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FINTECH AND EMERGING PAYMENTS – COMPLIANCE AND REGULATORY CHALLENGES

REPRINTED FROM:

RISK & COMPLIANCE MAGAZINE

OCT-DEC 2018 ISSUE

www.riskandcompliancemagazine.com

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Acuris Risk Intelligence

Published by Financier Worldwide Ltd
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ONE-ON-ONE INTERVIEW

FINTECH AND EMERGING PAYMENTS – COMPLIANCE AND REGULATORY CHALLENGES

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Nick Parfitt is responsible for determining Acuris Risk Intelligence's approach to the market and building subject-matter expertise. He has 18 years' experience in project and programme management, business process change and in implementing technology and business solutions at financial services, telecoms and public sector organisations. His experience in the financial crime sector spans seven years helping tier 1 financial institutions assess and improve AML, KYC and sanctions operations. Mr Parfitt has worked for several tier 1 banks in the UK and holds an MBA (Distinction) from Cardiff University, and a BA (Hons) in Biochemistry from Imperial College.

R&C: Could you provide an overview of the main trends and developments to have emerged in the FinTech and emerging payments space in recent years? To what extent are established financial institutions' (FI) systems and protocols being disrupted?

Parfitt: A plethora of new entrants are changing the market significantly, typically bypassing legacy back-office processes and systems. They are attracting consumers with more personalised financial services and a better customer experience than traditional banking can offer. The new entrants pitch themselves as more nimble and consumer-friendly than stale and lethargic incumbents. They also promote the ease and convenience of remote access and are leading technologies and innovation in this area. However, not everyone is in their target market. Consumer adoption runs across a very broad spectrum, from early adopters to risk-averse consumers, so these challengers focus their efforts on more technology-savvy prospects. Both national and international regulators are driving change and innovation, for example with the Payment Services Directives – PSD 1 and PSD 2. This puts pressure on banks, financial service providers and payment schemes to increase competition, innovation and access.

R&C: Could you outline what new FinTech players are bringing to the payments market? How are FIs, such as banks, responding to innovation in the payments space?

Parfitt: New FinTech players are capitalising on the vision that they can completely change the status quo through being new, small, innovative, agile and niche. But with this comes a degree of hyperbole until the solutions and innovations are well embedded in practice. I am sure it will happen, but maybe at a slower pace than originally envisaged. An interesting comparison is with supermarkets' launches of financial services offerings that were little more than white-labelling traditional banking services and propositions. The result was 'me-too' propositions that delivered little added value to the consumer. So while the new entrants' messaging has promised more innovation, and services that deliver greater relevance and choice without being linked to expensive and restrictive brands, the challenge is that some have also become a 'me-too' offering, while others have struggled to gain traction in a marketplace dominated by the traditional players. We see a move toward partnerships and symbiotic relationships where incumbents and new entrants can genuinely offer the best of both worlds: innovative and convenient services grounded in secure and well-established infrastructure. An interesting example is the announcement that RBS and NatWest have signed with Starling Bank for the provision of payment services to support their digital banking ambitions.

R&C: How much of an impact do you expect regulation to have on a more open payments market? What types of FinTech products and services are of most concern to regulators?

Parfitt: It is quite startling how much change is being driven by regulators at all levels. This is having a massive impact, particularly where there is the potential for regulatory conflict, for example when the full implications of EU General Data Protection Regulation (GDPR) are overlaid onto PSD 2. As is so often the case, regulatory change is proving to be the catalyst that enables new entrants to play in what has traditionally been a very difficult space due to regulatory restrictions, risk aversion and near-monopolistic players. These incumbents are now being significantly challenged as their business models will need to transform. Regulators are keen on competition and are actively looking to challenge the big players, global payment schemes and legacy systems. Regulation has forced greater transparency, competition and innovation, which has attracted new entrants unencumbered by legacy technology, processes and scope of service delivery. They are also free from the tarnished brand images associated with many traditional banks and financial services providers. Perhaps perversely, regulators have pushed this openness and consumer-focused approach without necessarily fully understanding the associated risks around personal and commercial payments and how they are managed. This is a particular issue around security and accountability within the overall payments framework and responsible parties. It introduces additional levels of complexity that need to be factored into the overall solution. Regulators are particularly interested in firms acting as 'payment and account information services providers', as these are regulated businesses that fall under the Fourth Anti-money Laundering Directive (4AMLD), which means that the challenge of remotely identifying customers has become more complex. PSD 2 requires merchants to work with their payment services provider to implement strong customer authentication for all transactions processed within the EU via a card or wallet.

R&C: To what extent have tighter regulations created more favourable conditions for non-bank participants in the payments market? In your opinion, how much of a threat do regulations, technological innovations and evolving consumer demands pose for the dominance of banks?

Parfitt: Clearly, regulatory changes have actively enabled new, non-bank participants to demand a seat at the table with the current incumbents. Their focus on customer choice, disruption of a close-knit industry and product innovation resonates strongly with regulators. If this delivers real, positive value, then the pace of regulatory change may increase. From an incumbent's perspective, its ability to change quickly and compete is limited by its investments in infrastructure, security, global applicability and interoperability, combined with its operation in a highly regulated and global industry. So, the opportunity to cherry-pick certain aspects of a process, whether it is in screening, clearing, matching, aggregation or authentication – and do it faster or in a more customer-centric manner – opens the playing field for change and innovation. Twelve months ago, there was serious talk of banks becoming 'disintermediated' through regulatory change, and questions around what a bank really does for a consumer. But incumbents still represent security and safety for the risk-averse, whether or not they actually deliver it. I think we will see people continue to be reassured by this. They may experiment with the near-instant spend notifications, ease of 'topping up' and analytics offered by the likes of Monzo, but whether they will actually bank with challengers like these as their primary current account is open to question.

R&C: With FinTech firms potentially expanding into other key banking services such as lending, foreign exchange and money market funds, to what extent is there a risk that banks could involuntarily become utilities and thus face lower margins? How realistic is industry collaboration?

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Parfitt: To a certain degree, traditional banking services are already becoming utilities, with free core services but differentiation across paid-for services such as bundled insurance products. So to stay relevant and maintain margins, they need to know what their customers actually need at their stage in life and offer products and services accordingly. New entrants will continue to challenge existing players in all aspects of core service and more specialised offerings, but only where this will demonstrate more innovative approaches, greater flexibility, and greater price and service competition. Industry collaboration is already happening and will gain momentum as long as solutions deliver outcomes for consumers that are desirable or more cost effective than traditional offerings. For both existing and new players, the benefits of collaboration are around ensuring the relevance of existing offerings and, for new players, securing routes to big markets.

R&C: What final piece of advice would you give to FinTech players in terms of meeting the compliance and regulatory challenges they face?

Parfitt: Providing financial services means adhering to regulations that are complex and highly nuanced, particularly when organisations operate in multiple jurisdictions. Compliance can be expensive to implement, maintain and optimise – yet it can also present opportunities. FinTech players have an advantage because they do not have the legacy hangovers of the big financial services organisations, can focus on niche, value-added services, and are generally not subject to the full gamut of regulatory requirements. FinTech firms can have challenges because they are primarily technology firms and do not think about their regulatory obligations, or deal with them as an afterthought. As with security, it is paramount that FinTech firms design their organisations and solutions from the ground up with compliance in mind. This includes how they work with customers, suppliers and other stakeholders. At the core of this is to ensure they have the right resources and skill sets to understand the regulatory environments they operate in, and the degree to which the products and services they offer are impacted or have regulatory implications. This is a key finding from many anti-money laundering (AML) compliance function reviews, so it is useful to learn from prior experience of this industry and its challenges and successes. Additionally, the use of a risk management framework that includes the jurisdictional regulations to be implemented and controlled is a good practice. It helps to assess current gaps and future requirements in a way that will hold up to regulatory scrutiny.

R&C: As new technologies allow more FinTech firms to enter the payments market, how do you envisage the extent of the trust in new entrants in the years ahead? To what extent is the payments market status quo under threat?

Parfitt: New entrants to the market should learn from history. Those that build regulations and security directly into the fabric of their organisations and solutions will endure, because security and trust in the overall payments system are paramount. Furthermore, as new entrants into a process increase complexity, it will create potential issues and threats. There must therefore be trust to ensure that corrective action is rapid and robust, with liability and responsibility clearly owned and understood among participants. Financial services and the payments industry are already going through significant change and evolution with the status quo already under threat. Those that fail to evolve or embrace the regulatory and FinTech challenges will not only struggle vis-à-vis peers and competitors, but also potentially miss out on unique, industry-disrupting opportunities. R&C