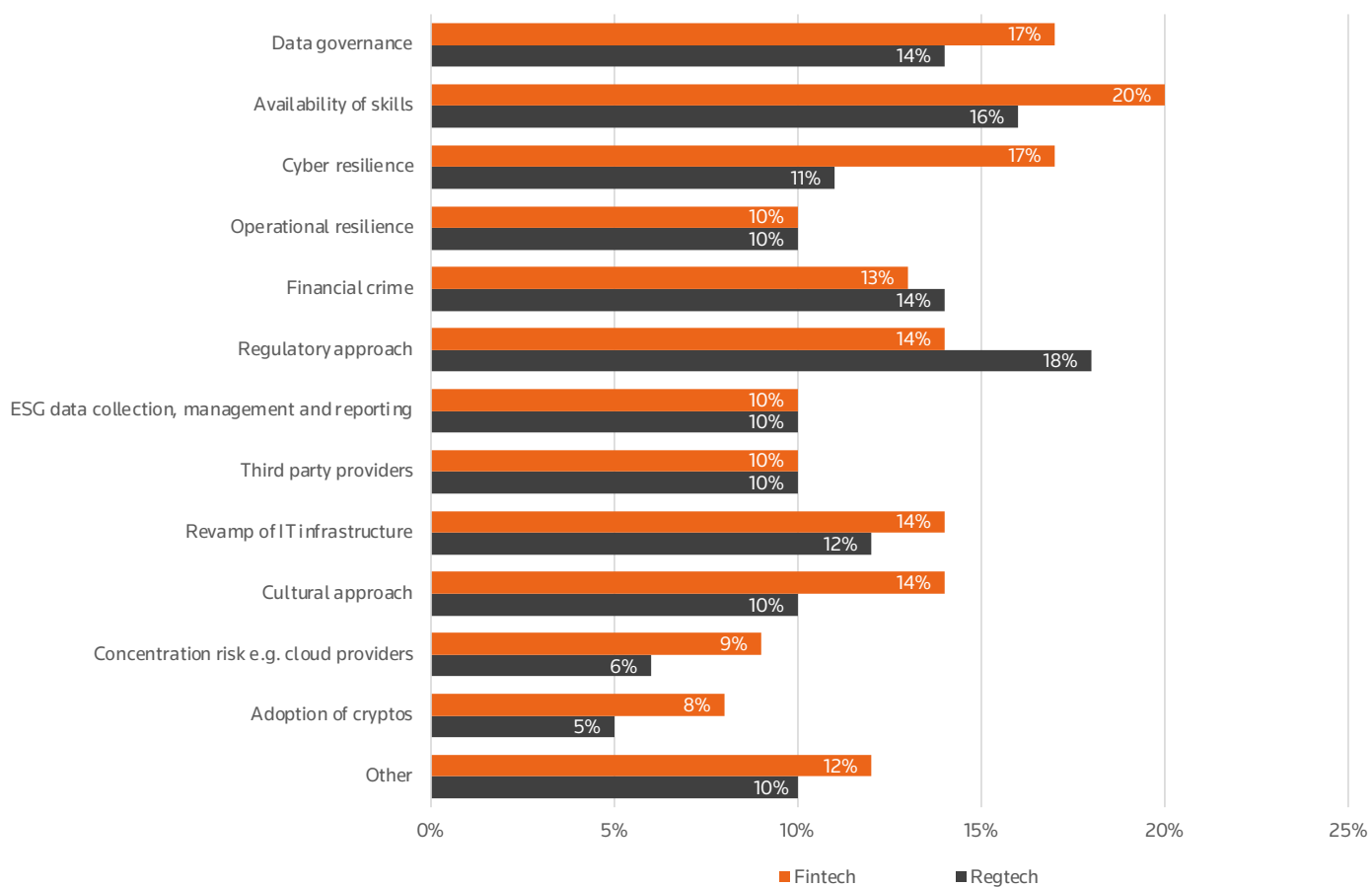
Regtech: What is your view of innovation and digital disruption?



“We cannot disregard the headwinds that are being faced by the fintech sector. It has become more challenging to access capital with rising interest rates, falling valuations, and investors quite rightly emphasise a path to profitability.”

Dr Vivian Balakrishnan, Minister for Foreign Affairs, Singapore, July 2022

The greatest financial technology challenges you expect your firm to face in the next 12 months are...



Significant challenges when implementing fintech

It is unsurprising that respondents felt less positive about innovation and digital disruption given the challenges that firms must address. This year respondents said that the availability of skills (20% fintech, 16% regtech) and regulatory approach (14% fintech, 18% regtech) were the top challenges firms anticipate in the next 12 months with regards to fintech and regtech. For G-SIBs, concentration risk and third-party providers ranked highest for fintech (15%), whereas cultural approach (15%) was the biggest challenge facing G-SIB

regtech users. Data governance and cyber resilience also feature highly in the list, with other areas including financial crime and operational resilience prominent.

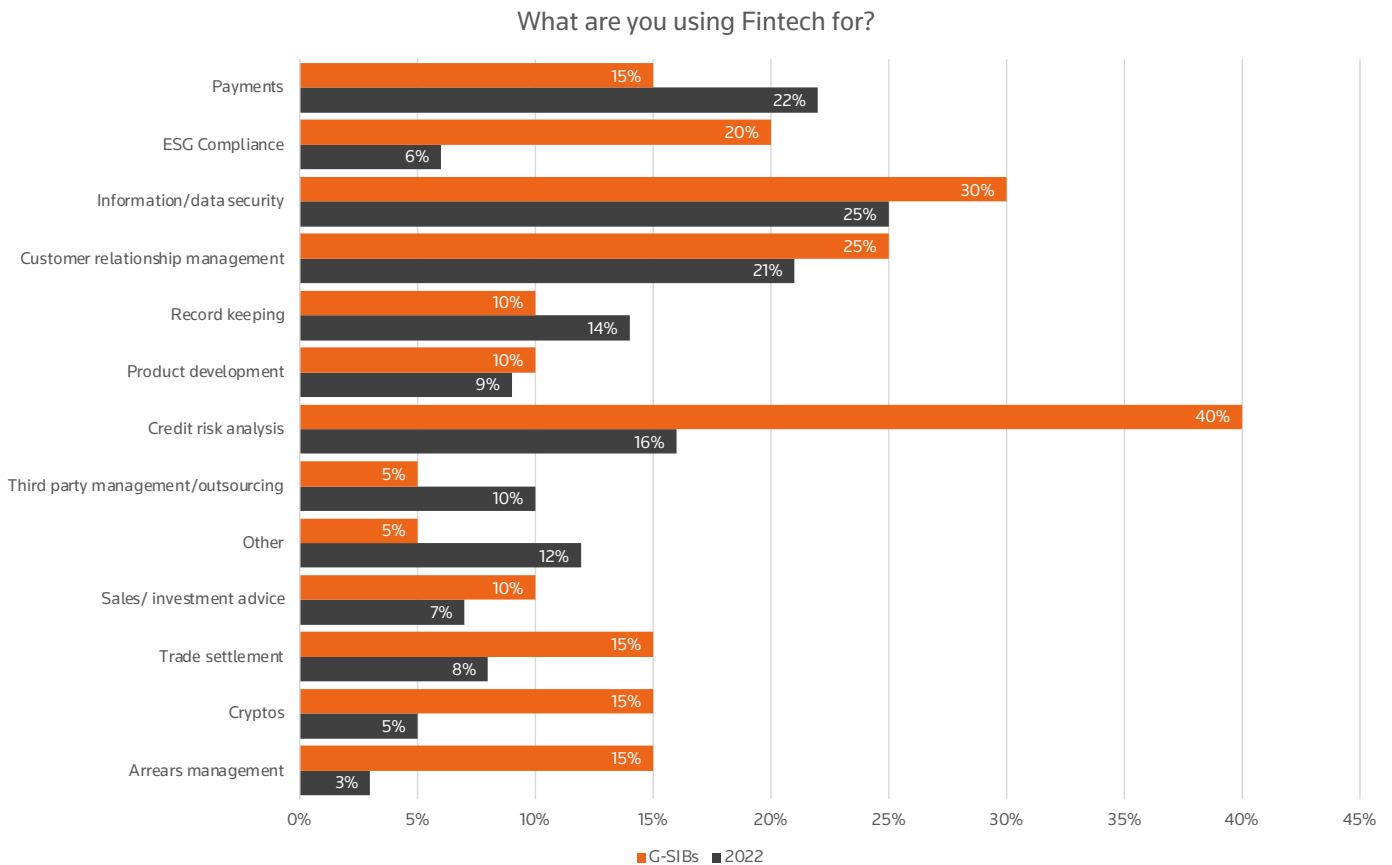
Availability of skills was listed as one of the greatest fintech challenges among firms in Asia (20%) and the UK (23%), compared with just 11% for firms in Australasia and the United States. Nearly a quarter of respondents from the UK (23%) also listed availability of skills as one of the greatest regtech challenges.

Wider set of application for fintech

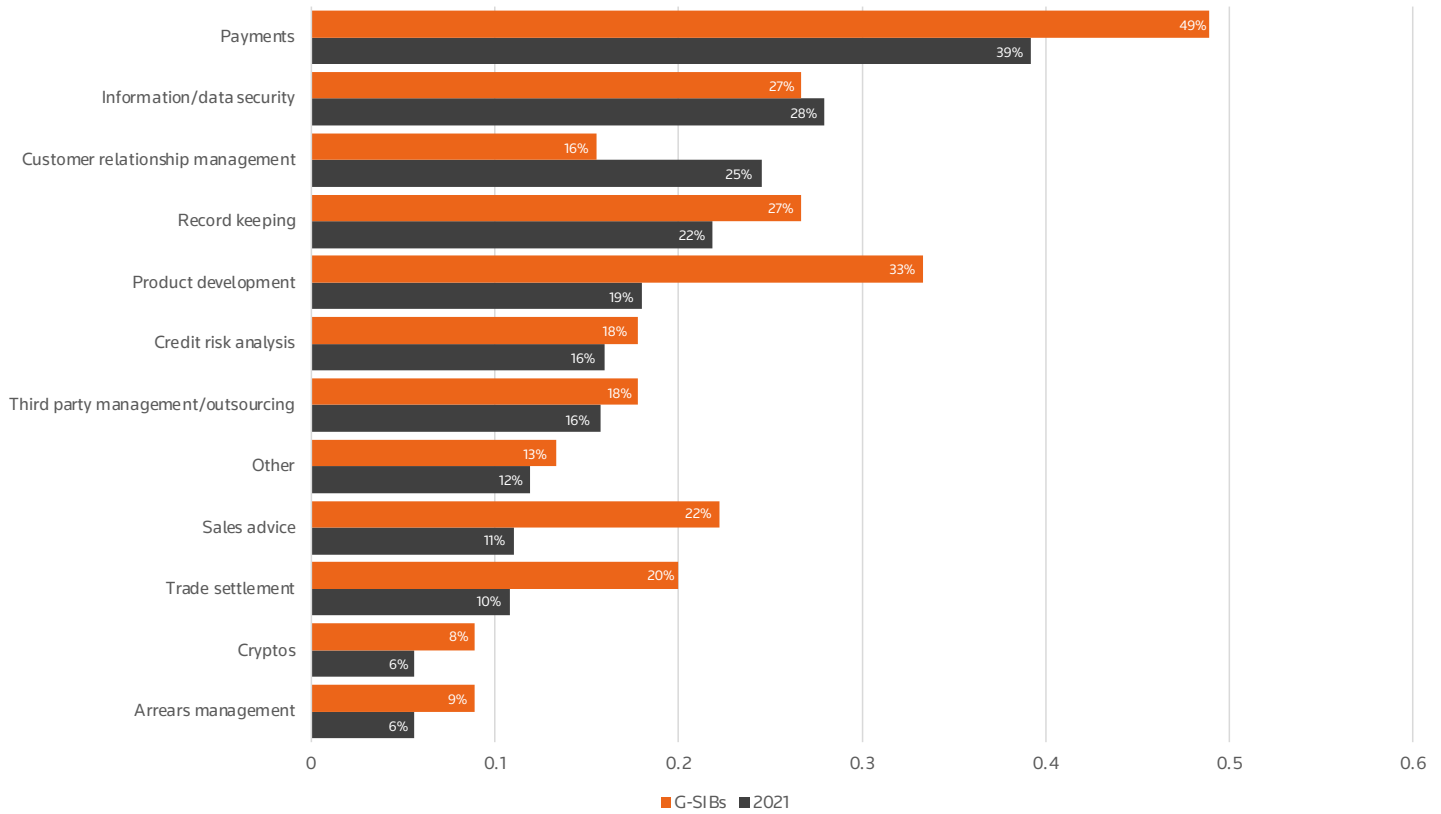
The profile of the different fintech applications has materially changed since last year. A total of 40% of G-SIBs are using fintech for credit risk analysis (18% 2021). Fewer respondents are using fintech for payments –22% (39% 2021) and 15% G-SIBs (49% 2021), perhaps reflecting a waning impact of the COVID-19 pandemic on financial transactions. Information/ data security and customer relationship management are the next most popular. Environmental, social and governance (ESG) compliance is a new entry and is popular among G-SIBs (20%).

From a regional perspective, 45% of respondents from continental Europe are using fintech for payment services.

Whereas a third of respondents from Asia (33%), Africa (38%) and the Middle East (31%) are using fintech for information/ data security.



2021: What are you using Fintech for?



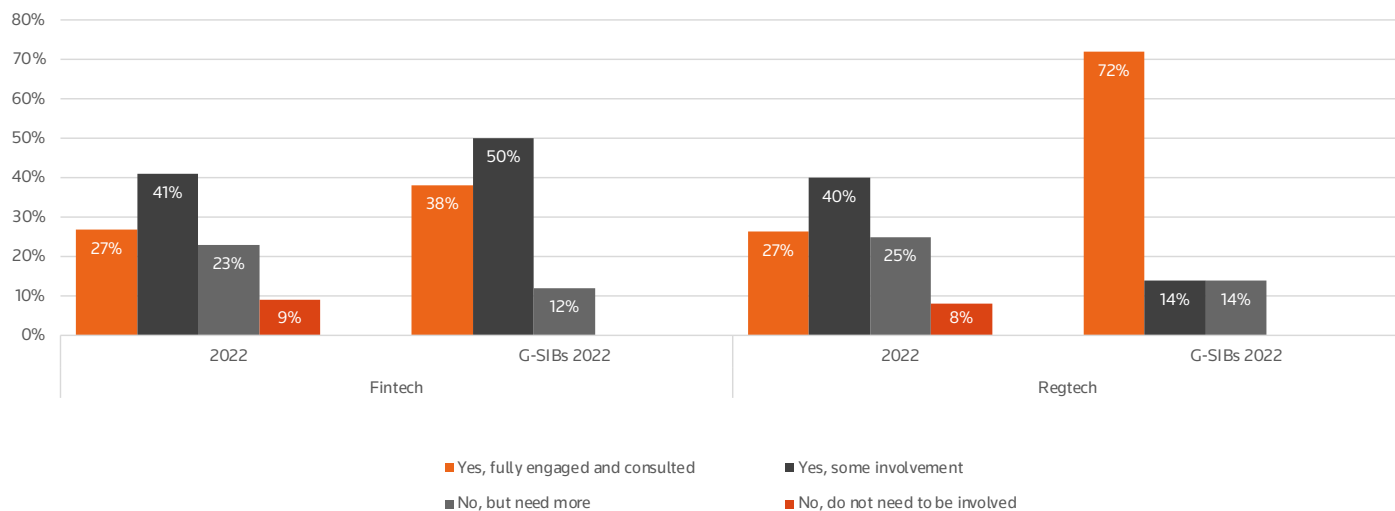
“Nowadays, a bank’s board should be well-versed in climate and environmental risks, as well as IT infrastructure and digitalisation strategies.”

Frank Elderson, member of the Executive Board of the European Central Bank (ECB) and vice-chair of its Supervisory Board, in a speech at the Florence School of Banking and Finance’s Bank Board Academy, June 2022

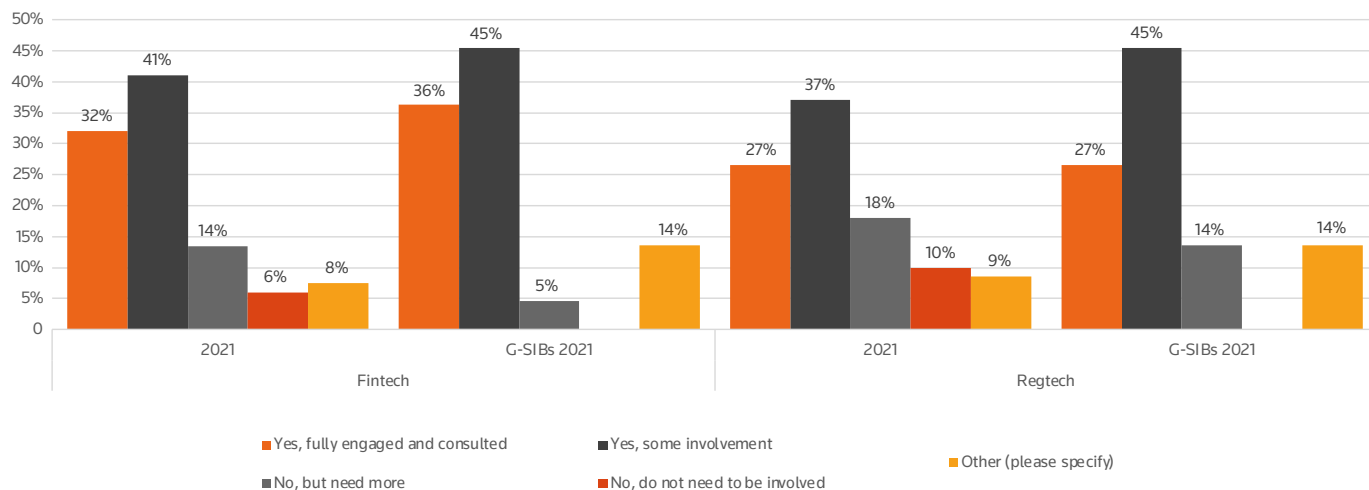
More board involvement needed

A problem highlighted in previous reports has been boards’ level of involvement with the application of fintech solutions. This year almost two-thirds (68%) of boards were involved with their firm’s approach to fintech (88% G-SIBs), while 67% were involved with regtech (86% G-SIBs). 72% of G-SIBs were fully engaged and consulted at board level on matters related to regtech

Does your board have enough involvement in your firm's approach to fintech, regtech?



2021: Does your board have enough involvement in your firm's approach to fintech, regtech?

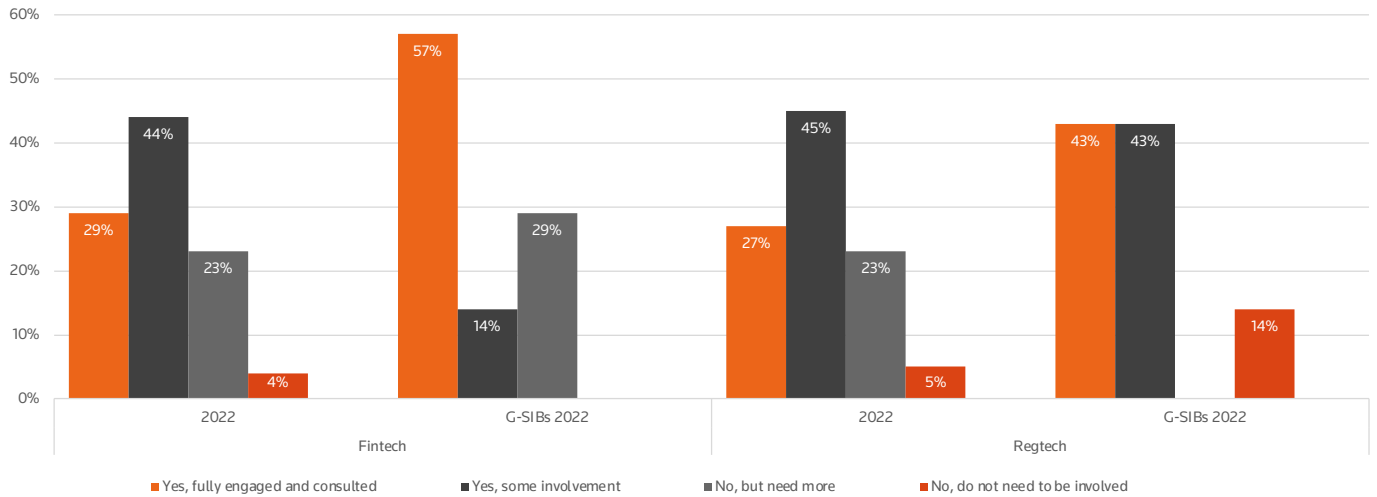


“Firms should ensure that there is an appropriate level of understanding and awareness of AI’s benefits and risks throughout the organisation. This can include more formal governance arrangements and a clear role for senior leadership.”

Bank of England and the UK Financial Conduct Authority, final report of the AI Public-Private Forum (AIPPF), February 2022

Involvement of risk and compliance functions has increased

Do the risk and compliance functions have enough involvement with your firm's approach to fintech and regtech?

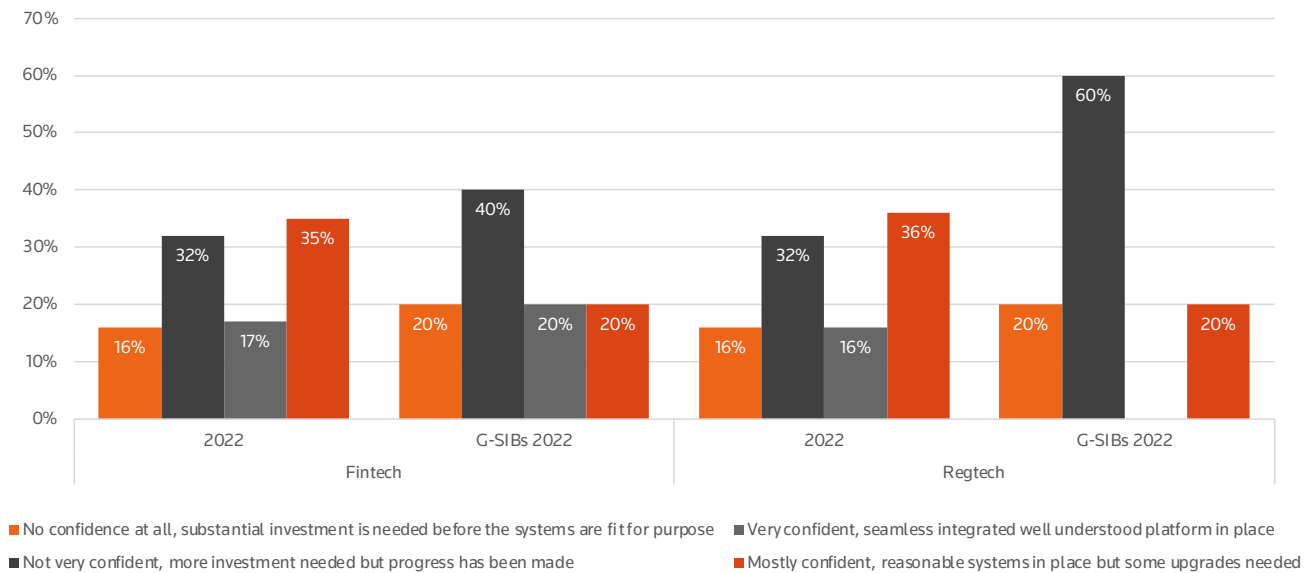


Overall, risk and compliance functions' involvement in their firms' approach to fintech and regtech has increased; 73% participated in their firm's approach to fintech, with 29% fully engaged and consulted. In 2021 this figure was 70%, with 26% fully engaged. While 72% participated in their firm's approach to regtech, 27% were fully engaged and consulted (68% and 30% in 2021 respectively). In the G-SIB community there was a notable increase in the fully engaged and consulted category from 26% to 57%.

IT infrastructure holding firms back

The ability of firms' existing IT infrastructures to support future fintech and regtech solutions has been a worry for some time, and this year's results were no exception. A third of firms said reasonable systems were in place, although upgrades were needed for fintech (35%) and regtech (36%) solutions. However, almost a fifth of firms (16% overall and 20% of G-SIBs) reported that they had no confidence in their IT infrastructure.

How confident are you that your IT infrastructure is/will be able to support fintech, regtech and insurtech solutions?



Skill sets are a challenge

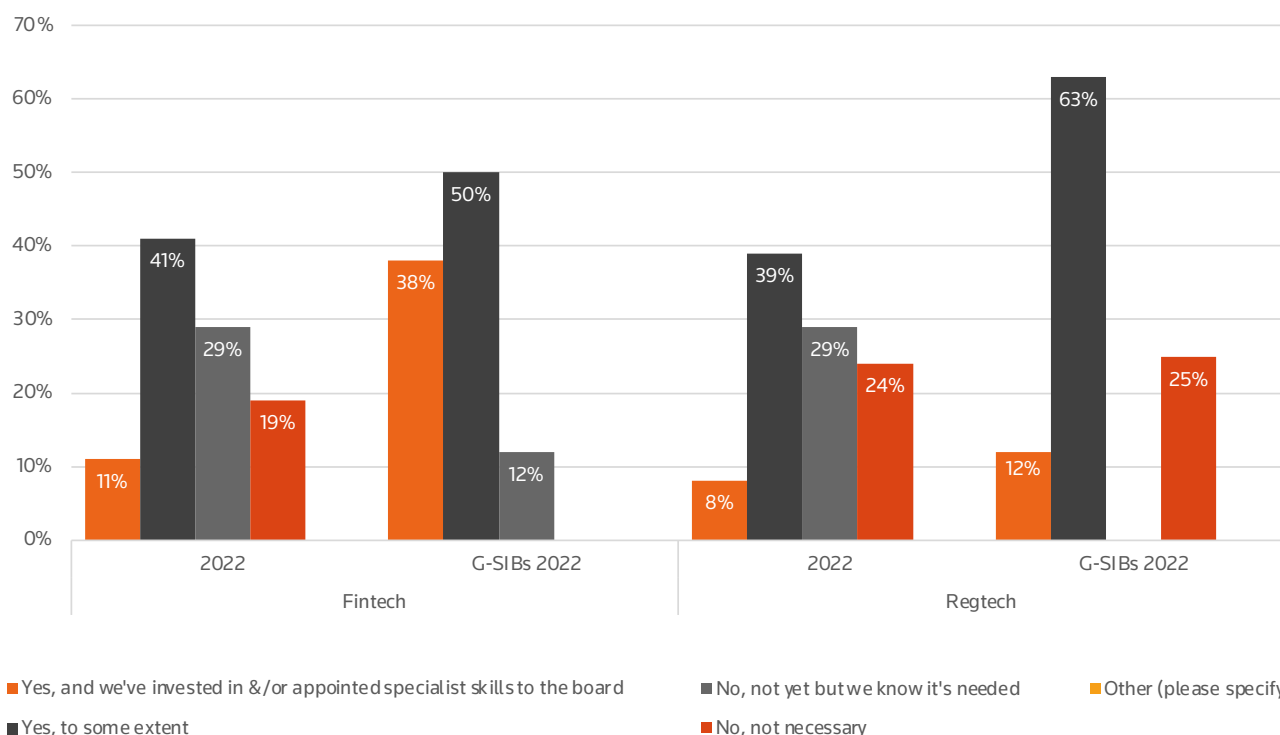
In previous years, the report has highlighted the need for firms to have skill sets that enable them to understand and manage fintech applications. In this year's survey, half of boards (51%) have had to widen the firm's skill set to accommodate developments in innovation and digital disruption regarding fintech (88% G-SIBs), compared with 47% regarding regtech (75% G-SIBs).



“The increasing prominence of fintech and green and sustainable finance have been a game changer to the global financial industry. Financial institutions across the globe are actively looking for experts with relevant knowledge and skillsets to help develop innovative fintech solutions or sustainable investment products, manage the climate risks.”

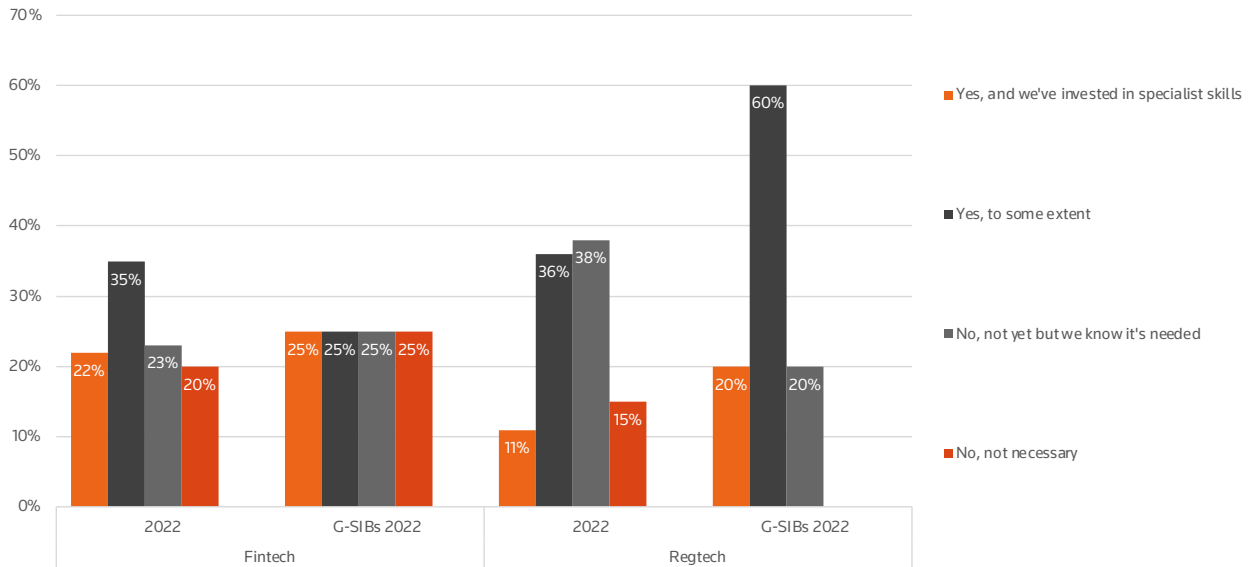
Arthur Yuen, deputy chief executive, Hong Kong Monetary Authority, June 2022

Have you had to widen the skill set at board level to accommodate developments in innovation and digital disruption?



From a regional perspective, 22% of firms in Africa had invested in or appointed to the board people with specialist skills related to fintech and 29% of firms in the Middle East had done so with regards to regtech. Only 4% of firms based in Asia had invested in or appointed people with specialist skills for fintech and regtech.

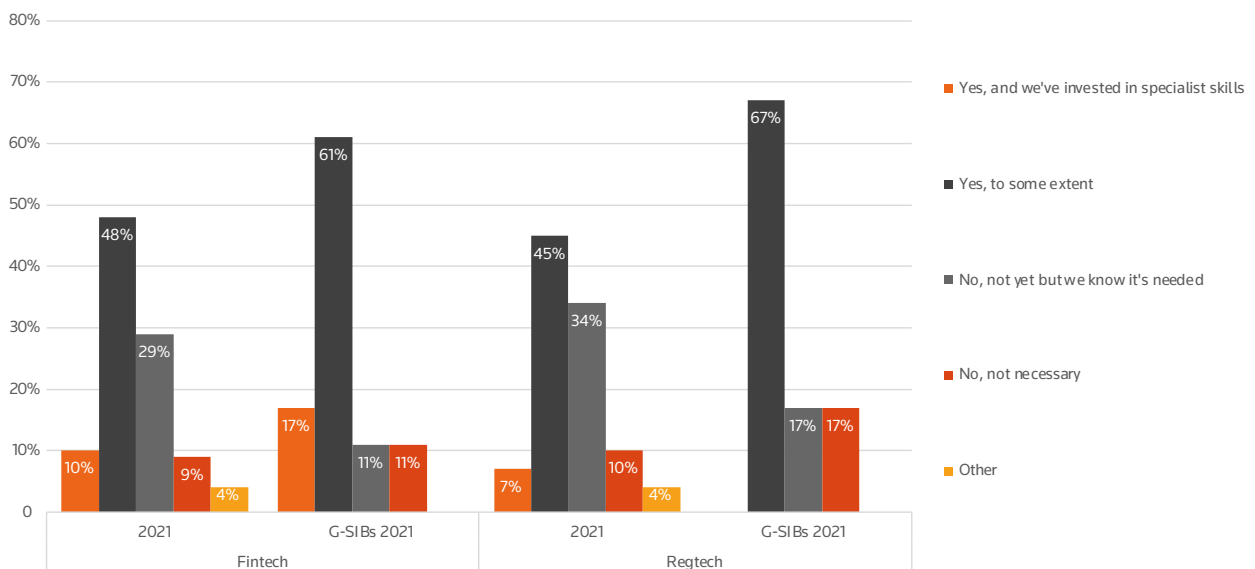
Have you had to widen the skill set within your risk and compliance functions to accommodate developments in fintech, insurtech and regtech innovation and digital disruption?



Investment in specialist skills remains difficult. A fifth of firms (22%) had widened the skill set of their risk and compliance function to accommodate developments in fintech innovation and digital disruption, and only 11% had done so for regtech innovation. G-SIBs were slightly ahead, but there is still room for improvement.

Firms in the United States are ahead of peers, with 38% widening skill sets within the risk and compliance functions and investing in specialist skills.

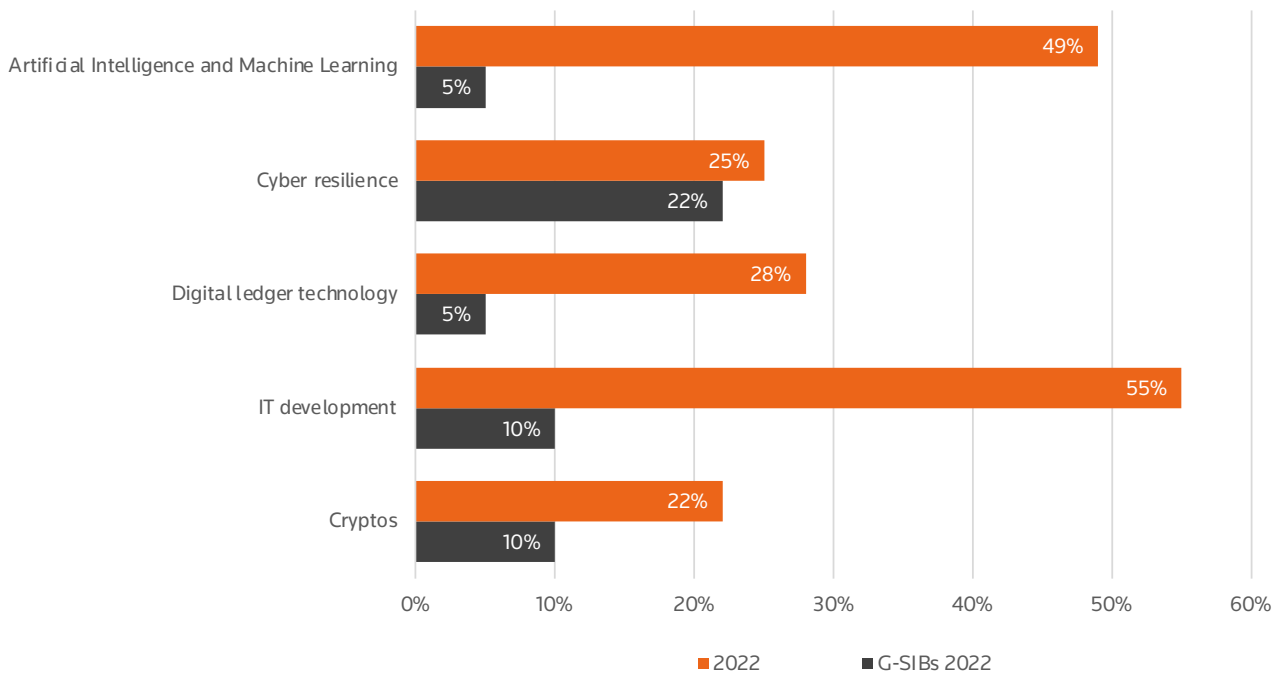
2021: Have you had to widen the skill set within your risk and compliance functions to accommodate developments in fintech, insurtech and regtech innovation and digital disruption?



To address these issues, the survey asked respondents for their views on what skills would be needed in the future. IT development and artificial intelligence (AI) and machine learning were considered to be the most important skills

needed by risk and compliance in the future; regionally, IT development ranked as the most important skill for more than a third of firms in Asia (33%) and a quarter in Africa (25%).

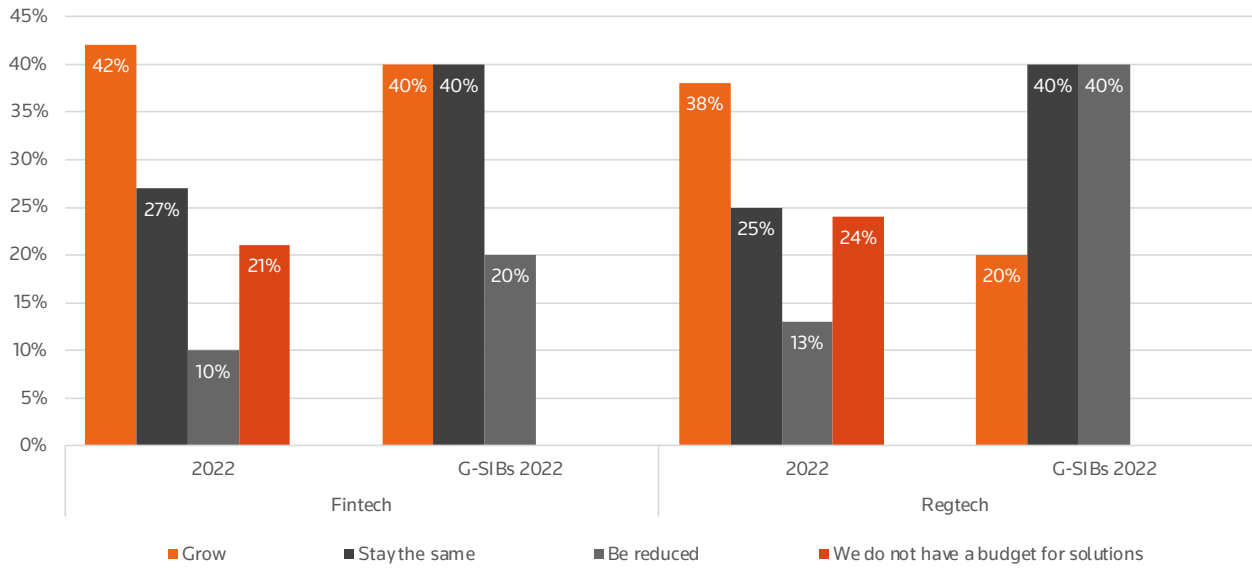
What skills do you see risk and compliance needing in the future?



Is money the problem?

Overall, budgets for fintech and regtech solutions are expected to grow in the next 12 months, although slightly more than a quarter of respondents expected budgets to remain the same for fintech (27%) and regtech (25%) solutions.

Your firm's budget for fintech/regtech solutions over the next 12 months will:



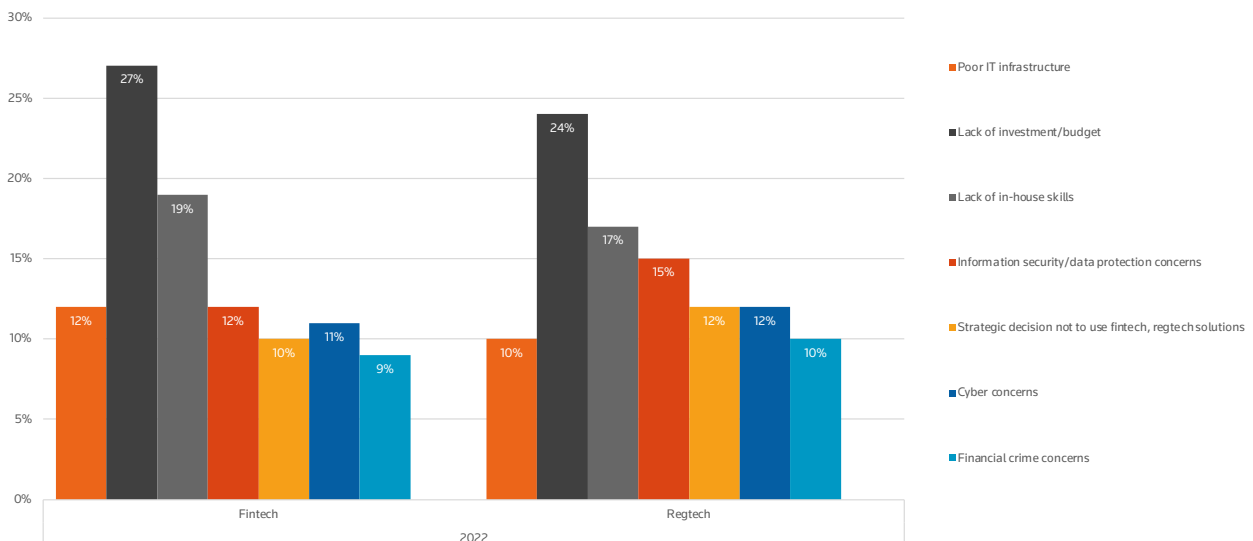
Regionally, 58% of firms in the United States and 60% of firms in Africa expected budgets for fintech solutions to increase in the next 12 months. A quarter of firms in the Middle East expected budgets for fintech and regtech solutions to reduce.

At some firms there appears to be a persistent failure to invest in technological solutions. This manifests itself in several ways – for example, through continuing failure to address poor IT infrastructure or through holding back

investment in the kinds of in-house skills and budget required to deploy fintech or regtech solutions.

Although respondents reported budget increases, those that had not yet deployed fintech and regtech solutions reported lack of investment and budget as the main reason for not taking this path. Mirroring findings from above, a lack of in-house skills and poor IT infrastructure were also cited as significant reasons.

If your firm has not yet deployed fintech or regtech solutions, what is holding you back?



Regionally, nearly a third of U.S. firms have not deployed a fintech (34%) or regtech (32%) solution due to lack of investment/budget.

REGTECH

The UK Financial Conduct Authority defines regtech as “a subset of fintech that focuses on technologies that may facilitate the delivery of regulatory requirements more efficiently and effectively than existing capabilities”.

Implementation of regtech solutions increasing



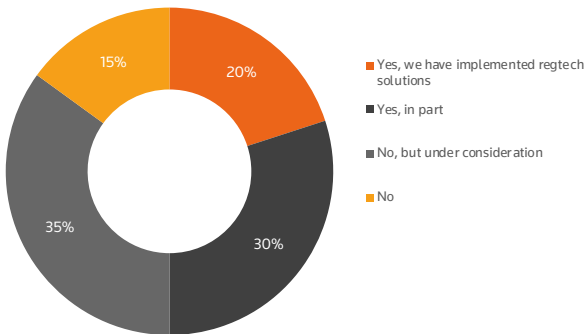
78% of Jersey firms believe regtech tools are increasingly necessary for achieving compliance.

Source: Jersey Financial Services Commission, July 2022

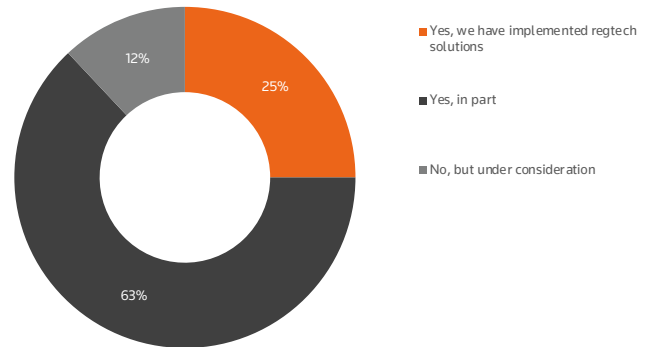
The fall in enthusiasm reported above has failed to dent the adoption of regtech solutions among firms. When asked whether regtech solutions affected the way they managed compliance, half of respondents (50%) said they have either

implemented a regtech solution or have done so in part, up from 38% in 2021. G-SIBs have really embraced regtech, with nearly 90% having implemented a solution in part or in full.

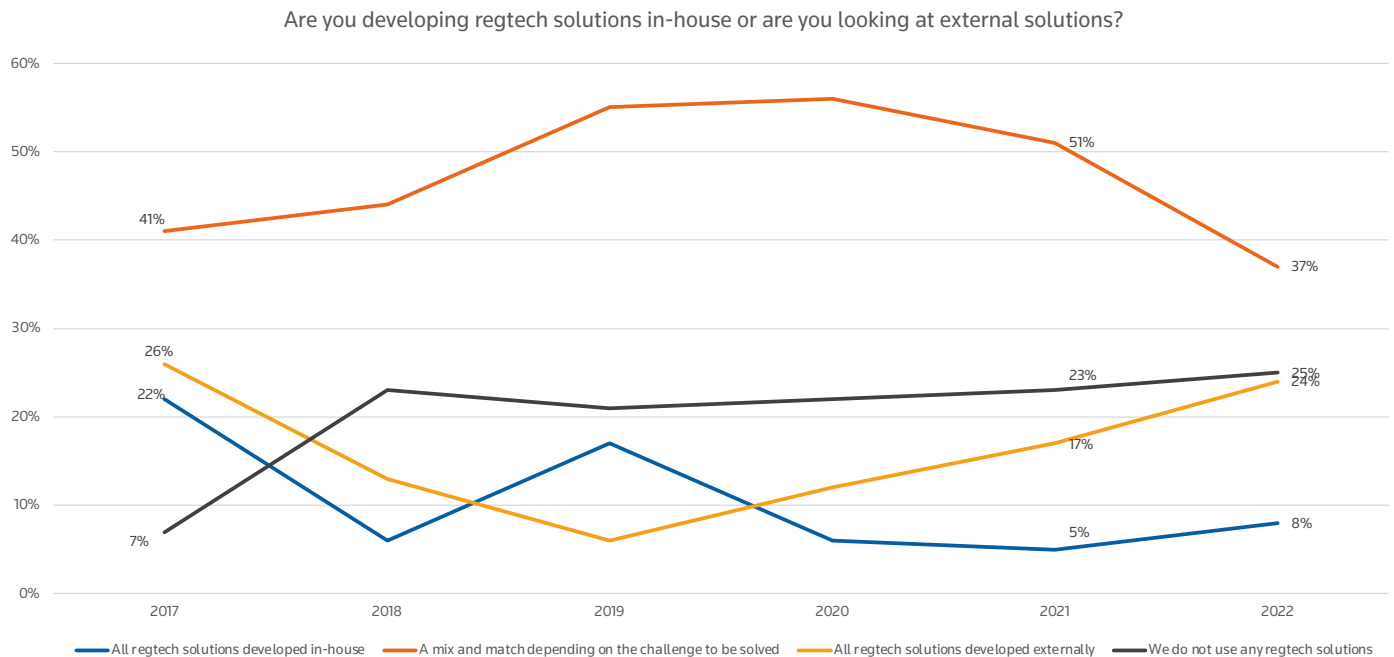
Are regtech solutions impacting how you manage compliance?



G-SIBs: Are regtech solutions impacting how you manage compliance?



Growing popularity of external regtech solutions



Responses this year show a move toward the external development of applications. Most firms reported that regtech solutions are being developed through a mixture of external and in-house initiatives, but this percentage has dropped from last year (37% this year, 51% in 2021) and has been a declining trend in the last few years. The percentage of firms developing all regtech solutions in-house has risen slightly to 8%.

Also, 25% of respondents reported not using any regtech solutions. This may indicate respondents' frustration with internal capabilities, whether that is the dearth of in-house specialist technology skills, availability of budget and compatibility of legacy IT systems.



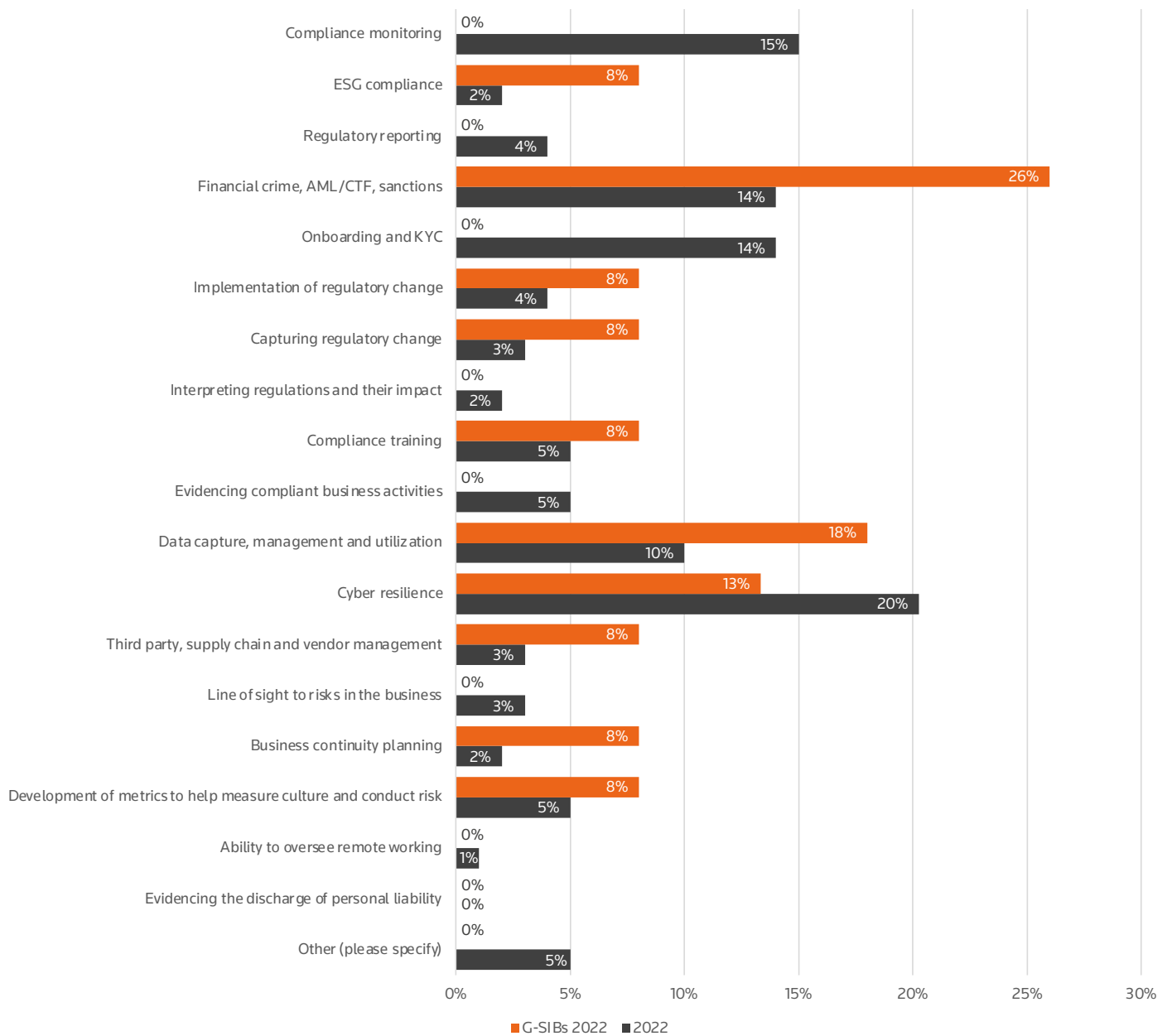
“Technological solutions offer the possibility to deliver tremendous benefits and we should be ready to harness them. But any technology solution needs to be buttressed by three pillars: an appropriate regulatory framework, sufficient supervisory oversight and [...] a deep understanding [...] not only of the potential but also the limitations and risks of new technologies.”

Elizabeth McCaul, member of the Supervisory Board of the ECB, July 2022

Regtech used for a wide range of risk and compliance processes

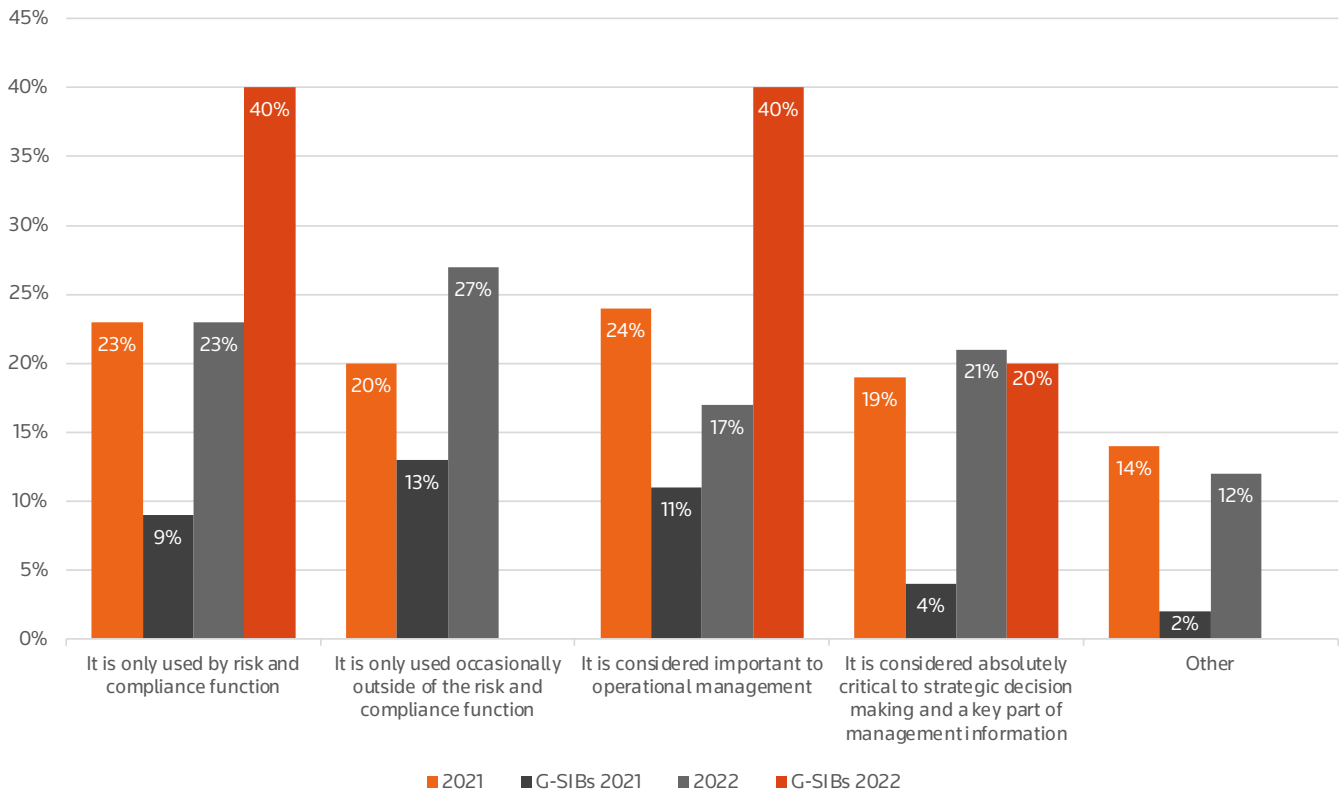
Financial crime, including AML and sanctions checking, are the parts of compliance most affected by regtech solutions (26%).

Which part of compliance and regulatory risk management is most likely to be impacted by regtech at your firm?



Output from regtech solutions more useful at operational level

How is the output from regtech used within your firm?



The ways firms use the outputs from regtech solutions has varied over time. While more firms are considering the adoption of regtech solutions, the output from those solutions has yet to become a trusted source of management information used for strategic decision making. G-SIBs look to be more accepting, with 20% of firms saying that the output from regtech was a central part of management information used in decision making.

The greatest benefits/values you expect your firm to see from financial technology in the next 12 months are:

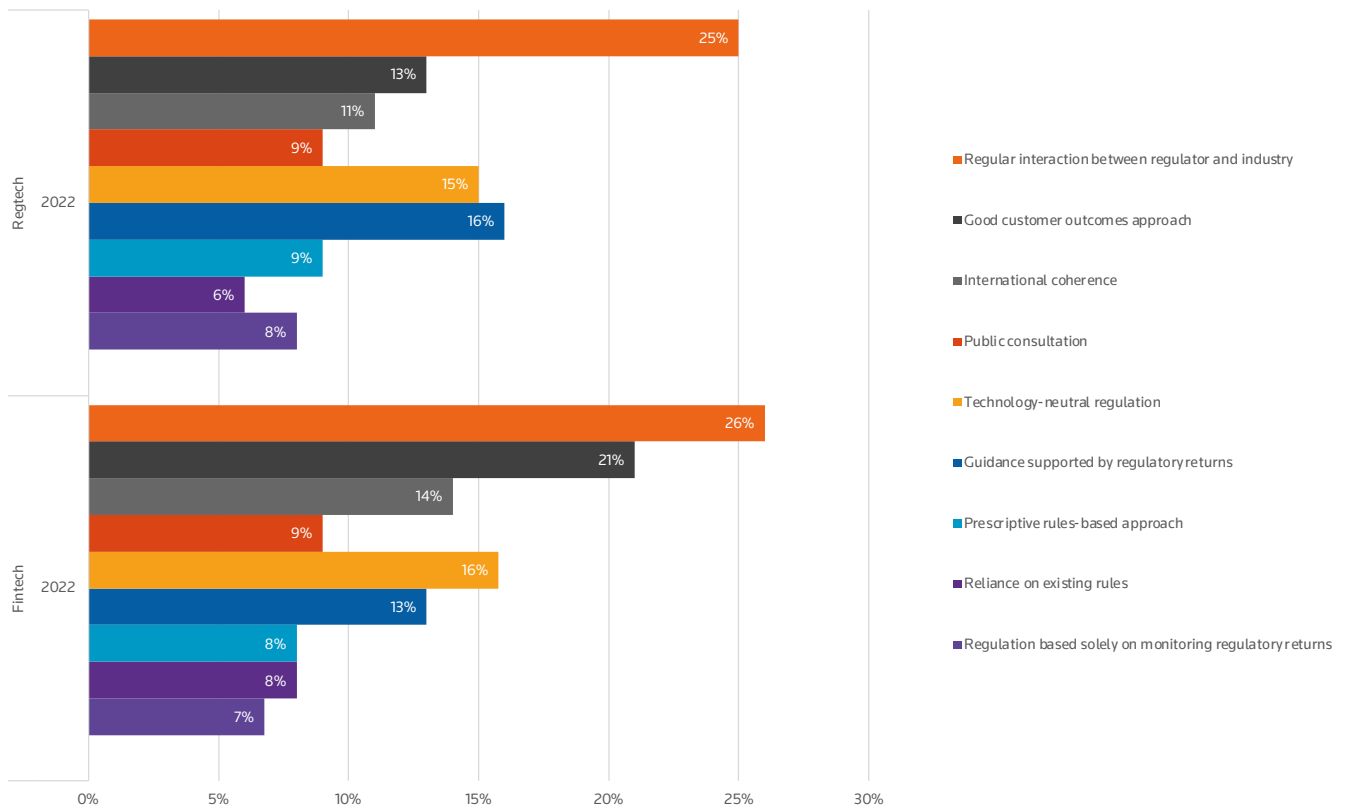
“The ability to compare and organize data for the benefit of multiple departments at our organization.”

Compliance officer, United States

REGULATION

The pandemic accelerated the use and adoption of technological solutions. Regulators have themselves adopted solutions to meet evolving supervisory approaches, including the need to gather and analyse increasingly large volumes of data.

What do you consider to be the hallmarks of good regulation with regards to fintech/regtech?

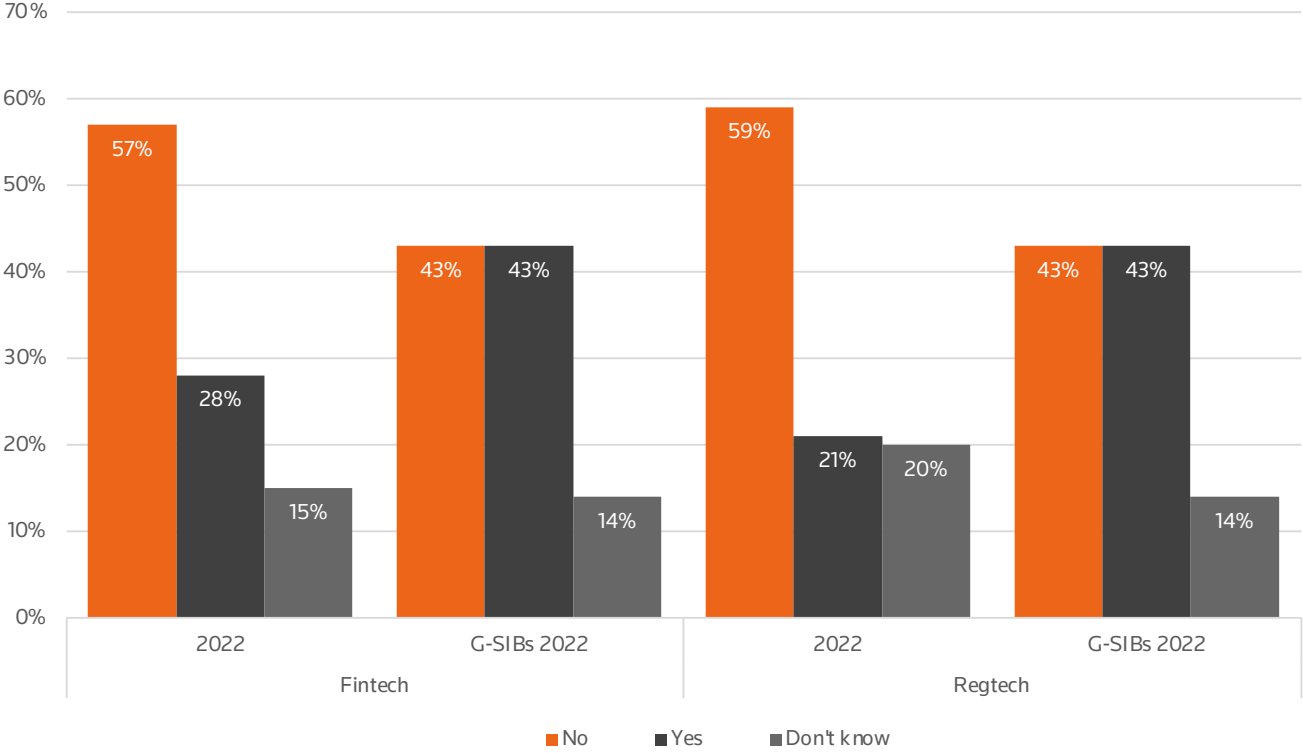


For both the use of regtech and fintech the top hallmark of good regulation was seen as regular interaction between regulator and industry. For regtech the next two hallmarks were guidance supported by regulatory returns (16%) and technology-neutral regulation (15%).

For fintech, the second and third hallmarks of good regulation were a good customer outcomes approach (21%) and technology-neutral regulation (16%).

Against a backdrop of the stated need for regular interaction between regulator and industry on fintech and regtech, respondents were asked whether their regulator had spoken to them about their approach to fintech/regtech.

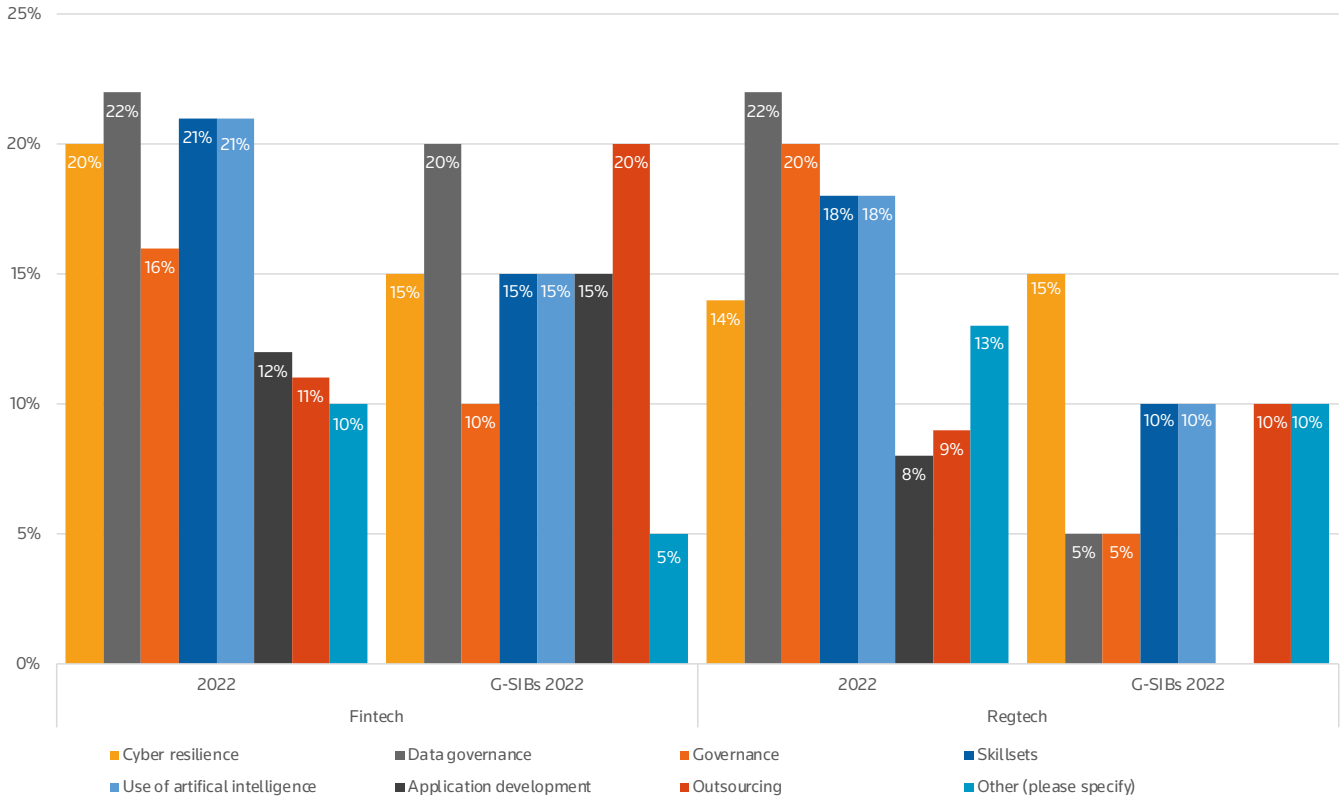
Has your regulator spoken to you about your approach to fintech/regtech?



Responses paint a disparate picture, with regulators having prioritised communication with the largest financial institutions about their approach to fintech (43%) and regtech (43%). This contrasts with other firms, nearly 60% reported that their regulator had not spoken to them about their use of technological solutions.

More widespread use of fintech/regtech by regulators themselves means that firms of all sizes would be well-advised to initiate regular, in-depth conversations with their regulator on the use of fintech and regtech. This might help bridge the apparent disconnect between firms and their regulators.

In what areas is additional regulation/guidance needed?



The areas in which additional regulation and guidance are seen to be needed give an indication of potential future worries for firms and their compliance officers.

Data governance emerged as a particular concern in last year's report. Firms must embrace the fact that data is a vital strategic asset, and from there build a business-wide approach to data aggregation, management, storage, security, retrieval and destruction; in other words, build a business-specific approach to data governance. The successful governance of data will have multiple benefits, including greater visibility of risks being run in a hybrid working environment and enhanced recordkeeping.

To deliver on data governance, firms will need to invest wisely in both skills and infrastructure. They may well need to reassess their priorities in a (post) pandemic world.

In addition to the focus on data governance, respondents highlighted skillsets and the use of AI (equal 21% fintech) and governance (20% regtech) together with cyber resilience (20% fintech) and outsourcing (20% fintech G-SIBs) as top areas where firms would appreciate additional regulation or guidance.

INTO THE FUTURE



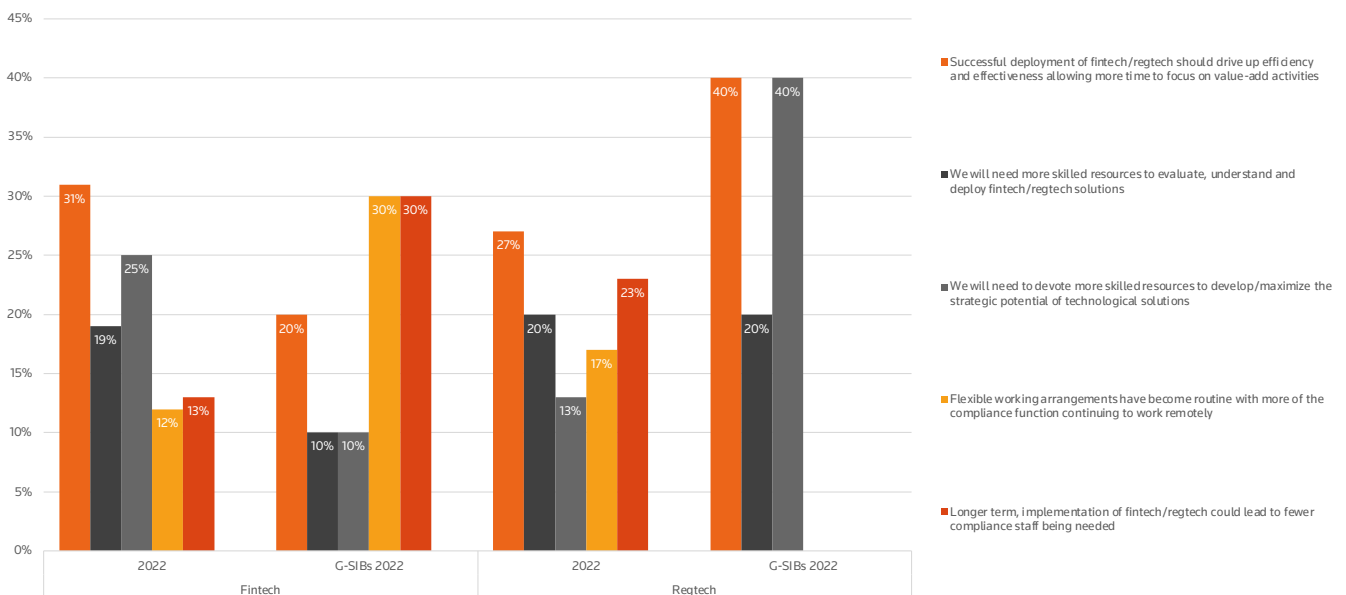
“The changing role of data in the AI lifecycle raises questions on the appropriate governance structures within an organisation. And as firms develop their data strategies to accommodate the use of AI systems, there is an increasing call for the development and use of AI-specific data standards.”

Bank of England and the UK Financial Conduct Authority, final report of the AI Public-Private Forum (AIPPF), February 2022

The implementation of fintech and regtech solutions will have potentially wide-ranging effects for the compliance function. For regtech the sense from the G-SIBs is that it will drive up efficiency and effectiveness, allowing more time to focus on adding value. It is likely that more skilled resources will need to be devoted to developing and maximising the strategic potential of technological solutions. From the fintech perspective, for the G-SIBs there are the two main elements. First, flexible working arrangements have become routine, with more members of the compliance function continuing to work remotely. Secondly, in the longer term, the implementation of fintech could lead to fewer compliance staff being needed.

In the adoption and deployment of technology, the record of G-SIBs could be seen as a leading indicator for the wider financial services industry. Other, smaller, firms would do well to focus on the need for additional skilled resources, to maximise the strategic potential of technological solutions and to help them evaluate, understand and deploy fintech/regtech solutions.

What will be the impact of fintech/regtech on your compliance function?



The greatest benefits/values you expect your firm to see from financial technology in the next 12 months are:



Respondents were asked about what they expect fintech to deliver in benefits and added value in the coming year. Overall, fintech was seen as increasing the effectiveness of firms' operations by improving efficiency and speed of processing, while better data management was expected to

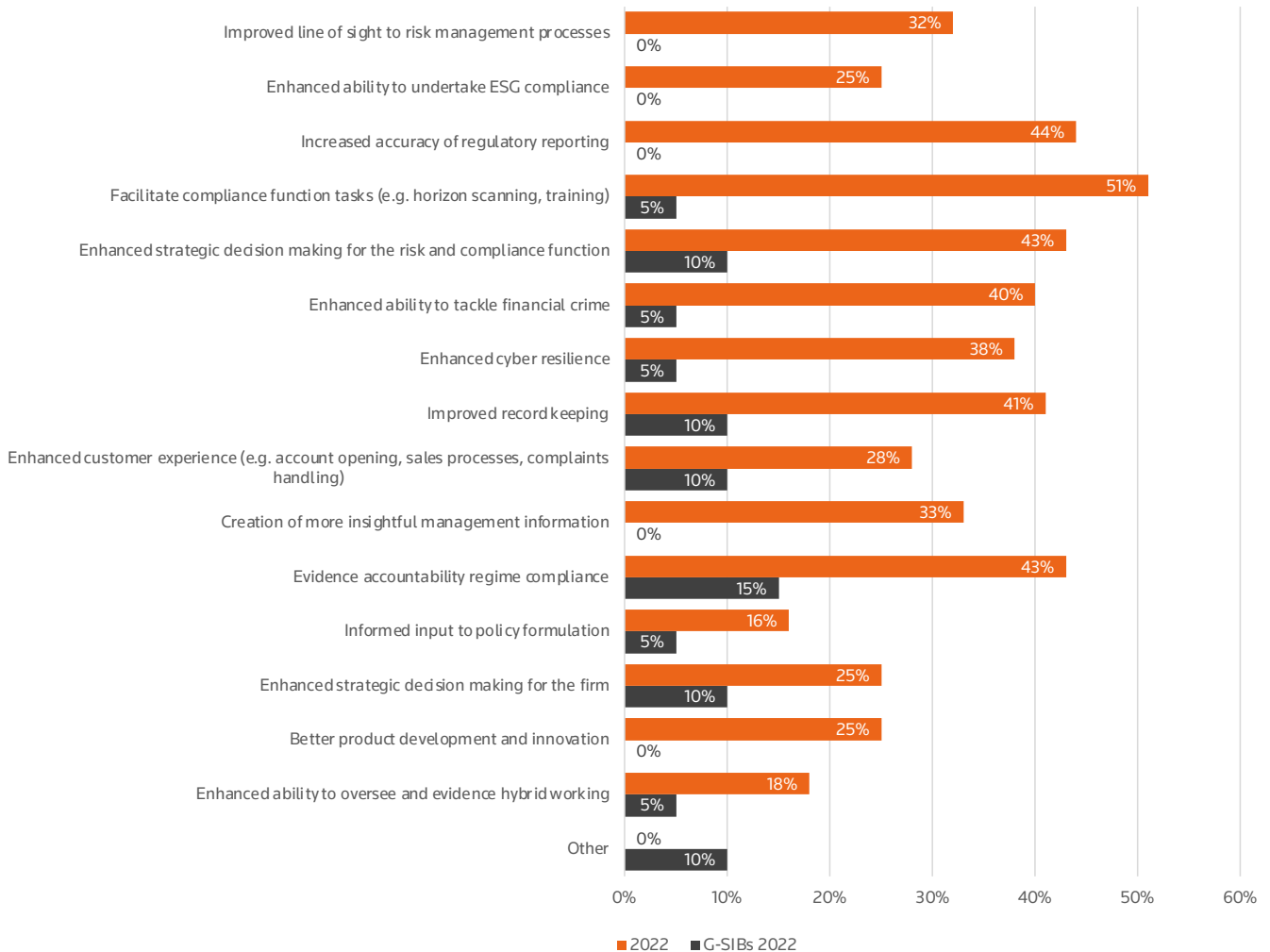
generate additional cost benefits. Coming back to the need for skilled resources, firms need to be aware that, to reap the potential benefits, they will need to invest in the supporting IT infrastructure as well as relevant skilled resources in all areas of the business.



"A streamlined onboarding capability that delivers an enhanced customer experience while maintaining compliance, robust recordkeeping and an efficient, cost-effective use of data sources."

Chief compliance and risk officer, UK

What would you like regtech to be able to do for your firm?



Respondents had a substantial wish list for what they would like regtech solutions to be able to do for them. The range of activities with which risk and compliance function professionals would like assistance shows the potential scope for the regtech marketplace.

Last year's survey found that the top requirement was for improved line of sight to risk management processes (21%) and more accurate regulatory reporting (19%). Regulatory reporting will continue to be a significant issue, particularly once the reporting and data requirements for ESG and the International Sustainability Standards Board standards come into effect.

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Last year's survey found that the top requirement was for improved line of sight to risk management processes (21%) and more accurate regulatory reporting (19%). Regulatory reporting will continue to be a significant issue, particularly once the reporting and data requirements for ESG and the International Sustainability Standards Board standards come into effect.

G-SIB respondents highlighted different priorities, with the evidencing of accountability regime compliance (15%) listed as the top requirement.

CLOSING THOUGHTS

When asked what was the one thing they would like technological innovation to be able to deliver for their firm in the coming year, respondents highlighted a series of requirements.

What is the one thing you would like technological innovation to be able to deliver for your firm in the next 12 months?



Technological innovation continues to have the potential to provide multiple benefits for financial services firms and their compliance functions. Firms still require more from their fintech and regtech applications and there is still a long way to go before digital transformation and the deployment of technological solutions is seen to have met the day-to-day needs of risk and compliance.

What is the one thing you would like technological innovation to be able to deliver for your firm in the next 12 months?

“To find a way to plan and budget and utilize some of the solutions already out there that we are currently performing manually. We need to take advantage of options already available for areas of the bank that could really use it and it would free up a good portion of time to dedicate to growing other areas and not have to be focused on menial tasks that can be made much simpler through a streamlined process in a fitting solution.”

Risk analyst, United States

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