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The bright side of fintech regulation: Opportunity

The fintech industry is a disruptive force revolutionizing financial services. That said, it now finds itself under the watchful eye of regulatory agencies. In fact, fintechs experienced a 26 percent increase in enforcement actions last quarter.[1] Also, the Consumer Finance Protection Bureau (CFPB)[2], the Federal Deposit Insurance Corporation (FDIC)[3], the Federal Reserve System (the Fed), and the Office of the Comptroller of the Currency (OCC) have all issued guidance in the past year that either directly impacts fintechs or indirectly inpacts them through guidance intended for the member/sponsor banks with which the fintechs do business. The regulators are looking to "close the gap" between fintechs and traditional financial services entities through heightened supervision and regulation.

> **Regulatory intensity is driving corporate costs as well as high anxiety. This is definitely true for fintechs, as they increasingly come under the regulators' "closing the gap" mindset.[4]**
>
> Amy Matsuo, Principal, U.S. Regulatory Insights & Compliance Transformation Lead, KPMG LLP

Viewed through another lens, all this increased regulation is a sign that the fintech industry is maturing. And if you're an established fintech, oversight can be a good move. It defines a level playing field for everyone and helps keep out the troublemakers.

For fintechs enlightened to regulation, there are front and center business opportunities.

> **We are seeing more tech companies enter into the financial services space, and their point of entry is often payments and typically in the form of embedded finance.**
>
> Jess Cheng, Partner, Fintech & Financial Services, Wilson Sonsini Goodrich & Rosati

[1] American Banker, "Fintech PARTNER banks facing 'volatile mix' of supervisory scrutiny," (April 12, 2024).
[2] KPMG LLP, "Buy Now, Pay Later (BNPL): CFPB Rule on Consumer Protections," (May 2024).
[3] FDIC Web site, "Interagency Guidance on Third-Party Relationships: Risk Management," (June 6, 2023).
[4] KPMG LLP, "Ten Key Regulatory Challenges of 2024: Mid-Year Look Forward," (June 2024).

Balancing regulatory risk with opportunity

For fintechs unaccustomed to regulation, doing business with banks, one of the most regulated industries, can sound like a potential quagmire that results in an increase in effort around operational compliance.

This collaboration does come with its own set of risks, as banks face increased exposure and the mandate to protect their customers. The alarming reality is that certain fintech companies and other players may have jumped headfirst into partnerships with banks without fully comprehending the risks and complexities of the regulatory environment in which they are operating. By partnering with a bank, this could indirectly subject the fintech to many of the bank's regulations and compound the regulatory compliance efforts required by the fintech.

With that caution noted, there are key aspects working in favor of your fintech making a bold move. While higher interest rates have translated into less investment and liquidity, some green shoots have emerged recently due to rate consistency and the prospects of a rate cut later this year.

Amy Caiazza, a partner in the Fintech and Financial Services division of a Palo Alto, CA-based law firm, Wilson Sonsini, also sees demographic and societal advantages for the fintech industry.

> **Millennials and Gen Zers are much more self-directed investors with a preference for fintech tools. The opportunity is for fintechs to bring in a whole new generation of investors.**
>
> Amy Caiazza, Partner and Practice Leader, Fintech & Financial Services, Wilson Sonsini Goodrich & Rosati

Finding success with banks

The antidote for regulation is compliance. If your fintech complies with in-scope regulations, you're doing business the right way and lowering the risk of being singled out by a regulator.

There are some steps to consider that could help ensure success while partnering with banks. A contractual agreement that spells out roles and deliverables is a must, as well as understanding the agreement thoroughly. Along with clearly defining roles for the fintech and the bank, the fintech entity should also take it upon itself to fully understand the various regulatory ramifications of the relationship. Awareness of the regulations that the bank must follow can be helpful if they get pushed down to the fintech in the future. Hiring team members and leaders that have experience with the regulations and the various regulators is essential.

With your fintech's embrace of regulation, you've likely added a compliance department. It's a good idea to have your compliance people engage with the bank's compliance staff. The bank is well-versed in regulatory compliance, so have your people soak up the learnings. The final tip involves auditors and advisers. It's a tense office environment waiting and worrying about findings. Be proactive and consider engaging an outside firm to conduct a self-assessment and address any findings. This advanced step can lessen the number of findings by the official audit.

Fintech regulation is a sign of industry maturity and levels the playing field. Fintechs have a big opportunity in payments and embedded finance. However, partnering with banks comes with risks amid a complex regulatory landscape. Yet, as the Bob Dylan song goes, "The Times They Are A-Changin." By embracing fintech regulation, you're also welcoming opportunity.

KPMG regulatory spotlight

For more insights on regulatory matters, please see KPMG Regulatory Insights. Through the regular publication of thought leadership papers, articles, and alerts, our professionals offer insights into the evolving supervisory, regulatory, and enforcement landscape and what those changes might mean for participants across the financial services industry. Here are two recent papers applicable to fintech regulation.

Buy Now, Pay Later (BNPL): CFPB Rule on Consumer Protections

Ten Key Regulatory Challenges of 2024: Mid-year Look Forward

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