



Financial futures

DISRUPTION IN GLOBAL FINANCIAL SERVICES

Introduction

Financial services organizations across the globe are facing unprecedented levels of change and uncertainty. Politically, many countries are experiencing changes in government, with many becoming increasingly protective of their national boundaries and institutions, contributing to rising trends of "deglobalization". Challenging global macroeconomic conditions have presented headwinds for business volumes, asset quality and financing conditions for financial institutions, and interest rates and cost of living challenges have yet to calm.

Social, technological, regulatory and environmental considerations now dominate the agendas of financial institutions who are having to engage with a multitude of issues – including the implications of Big Data, how digital banking continues to upend business models, how best to embrace AI while also dealing with the complexities of adopting such technologies, and how to harness the huge opportunities (both business and otherwise) provided by sustainable finance and the transition to net zero, while managing the threats of greenwashing and environmental litigation which have reached the top of risk dashboards.

In the present moment, these themes are major disruptors to the status quo. Amid this landscape, DLA Piper commissioned a global survey of key decision-makers in financial services organizations across the EMEA and APAC regions and North America to explore the impact this change is having on the sector. Overall, our survey's findings suggest that these organizations have a positive outlook and that financial services is a sector full of optimism – with 80% of organizations globally being optimistic about opportunities in the next 1-2 years, and with banks leading the levels of optimism across the sector.

Our survey identifies that this optimism is being driven by positivity around several themes including the likely impact of digitalization and technical advances, particularly AI, opportunities related to new products and services, and benefits from the impact of the ESG (Environment, Social and Governance) agenda. At the same time, our research indicates that the regulation of the sector – in these developing areas and more widely – is regarded as a doubled-edged sword: one that can both benefit and hinder a sector as broad as financial services as it seeks to fully capitalize on its opportunities.

In this report we explore the transformative impact of these themes – both the key drivers for optimism and the challenges posed by these disruptive forces, with insights as to how leading financial services organizations are seizing the opportunities resulting from this unprecedented change.

Finally, we look to draw some general conclusions as to how the global financial services sector can best position itself to respond, adapt and succeed in an uncertain future.

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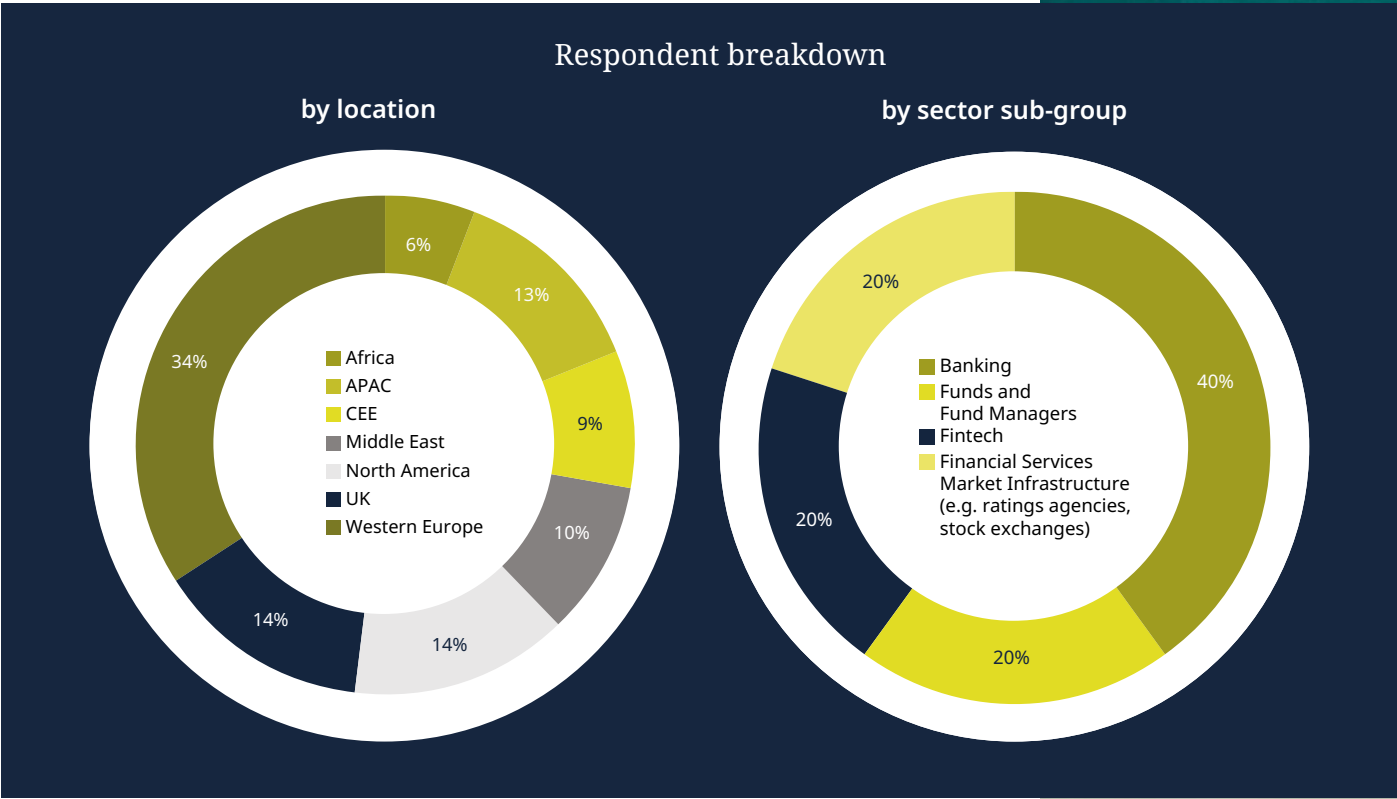
01 Methodology and sample

Methodology and respondent profile

To identify the principal disruptors of the financial services sector in 2024, DLA Piper commissioned Coleman Parkes Research to canvass views of key decision-makers in global financial services organizations across the EMEA and APAC regions and North America – with global coverage spanning from Hong Kong to Australia, from South Africa to the US, and from Western and Central Europe and the UK to the Middle East.

Respondent base and methodology

Nearly 800 interviews were conducted online in Q1-Q2 2024 with key executives in businesses across banking, funds and fund managers, fintech and financial services market infrastructure firms with revenues ranging from under USD10 million to more than USD10 billion.



02 Key findings

A summary

Overview and outlook

Respondents focused on three key trends transforming the financial services sector:

- The impact of the sustainability and ESG (Environment, Social and Governance) agenda and the opportunities and challenges it presents.
- Increasing digital transformation, with a focus on AI and the opportunities and challenges it presents.
- The sentiment across the sector around wider regulation in general. Is it too burdensome or does it have the potential to foster innovation?

In considering these themes (and others), the financial services sector, generally, has an optimistic outlook for the next 1-2 years. Around 80% of organizations globally are optimistic, including 1 in 10 who are very optimistic. Among organization types, banks are most optimistic.

Sustainability and ESG

- Overall, more than 80% of financial services organizations believe that it's "the new normal" for ESG concerns to be a core driver of the industry.
- Around half of FS firms want to be seen as leaders in the ESG space.
- However, firms are also overwhelmed by the ESG demands, with more than half of respondents describing the ESG agenda as one of their biggest challenges over the next two years (an increase of 24% in comparison to the past two years).
- Firms are worrying most about reputational risk as a result of ineffective ESG positioning, the challenges related to creating sustainable products, regulatory complexity and the integration of ESG throughout the business.

80%

have an optimistic outlook over the next 1-2 years

84%

consider it's the 'new normal' for ESG to be a core driver of the sector

86%

think AI will transform financial services over the next two years

73%

think regulation is stifling innovation in the sector



Digitalization and AI

- Respondents across the global sector believe that digitalization (more than 70%) and AI (86%) will have a transformative effect on financial services over the next two years.
- Digitalization and the implementation of new technology more widely is seen as a key opportunity and reason for optimism, but managing cybersecurity/data protection risks is seen as an important challenge.
- More than half of the sector is concerned about the risks to their business presented by AI and a significant number (14%) report that it's the most critical issue faced by their organization.
- Most (75%) believe that regulators are struggling to keep up with the rapid pace of evolution of AI in the financial services sector and there is widespread concern that greater use of AI will widen inequalities.



Wider regulation

- For those more pessimistic about the sector, the impact of excessive regulation is a key concern (89%). More broadly, few believe that regulatory levels are generally positioned appropriately.
- Many aspire to be leaders in managing regulatory compliance and recognize its importance in fostering innovation, especially in Western Europe and the APAC region.
- Half of respondents state that the greatest impact on their business over the past two years has been managing risks related to cybersecurity and financial crime, and over half (57%) expect this issue to affect them in the immediate future.
- Most feel that regulation is stifling innovation in financial services (73%).

03 Outlook

The view across global financial services

Survey respondents suggest there is optimism across the financial services sector – but where are the greatest opportunities for growth?

Eight in ten financial services sector organizations (80%) are optimistic about the next two years, with confidence at its highest in the UK (93%) and North America (90%) (Fig 2). Among organization types, banks are most optimistic globally (88%) (Fig 3).

This optimism is driven by positivity about the likely impact of digitalization and technological advances, especially AI. Many are also realizing benefits from the ESG agenda (Fig 1).

Most (75%) are content with the conditions for growth in their own region, especially those in North America (97%), while those who believe that circumstances are better elsewhere are most likely to identify North America as optimal (35%) followed by Western Europe (24%) (Fig 4).

While optimism is the prevalent sentiment worldwide, geopolitical instability in some regions can prompt more muted or negative responses, as businesses see these factors impact their economic prospects. Among those who are more pessimistic about the sector’s future, the impact of excessive regulation is also a key concern, followed by perceived negative consequences of the ESG agenda and ongoing market volatility across international regions (Fig 5).

Fig 1: Reasons for optimism in the next 1-2 years

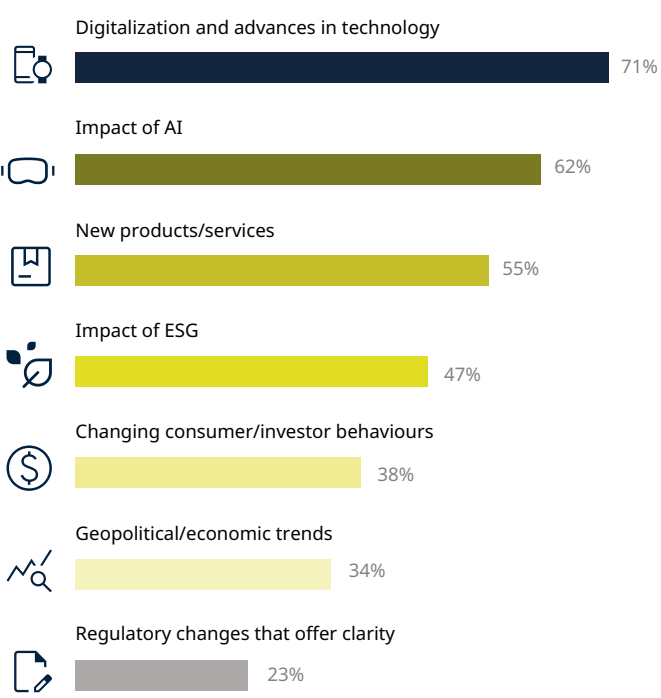


Fig 2: Outlook over the next 1-2 years – by region

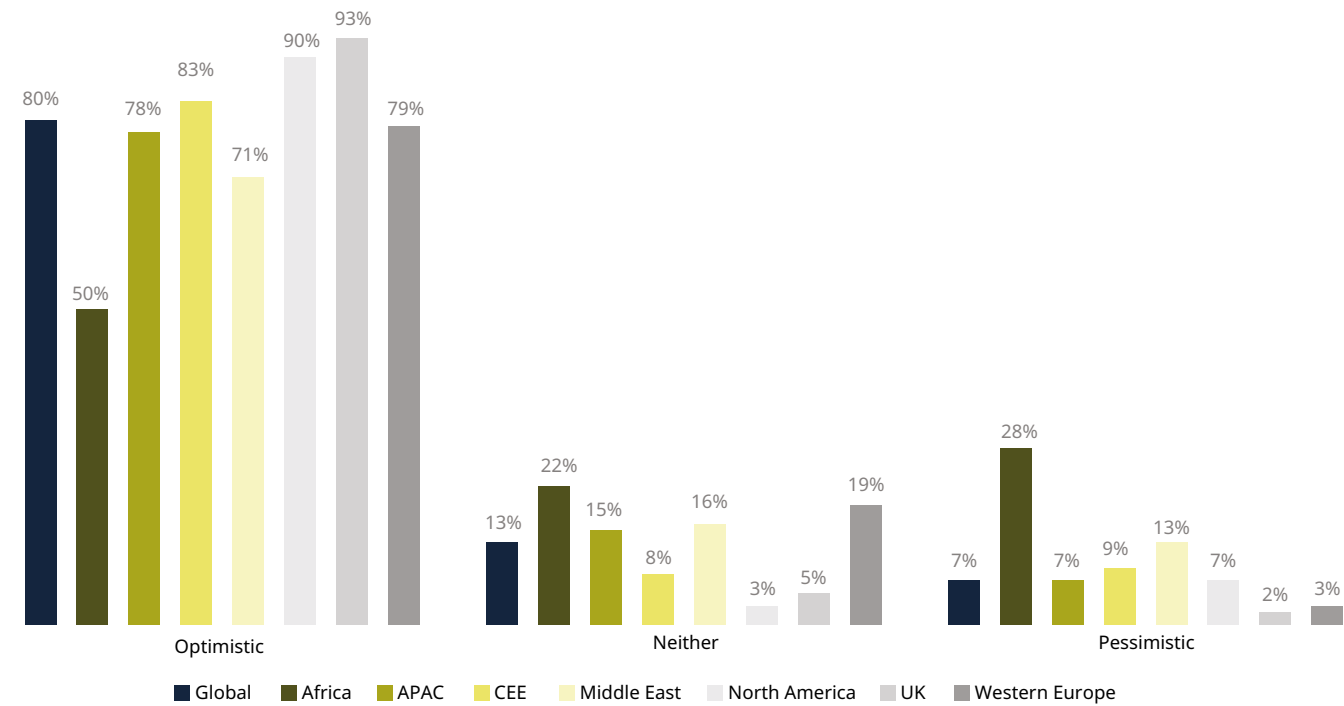


Fig 3: Outlook over the next 1-2 years – by organization type

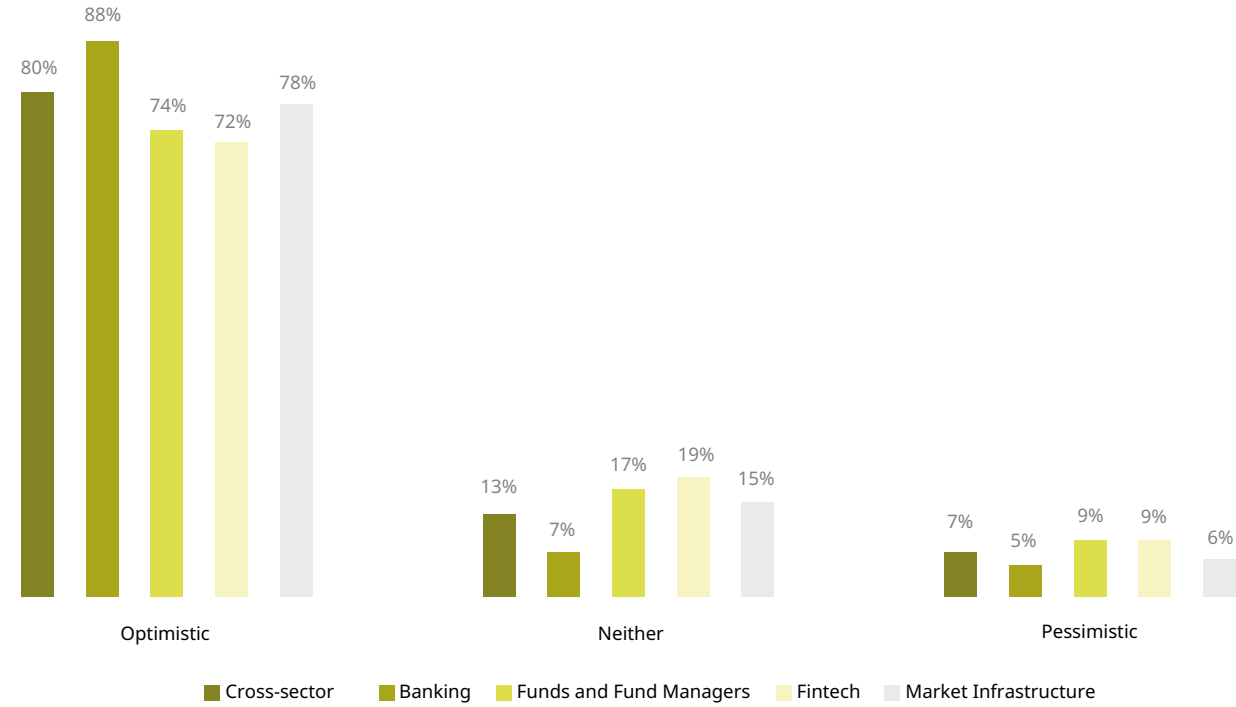
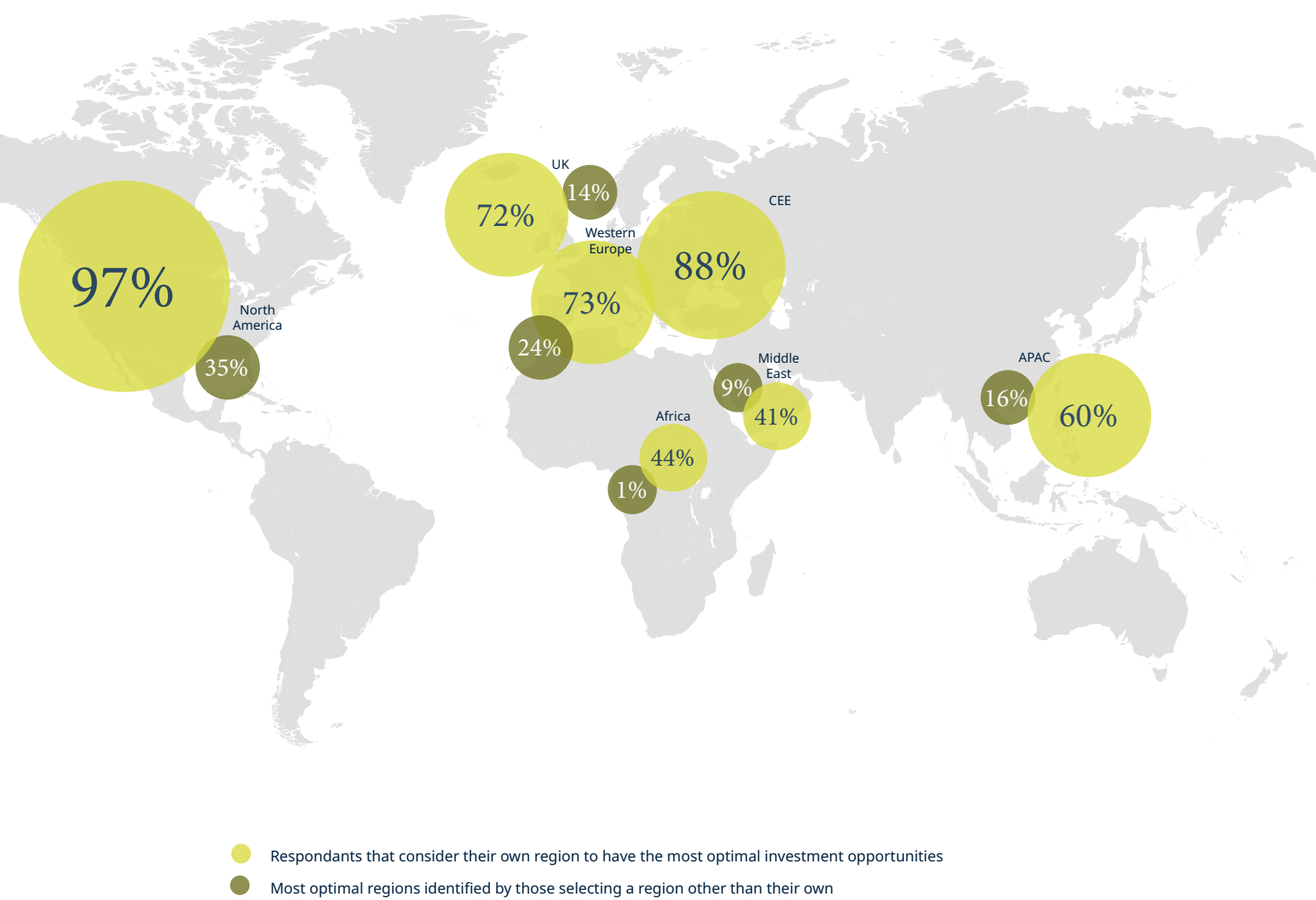
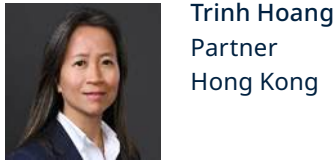


Fig 4: Regions with most optimal conditions for growth in the financial services sector

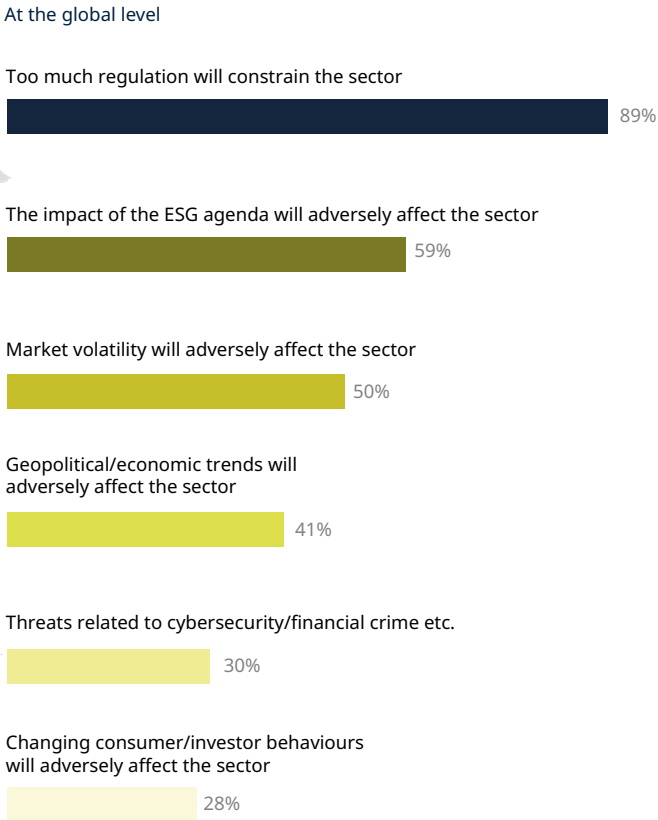


The Asia Pacific financial services sector is poised for significant growth, driven by rapid digital transformation, increasing consumer demand and a strong focus on sustainability. As we navigate into 2025, the region’s financial markets are expected to remain resilient, despite challenges such as geopolitical tensions and economic uncertainties. Innovations in digital banking, cross-border payments, private credit and green finance will be key drivers of this growth, offering new opportunities for financial institutions to thrive in a dynamic and evolving landscape.



Trinh Hoang
Partner
Hong Kong

Fig 5: Reasons for pessimism about the future in the next 1-2 years



Whilst we are facing turbulent times coupled with greater regulatory complexity, we see strong growth opportunities for the UK market, driven by AI and wider digital transformation across the FS ecosystem.



Anthony Day
Partner
UK

There remains uncertainty across the European landscape, in part driven by continued geopolitical tensions. The Italian economy is expected to show moderate but steady growth over the next 12 months. Disinflation, business confidence, investment and consumer purchasing power are amongst the positive factors to benefit the financial services sector, whilst debt and deficit levels remain a concern.



Luciano Morello
Partner
Italy

The international financial services sector continues to be a major success story for Ireland and of key strategic importance to our economy. The prospects for the sector remain strong, with significant growth potential. Critical to our success has been industry collaboration with government and regulators. This remains more important than ever in light of the rapidly changing operating environment.



Gavin Smith
Partner
Ireland

Opportunities and challenges

All respondents recognized a variety of business opportunities for the next two years, with the biggest opportunities seen to be around digitalization/new technologies, AI and the development of sustainable finance products and investments. Linked to this, AI and ESG are seen as the biggest disruptors going forward, moving up the agenda in terms of importance compared with the extent to which they've been key drivers over the last two years.

Despite the high levels of optimism and positivity, respondents globally identified a number of challenges facing them in the near future, particularly in complying with new regulations, navigating ESG positioning and cybersecurity and data protection risks (Fig 6).

The European investment management industry is navigating a period of significant transformation which requires the ability to effectively manage complexity. Those who can adapt to the packed rulemaking agenda, responsibly embrace technology, identify emerging opportunities and secure the right talents will be the ones who succeed.



Catherine Pogorzelski
Partner, Global Co-Chair – Investment Management and Funds Luxembourg

The outlook for the US is strong, with innovation in AI and other technologies already creating new opportunities. Looking forward, the outcome of the 2024 US elections will have significant effects on the focus and extent of regulation, including in the areas of AI and ESG. Other points to monitor include stress on consumers from inflationary cost-of-living pressures that may drive regulatory and litigation risk.



Isabelle Ord
Partner, Global Co-Chair – Financial Services sector US

Innovation has always been key to dealmaking. The financing of deals is constantly evolving and we are increasingly helping clients to structure transactions that balance profitability with sustainability. From green bonds to ESG-linked loans, financial institutions have a growing focus on embedding environmental and social metrics into their financing frameworks.



Colin Wilson
Partner, Global Co-Chair – Finance UK

Our survey respondents show that the international banking sector continues to be cautiously optimistic for the future but amid that optimism there are continuing changes – banking groups are reacting to geopolitical realities by altering their geographic focus, dealing with regulatory change and digitalization with developments such as open banking creating increasing pressures as banks move away from physical branch banking and increasingly focusing on financing the transition to net zero.

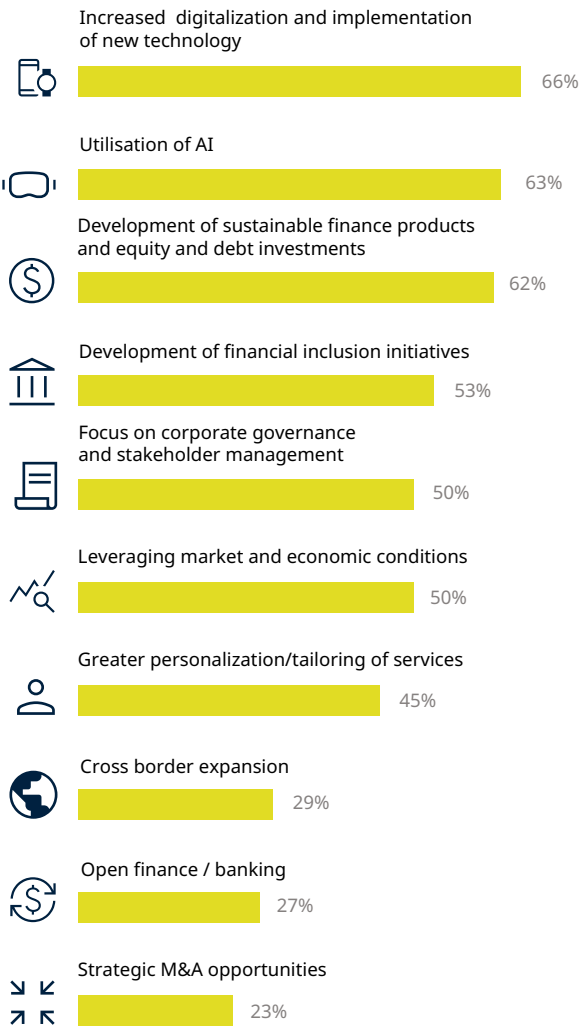


Mark Dwyer
Partner, Global Co-Chair – Financial Services sector UK

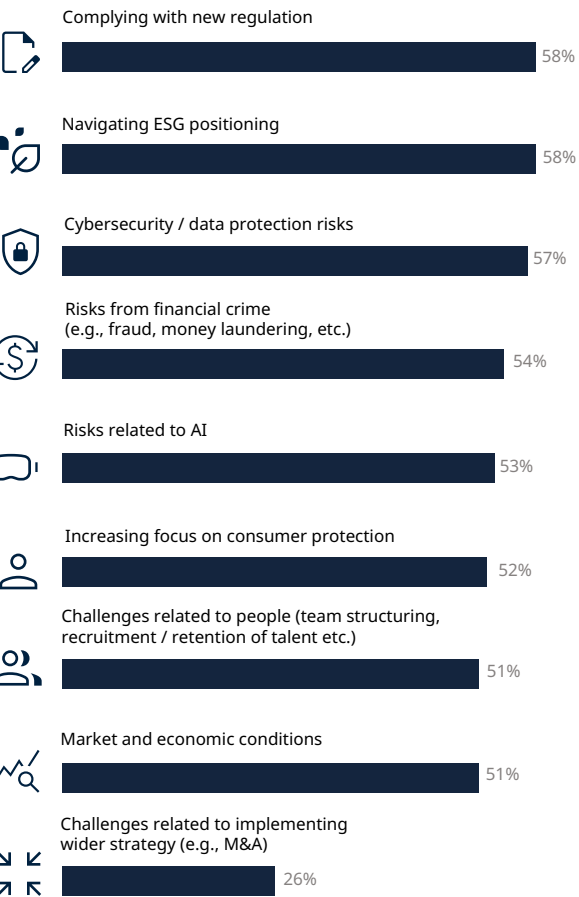
Fig 6: Biggest business opportunities and challenges in the next 1-2 years

At the global level

Opportunities



Challenges



Financial services organizations need to adapt and modernize their business models. Evolving inorganically through M&A (particularly in relation to digitalization) is a route that many financial services organizations are pursuing and is likely to see a general uptick in financial services M&A levels. However, we do not expect there to be a large number of "bet the bank" M&A transactions in the sector but rather a focus on smaller transactions.



Chris Arnold
Partner
UK

In May 2024, the European social partners in the banking sector issued a joint declaration addressing the impact of AI on employment. This makes the financial services sector a pioneer – the declaration outlines a balanced approach towards the integration of AI in the sector, putting equal focus on innovation and employees.



Dr Hans-Peter Löw
Senior Counsel
Germany

04 Sustainability and ESG

Responding to a broad agenda

As the United Nations Global Compact explains, more and more mainstream capital markets – including major institutional investors – now evaluate companies’ performance on environmental, social and corporate governance issues. It is accepted that issues related to climate change, water, human rights or anti-corruption can affect companies’ ability to create value. As such, environmental, social and governance (ESG) factors are increasingly pivotal in shaping the financial services industry, influencing its strategies, operations, and wider responsibilities.

To reflect this growing stakeholder expectation of greater accountability and sustainability, financial institutions are integrating ESG principles into their core practices, from investment decisions to risk management. This shift is designed not only to drive ethical and sustainable growth but also to enhance long-term value creation and resilience. By prioritizing ESG considerations, the financial services sector can play a crucial role in addressing global challenges such as climate change, social inequality, and poor corporate governance, reinforcing its commitment to broader societal and environmental responsibilities.

The conclusion of the significant majority of survey participants is that it's the "new normal" for the sustainability and ESG agenda to be a core driver of financial services (Fig 8b), and most feel it will bring benefits to the sector over the coming period. Furthermore, the sector is engaging across the broad scope of its environmental, social and governance components. For example, six in ten respondents report that the development of sustainable financial products is a key business opportunity for their organization over the next two years, with a rapidly developing appetite for sustainability-linked loans and bonds in many markets. Likewise, half are developing financial inclusion initiatives and developing their approach to corporate governance for the same reason (Fig 6).

46%

globally want to be a leader and innovator on ESG

58%

consider ESG to be one of their biggest challenges over the next two years

It is clear that ESG factors are here to stay as factors driving changes to activity in financial markets – from financing the enormous capital requirements for transition to ensuring accurate reporting of environmental, social and governance metrics to facilitate choice for investors and supervision and stress-testing by regulators.

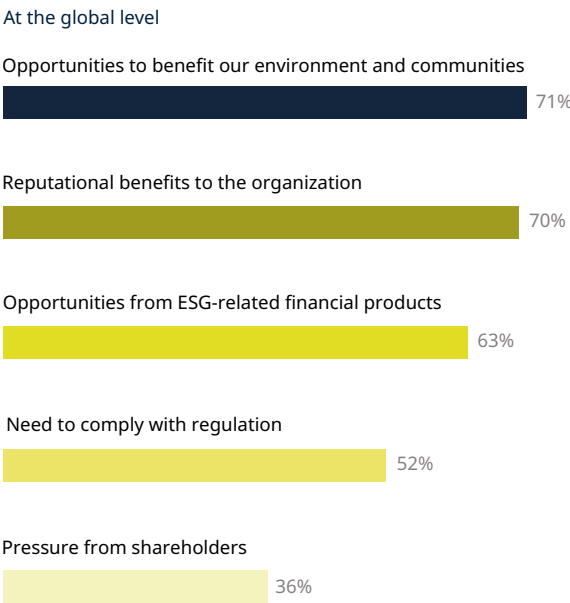


Mark Dwyer
Partner,
Global Co-Chair –
Financial Services sector
UK

Motivators for engagement

Though the research data doesn't suggest regulatory compliance as being as important a driving force as altruistic and commercial factors, legislative developments in key jurisdictions support, and indeed, encourage ESG-related activity. For example, in the EU, the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation require transparency regarding environmentally sustainable activities. Likewise, developments in the UK, with the Financial Conduct Authority (FCA) mandating disclosure on how asset managers integrate ESG factors, and in the US, with the US Securities and Exchange Commission's (SEC) proposed rules on climate-related disclosures, all help to promote ESG engagement across these developed markets. And following the work of the Task Force on Climate-related Financial Disclosures (TCFD) from 2015 to 2023, the TCFD recommendations now form part of the ISSB Standards applicable to public companies in particular in IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*.

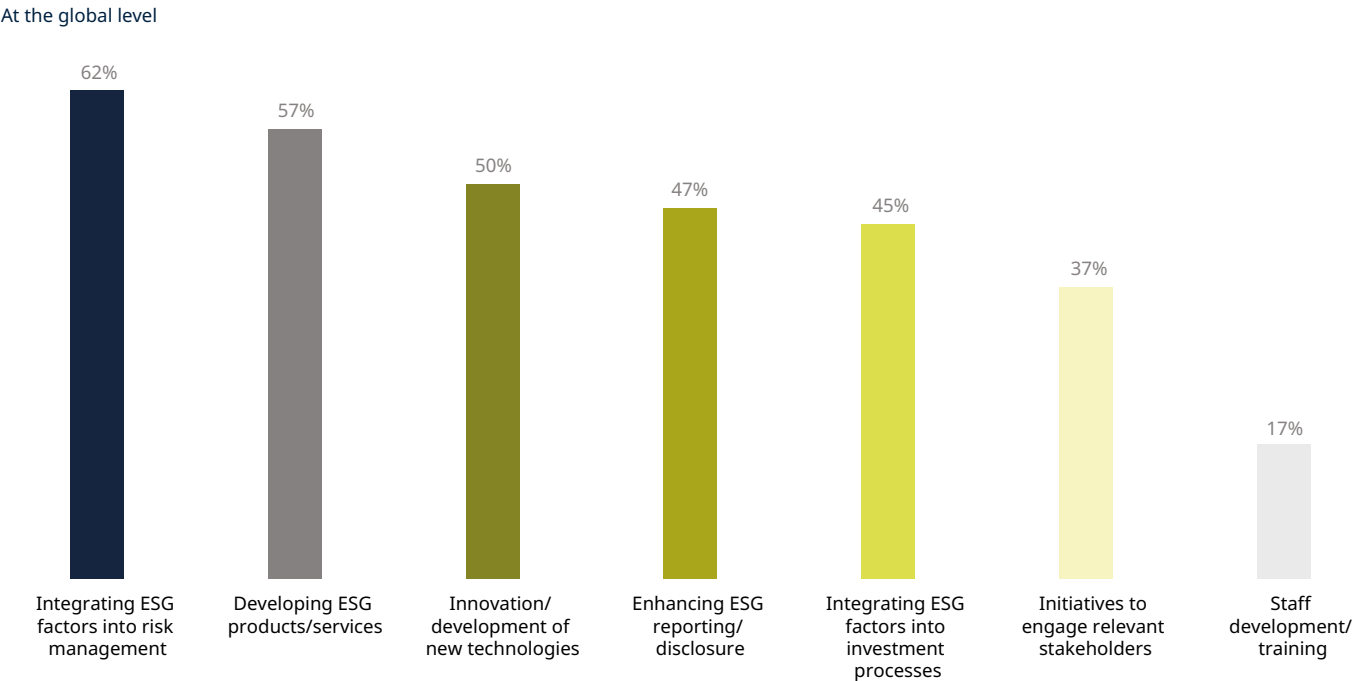
Fig 7: Biggest drivers encouraging engagement in ESG activity



Opportunities aplenty

While the desire to benefit the environment and their organization's reputation are clear drivers for respondents in developed markets, all respondents are undertaking some kind of activity in response to sustainability and ESG opportunities, although the areas of particular focus depend on the maturity of ESG in the geographic area in which the respondents operate. Western European organizations are prioritizing the integration of ESG factors into risk management to reflect the requirements of SFDR and UK SDR, and organizations in other geographies such as North America are still focusing on enhancing ESG reporting and disclosure (Fig 8).

Fig 8: Actions being taken to maximise ESG opportunities

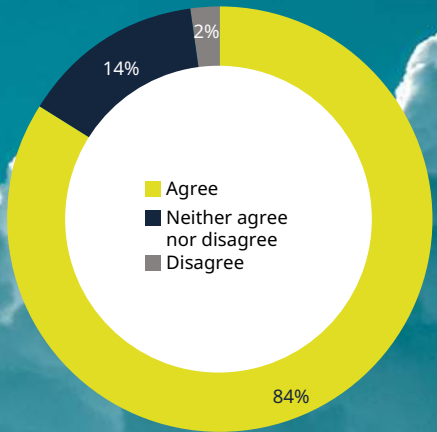


Our research data indicates that ESG considerations are increasingly being integrated into the long-term goals of financial services organizations. This shift is being driven by several factors, including regulatory pressures, stakeholder demands, the opening of new revenue opportunities and the recognition of ESG as a component of strategic value and risk management.

Furthermore, 46% overall want to be a leader in driving innovation in responding to the ESG agenda, though there are notable regional differences (Fig 9).

Fig 8b: Do respondents agree with the statement: ESG as a core driver in financial services is the "new normal"?

At the global level



We are seeing growth in transition finance linked to the development of new products, the fostering of innovation and a range of opportunities on offer. As climate risks become more pronounced, the global economy will take this transition seriously and growth will accelerate. The scale of global projects to effect change is unprecedented, as is the scale of the finance involved.



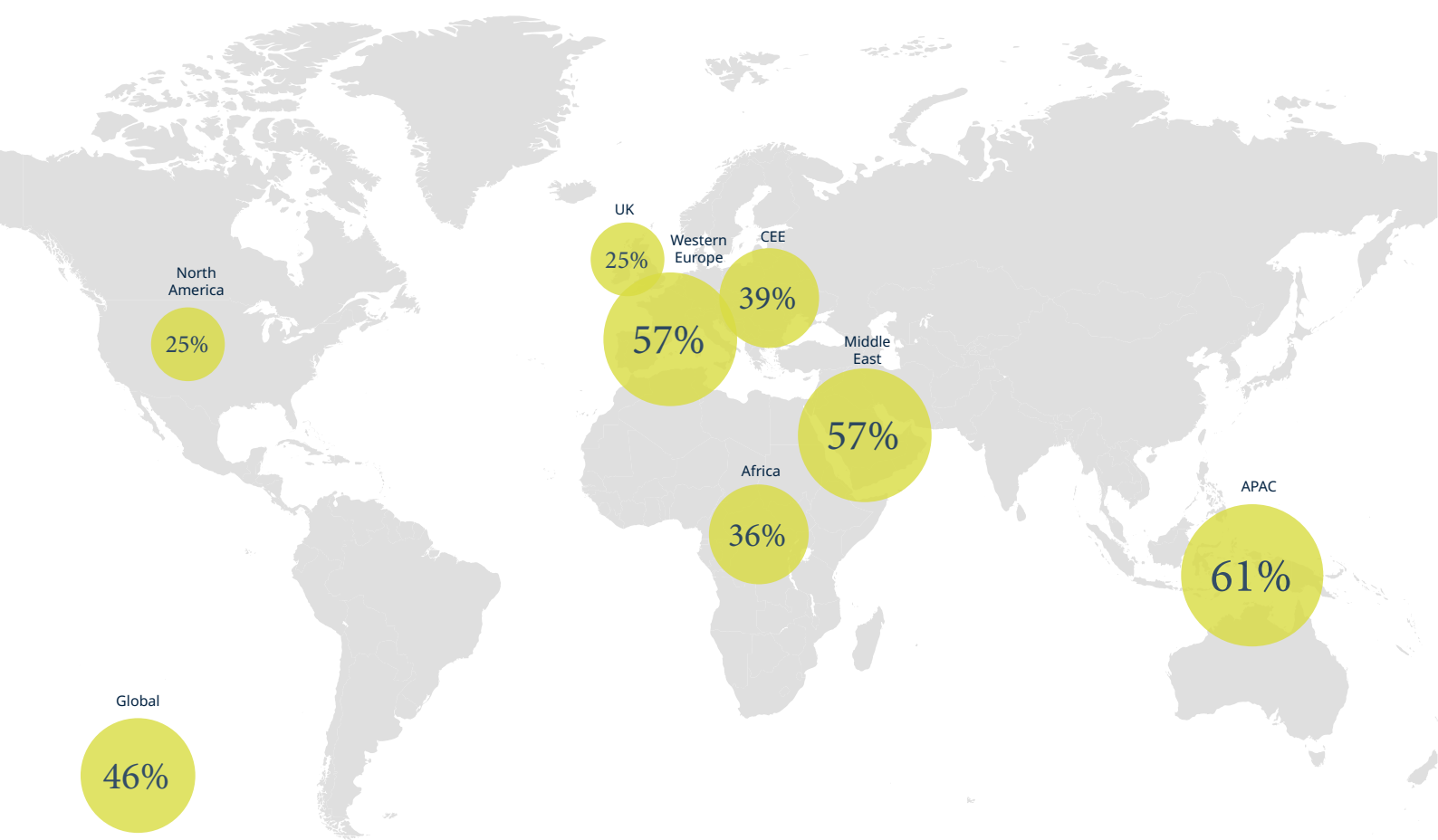
Mei Mei Wong
Partner
UK

Financial services firms that excel in ESG not only manage risks and ensure regulatory compliance, but also unlock opportunities such as enhancing reputation, attracting investment, driving innovation, providing access to capital, and creating long-term value.



Shaun Walden
Head of Sustainability and ESG, Business Advisory – UK and Europe

Fig 9: Respondents wanting to be seen as a leader on responding to the ESG agenda



Green activism as a driver of change in boardroom and corporate behaviour is not as prevalent in Asia as it is in Europe, the US or Australia. However, business leaders are expecting such activism to come to Asia in the near future and have been readying their businesses to be more ESG conscious. Whilst financing in Asia has faced challenges over the last few years, sustainable financing remains strong and continues to attract strong demand in the market. Almost every investor, fund or asset manager in the region will have an ESG focus as part of their investment portfolio and are actively looking for assets with a sustainability/carbon transition or other ESG angle.



Philip Lee
Partner
Singapore

The challenges of ESG engagement

As well as the opportunities, our research data also noted the challenges to realizing the benefits of ESG engagement. These issues can manifest across a number of areas, including:

- ESG regulation is intensive, and lacks international consistency, with divergent EU, UK, US and other international regimes – although the move to disband the TCFD and include their recommendations in the ISSB Standards is a welcome move to reduce the alphabet soup of ESG disclosure requirements.
- It can be a challenge for organizations to define their stakeholders’ appetite for the ESG agenda and position themselves accordingly.
- Issues relating to projected timing for implementation increase the risk of litigation: the economy is not yet ready to provide accurate data to support the ESG disclosures required by bank regulation.
- The process of efficient capital allocation can take several years, meaning that institutions feel the burden of regulation before enjoying the benefits.

As a consequence of these and other factors, over half (58%) of respondents consider the ESG agenda to be one of the biggest challenges faced by the sector over the next two years (Fig 6), an increase of 24% in comparison to the past two years.

It is important to note that while respondents highlighted the development of new products as being among the greatest opportunities in relation to ESG activity, it is also perceived as a prime challenge. This view is shared across geographical locations, and financial services organizations generally seem to be mindful that what’s seen as an opportunity is also considered a key challenge to overcome.

Organizations also report that they face reputational risk as a result of ineffective ESG positioning (49%). They’re also experiencing challenges related to creating sustainable products (49%), regulatory complexity (47%) and integration of ESG throughout the business (47%) (Fig 10).

These challenges have been particularly apparent in the past year, with some criticism of the prominence of the ESG agenda, focused around businesses’ need for financial returns as well as environmental and social gains, and with some economies choosing to invest in short-term crises rather than ESG concerns. However, where this is apparent, it likely represents a temporary dip in a steep upwards curve as all respondents are actively engaged in some form of ESG related activity (Fig 8) and with most recognizing business opportunities in the next one to two years.

Fig 10: Greatest challenges in relation to ESG activity



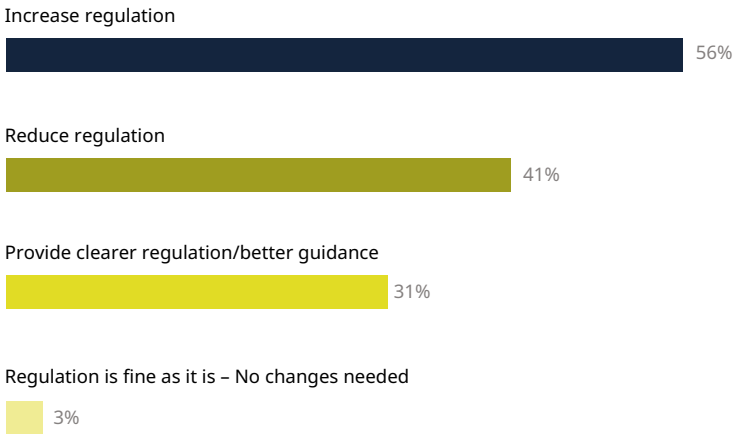
Call for regulation

It is interesting to note that against a sentiment of excessive regulation and complexity in the sector generally, over half of respondents (55%) would actually like to see more regulation in this area, while only 3% said that no change is needed to ESG regulation (Fig 11).

This is likely related to a broader area of concern for our respondents about the lack of harmonisation of ESG regulation across jurisdictions and absence of standardized reporting standards that would encourage transparency and efficiency that is more cost effective.

Fig 11: How should regulators be responding to the ESG agenda?

At the global level (respondents could select a combination of options)



We're at the start of a massive ramping up of ESG regulation, which is going to last for the next eight to ten years, as global economies get to grips with what's required, from both a mandatory and voluntary perspective. Over the next few years, the regulatory change should be established, and the litigation risk will be omnipresent.



Stuart Murdoch
Partner
UK

There are a number of synergies between ESG and the broader objectives of the Islamic finance industry. The cross-over from the traditional application of Shari'a principles into much clearer environmental, social and governance goals in the Middle East is driving change across the region, with sustainability and a greener future featuring heavily in the economic visions of many Middle Eastern states. The adoption of more innovative Islamic financial products (such as green sukuk and sustainable sukuk) is contributing to that change.



Paul McViety
Partner
UAE

While the challenges relating to ESG are very real, the opportunity is also huge. We see this opportunity having a significant influence on the strategic direction of many banks and other financial institutions, who are also responding to increased demand for ESG products and services. For example, Ireland has set a goal of being a leading sustainable finance centre by 2025 and many financial services firms are establishing sustainability roles and capabilities here.



Conor Houlihan
Partner
Ireland

We are witnessing what could be the greatest reallocation of capital in history. As policymakers across the globe seek to fund international sustainability objectives and to address the financial risks posed by climate change and nature loss, we can expect an even greater focus on the one sector that the whole real economy depends on: financial services.



Jean-Pierre Douglas-Henry
Partner
Managing Director
Sustainability and Resilience
UK

05 Digitalization and AI

Transforming the sector

It is clear that digital transformation is already fundamentally reshaping the financial services sector, which was an early adopter in recognizing the benefits of information and communications technology to drive changes in the way institutions operate, engage with customers, and deliver products and services.

This change has not happened overnight. Profound change which is, by its nature, highly strategic, requires a long-term endeavour – especially when coupled with the challenges of digital transformation implementation. Financial services organizations recognize that digitalization is vital to compete in a crowded marketplace in an industry undergoing disruption from the rise of fintechs and increased regulation.

Historically, businesses have tended to define “digital transformation” broadly to include general and finite operational change. But for digital technology to be truly transformative, the change needs fundamentally to overhaul an organization’s business model. That requires organizations to harness advanced technologies, such as AI, cloud computing and data analytics, to revolutionize business operations by integrating technology and digitizing finance and to enhance customer experiences through personalized, convenient, resilient and secure services.

A (digital) world of possibilities

As organizations have come to realize that digitalization should be viewed as a continuing journey or digital evolution, this has not only seen increasing operational efficiency and cost reduction but also an expansion of financial inclusion and fostering of innovation in products and services. As a result, the financial services landscape is more dynamic, customer-centric and resilient than ever before as change and progress continues apace and with it, the emergence of new and developing opportunities and challenges.

This outlook is reflected across the global sector, with the majority view of survey respondents agreeing that further digitalization will have a positive transformative effect on financial services over the next two years (71%), and that it will provide the biggest business opportunity over the same period (66%).

86%

think implementation of AI will have a transformative effect on financial services over the next two years

71%

think digitalization will have a transformative effect on financial services over the next two years

53%

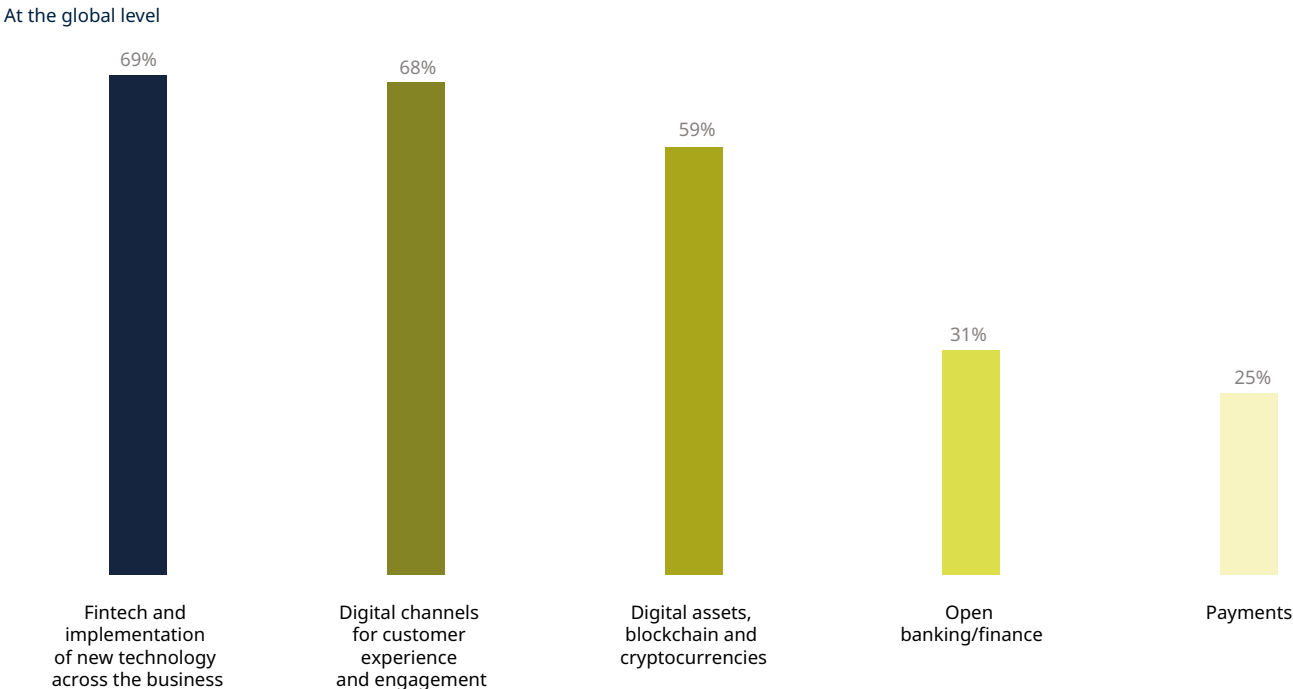
see AI as a major challenge

Digitalization and innovation sees the evolving delivery of products and services – where existing legal and compliance frameworks need translating to new models efficiently and without holding back improvements and efficiency gains.



Sophie Lessar
Partner
UK

Fig 12: Aspects of digitalization with the greatest impact in the next 1-2 years



Focus on Fintech

The regulatory landscape continues to evolve in relation to digital assets, open banking and payments. There is a patchwork of regulatory approaches, including Europe’s Markets in Crypto Assets Regulation (MiCA) and Dubai’s Virtual Assets Regulatory Authority (VARA). Respondents report that the two most impactful aspects of digitalization are fintech (69%) and digital channels for customer experience and engagement (68%). It seems that financial services organizations are primarily using digitalization to better deliver their existing products, while potential new

product offerings, such as those using blockchain (59%) and open banking (31%) are lesser priorities. Nevertheless, there is still some appetite for these innovations (Fig 12).

Recently, many banks are opting to work with fintech firms to present a joint option to the market. Working with partners who have specialist expertise can be helpful when deploying new products. This resembles the trend for banks to partner with large AI providers rather than investing in their own LLMs.

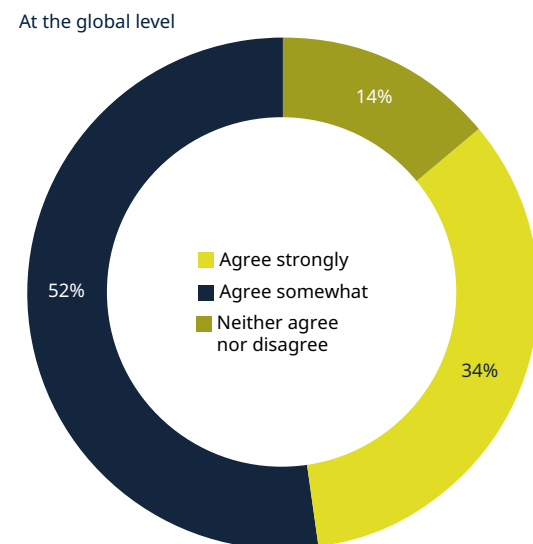
The rise of AI

While many organizations have made progress with digitalization more broadly, they're at an earlier stage with the adoption and deployment of AI. Even though AI tools are increasingly used in financial services to enable firms to offer better products and services, improve operational efficiency and drive innovation, AI also comes with a number of risks – including for consumers, market integrity and financial stability. A global regulatory patchwork doesn't inspire confidence or facilitate open and cross-border financial services, and the ethical concerns about the pioneering technology introduce another layer of complexity. As a result, it's not surprising that many firms are more conscious of risks than opportunities and are opting to be first or even second followers in this respect, rather than leaders (Fig 14).

Notwithstanding these challenges, the majority of survey respondents (86%) agree that the implementation of AI will have a transformative effect on financial services over the next two years (Fig 13). This demonstrates a confidence in the global sector that AI will be managed in an appropriate regulatory structure that provides adequate protection while retaining flexibility for business to implement.

AI is a broad term covering a spectrum of techniques that can be used alone or together as part of a broader process. Six in ten firms are investing in the technology required to implement it and these developments are accelerated

Fig 13: Will AI transform the financial services sector?



through mergers and acquisitions. So it's not surprising that the survey reveals that enterprises are looking at a range of potential applications for AI, beyond chatbots and productivity gains, in search of the much greater benefits that AI and machine learning can deliver. Many businesses see opportunities for AI to support them in regulatory compliance (63%), fraud detection and prevention (62%) and operational efficiency (58%) (Fig 15).

However, many respondents are concerned about the risks AI presents to their business. Over half (53%) see it as a major challenge, and one in ten (14%) report that it's the most critical issue faced by their organization. Most (74%) don't want to lead the market in adopting AI solutions (Fig 14), preferring to follow others or adapt only when stakeholders require them to do so.

It's interesting then to see that among the various actions being taken to engage effectively with AI, only four in ten (39%) are committed to hiring experts in the field of AI and imposing governance /oversight structures (Fig 16). Perhaps this is reflective of the "fast followers" noted in Fig 14 who aren't looking to forge a path for others to follow, even if the significant majority of respondents overall believe AI will have a transformative effect on financial services in the coming period.

Fig 14: Respondents' position on engaging with AI



Fig 15: Key AI related opportunities in the next 1-2 years

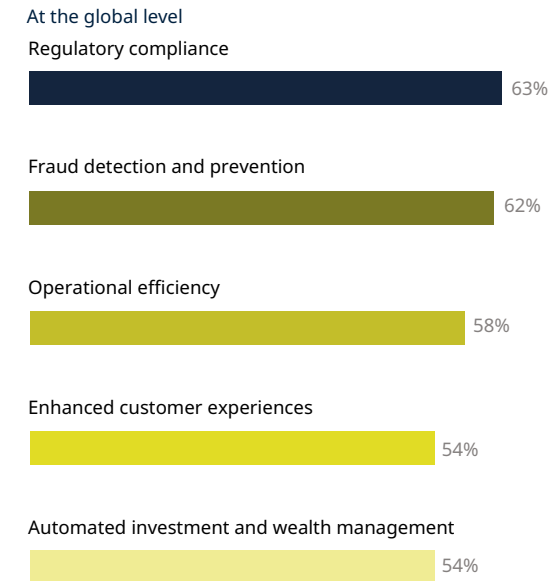
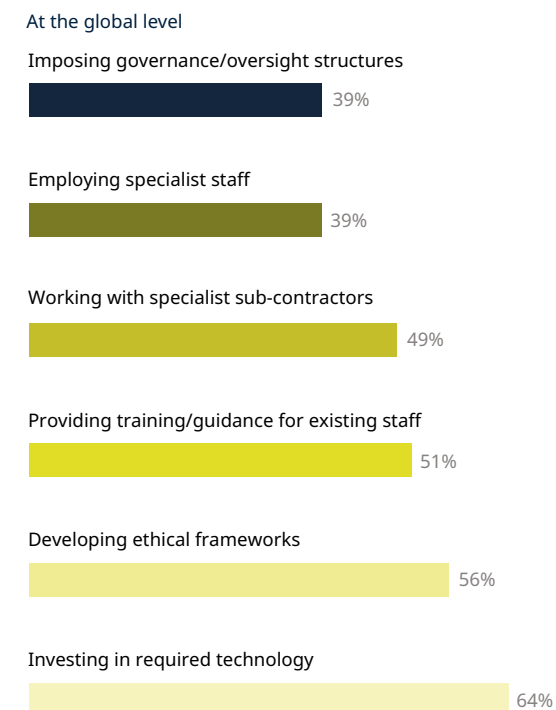


Fig 16: Actions being taken to maximise opportunities with AI



The intersection between AI, fintech and Web3 will become much more critical as the use of AI technology becomes more prevalent, cutting into various segments of the financial services and virtual asset industries. It is crucial that appropriate regulatory guardrails are in place to oversee the use of AI technology in such industries, balancing the need for fostering innovation and protecting market participants.



Kristi Swartz
Partner
Hong Kong

Banks are eager to be at the forefront of digitalization but, in relation to AI, many have identified material risks. There are concerns to what extent AI can be integrated into the decision making processes of banks and other financial services providers, particularly with regards to third party provider solutions.



Dr Caroline Herkströter
Partner
Germany

Regulation and governance of AI

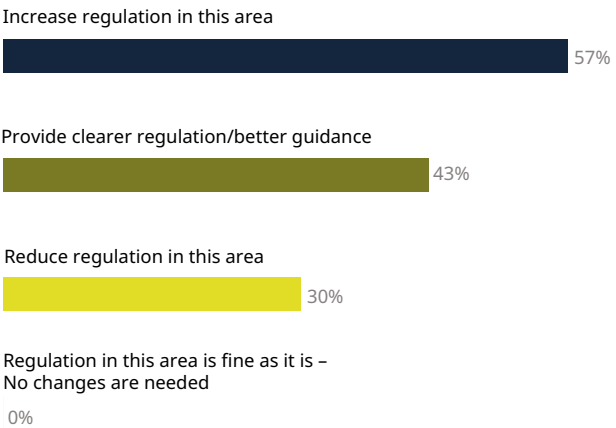
Nearly six in ten respondents (57%) would like to see an increase in regulation related to AI technology. (In contrast, only 35% would say the same about digitalization). Meanwhile, nearly half (47%) say they have trouble understanding AI regulation, and 43% would like there to be clearer regulation and better guidance (Fig 17).

While it remains to be seen whether the approach will be guidance and clarification on the use of AI over the introduction of new “hard rules,” what is clear is the need to develop a globally coherent regulatory framework to facilitate open and competitive cross-border financial services. A lack of clarity in AI regulation can hinder investment, since higher risk AI uses involve broad legal, commercial and reputational ramifications.

Despite this, a significant majority (75%) of respondents believe regulators are struggling to keep up with the rapid pace of evolution of AI in the financial services sector (Fig 18).

Fig 17: How should regulators be responding to AI?

At the global level (respondents could select a combination of options)



57% would like to see an increase in regulation related to AI

75% believe regulators are struggling to keep up with the pace of development in AI

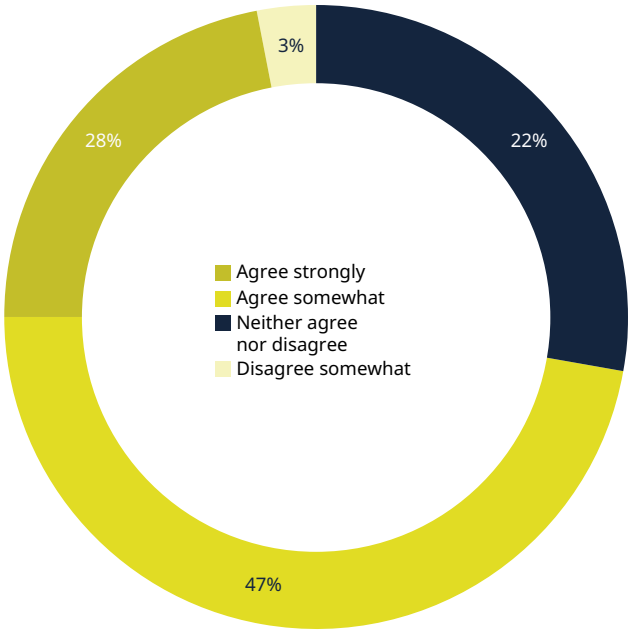
The financial services sector is heavily regulated on a product, governance and infrastructure basis. In the UK, we have a very thorough governance framework neutral of the technologies we implement. Businesses report that they would like guidance – similar to ESMA’s guidance in the EU – on how to align existing regulatory frameworks. This speaks to the tension between regulation as stimulus or regulation as a brake on innovation, and we see that playing out through the 'Brussels effect' arising from the new AI Act.



Mark O’Conor
Partner, Global Co-Chair
– Technology sector
UK

Fig 18: Are regulators struggling to keep pace with the evolution of AI in financial services?

At the global level



Harnessing opportunities, navigating challenges

To maximise AI opportunities, businesses report that they are primarily focusing on investing in the technology required (64%) and developing ethical frameworks (56%). It’s important to note that the majority of enterprises are choosing to invest in available generative AI tools/products rather than create their own solutions. This is likely to be attributable to resourcing constraints (as mentioned, only four in ten are committed to hiring experts in the field of AI and five in ten to hiring specialist sub contractors – Fig 16) and cost.

Half (51%) of businesses are providing training on AI for their staff as part of this adoption journey, which will form an essential element of firms’ internal AI governance. However, six out of ten (61%) are not yet imposing governance or oversight structures over their use of AI (Fig 16) so it appears that the development of internal governance models is being done in an incremental fashion. Ultimately, a firm’s

governance framework will be critical in giving organizations the opportunity to deploy the technology in a way that’s ethically and legally aligned with the organization’s risk appetite.

Key challenges related to the use of AI across the sector include ensuring ethical use (60%) (Fig 19). There is widespread concern that greater use of AI will widen inequalities (Fig 20), highlighting a need for careful oversight, perhaps by partnering with industry experts. It will be important for firms to manage bias in their data sets and processes. There is concern that using AI to assess risk might lead to some parties becoming unbankable or uninsurable. On the other hand, the technology’s granular assessment of risk factors could be used to take better and more informed decisions that lead to an increase in service provision to customers whose available options might otherwise have been more limited.

Fig 19: Key challenges related to AI in the next 1-2 years

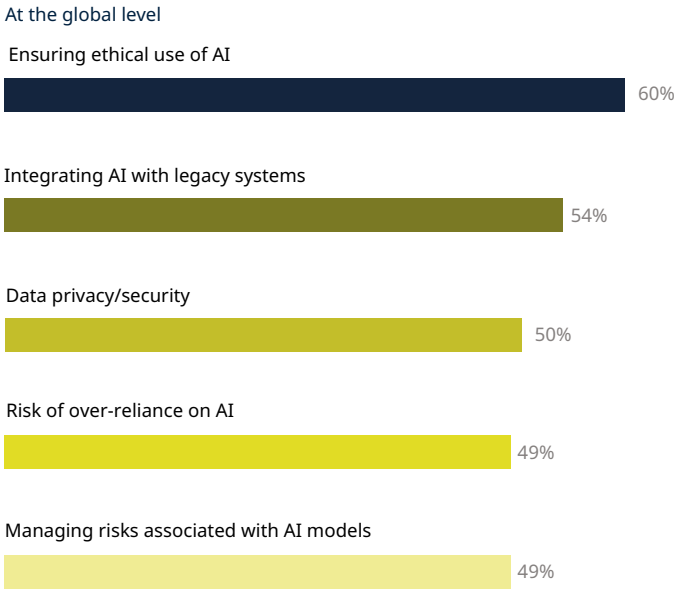
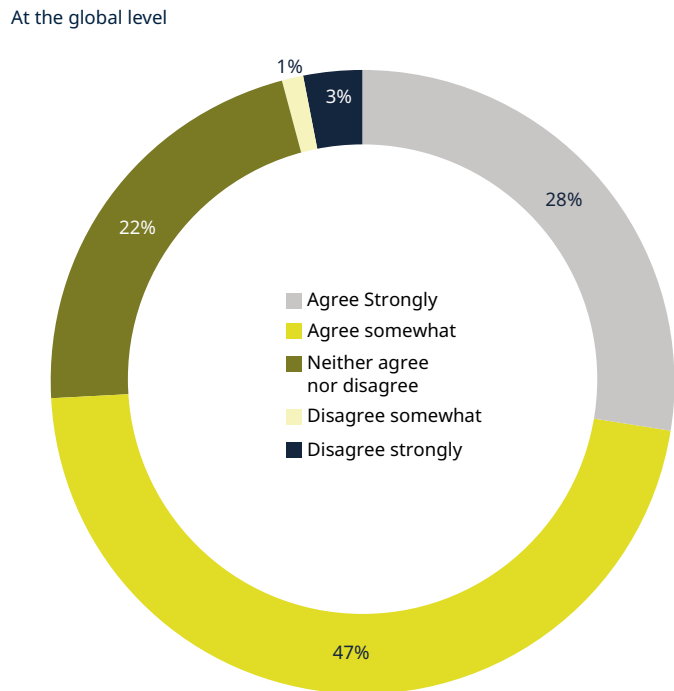


Fig 20: Will the use of AI in financial services widen inequalities?



Litigation risk from the use of AI is an emerging trend with early cases involving copyright claims against AI companies and a proliferation of chat bot claims in the privacy space in the US. ESG is already producing significant class action risk across all three pillars, including an increasing focus on social and governance related claims. We expect these trends to expand within financial services, driven in part by conflicting regulatory requirements across jurisdictions and political polarization in the US.



Isabelle Ord
Partner, Global Co-Chair –
Financial Services sector US

AI might increase opportunities for financial inclusion. At present, banks can treat you differently based on the passport you hold. With AI, we might be able to apply a level of refinement which allows banks to be a little bit more pragmatic and inclusive when it comes to risk-based regulation.



Adrianus Schoorl
Legal Director
UAE

Generative AI, the transition to the cloud, increased fraud and cyber risk, and de-risking are expected to be high on the agenda of financial services managers in 2025. Further, the digital and customer centric offering of financial products (such as B2B lending, embedded finance, new loyalty products and robo advisory and investment services) by regulated and non-regulated fintechs will require banks to be more agile than ever and create, or be part of, new customer platforms.



Pierre Berger
Partner
Belgium

06 Wider regulation

A balancing act

Regulation is a cornerstone of the financial services industry, underpinning its stability and integrity globally. Effective regulatory frameworks ensure that financial organizations operate within defined legal and ethical boundaries, safeguarding consumers and maintaining market confidence.

As the financial landscape evolves with technological advancements and globalization – including on key areas relating to ESG, digitalization and AI as this report highlights – robust and balanced regulation more widely is essential to address emerging risks, foster innovation, and uphold the resilience and sustainability of the global financial ecosystem. Globally, we continue to see trends of increased regulation and regulatory divergence. For international financial services organizations, anticipating, planning for and navigating regulatory change, is a significant priority.

Navigating increased regulation

The impact of excessive regulation is a concern for survey respondents – it’s a key driver for those pessimistic about the sector generally (89%) and more than half of all respondents (58%) think there is no greater challenge than complying with new regulation (Fig 5 and 6).

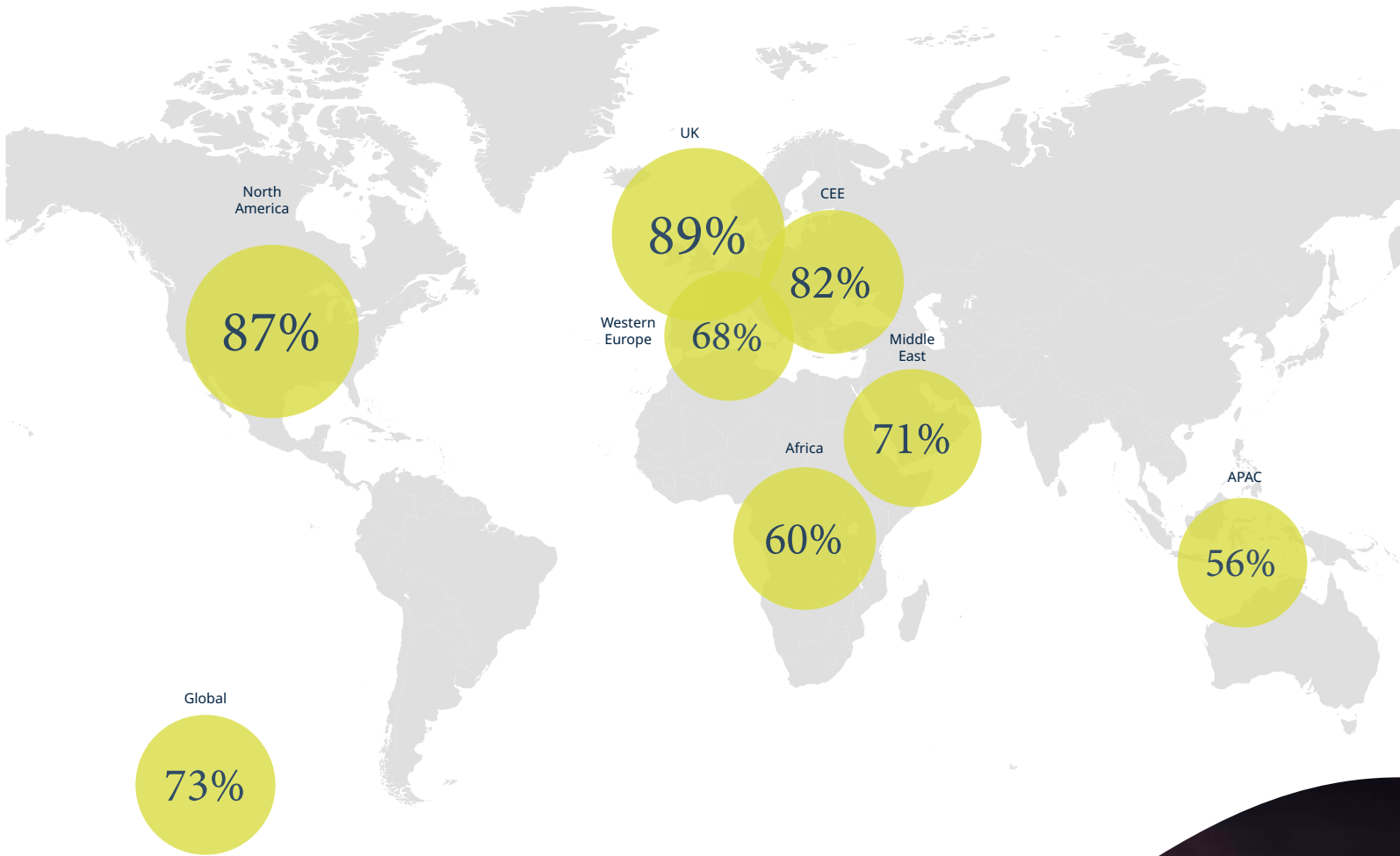
Generally, the strong view is that regulation is stifling innovation (73%). This is felt by a majority in the UK (89%) and North America (87%). It’s less of a concern in the APAC region (Fig 21).

Regulatory development in Asia has been dynamic, reflecting the region’s rapid economic growth, technological advancements and evolving market needs. Across Asia, there is a proactive approach to managing risks, promoting innovation, and ensuring market stability. Regulators are increasingly focusing on digital transformation, fintech, data protection, sustainability, and robust risk management to support the region’s financial sector’s growth and resilience. The pace of change is rapid and many businesses are having to strengthen their legal and compliance functions.



Philip Lee
Partner
Singapore

Fig 21: Do respondents agree with the statement: regulation in financial services stifles innovation?



Challenges and business impacts

Return on capital is used by banks not only as a measurement of profitability, but as an indication of the banks’ ability to create value on the amount invested by the shareholders. In that context, legal and compliance teams at financial services institutions have to continually compete for and justify their resources.

It can be nearly impossible to align internal compliance and control systems without investing in digitalization and legal advice. Furthermore, in many parts of the world, organizations feel that regulation is not consistently applied across different subsectors of the industry.

Other regulatory challenges include fulfilling reporting requirements (a particular issue in relation to cybersecurity/ financial crime), putting actions in place to ensure compliance and keeping up with the speed of change in regulation (both particular issues in relation to digitalization) and understanding the regulation (a particular issue in relation to AI and ESG) (Fig 22).

Respondents also see a range of potential impacts on their businesses from managing wider regulatory and compliance requirements. This highlights how these requirements touch on points of strategic and operational importance across the entirety of an organization (Fig 23).

- There are no challenges
- Fulfilling reporting requirements to demonstrate compliance with regulation
- Putting actions/ processes in place to comply with the regulation
- Differing regulation across jurisdictions
- Keeping up with the speed of change in regulation
- Understanding the regulation

Fig 22: Biggest challenges in complying with regulation in key areas

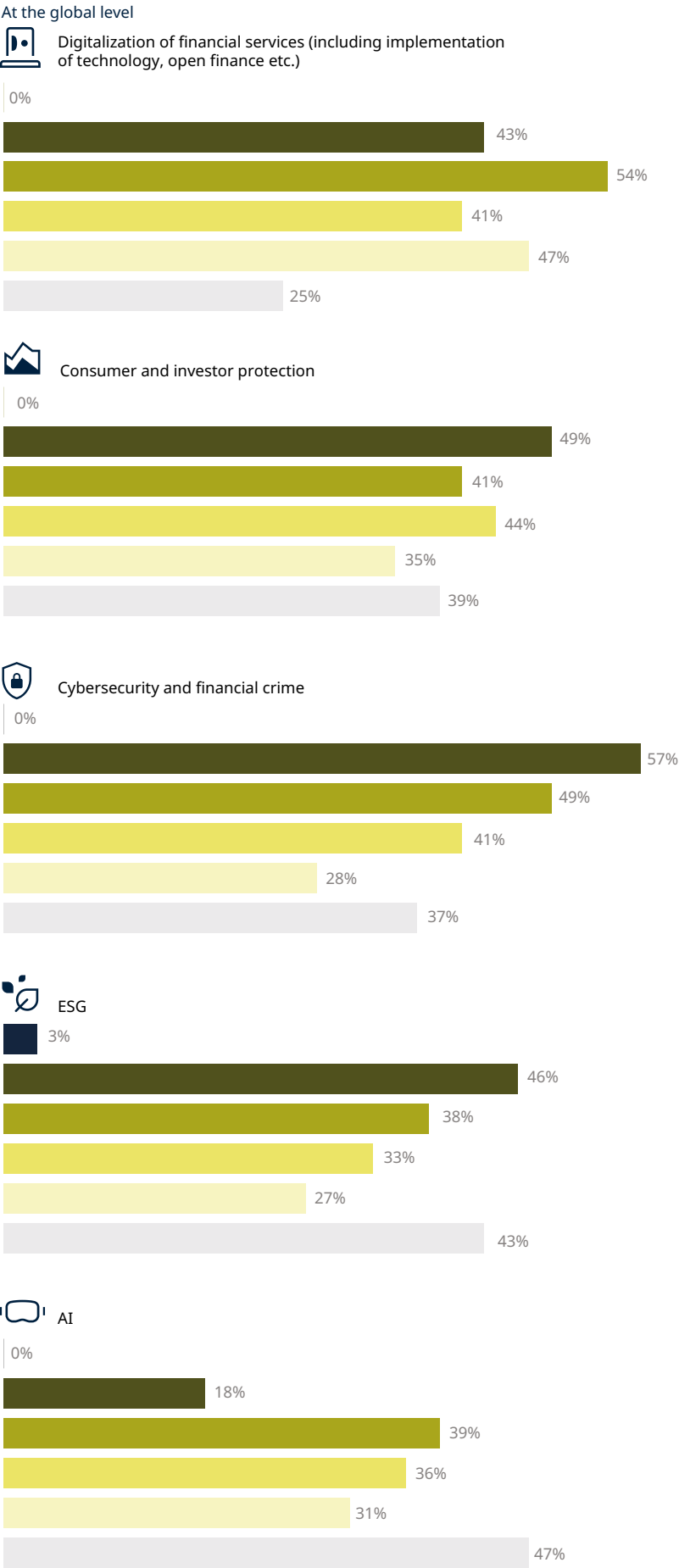
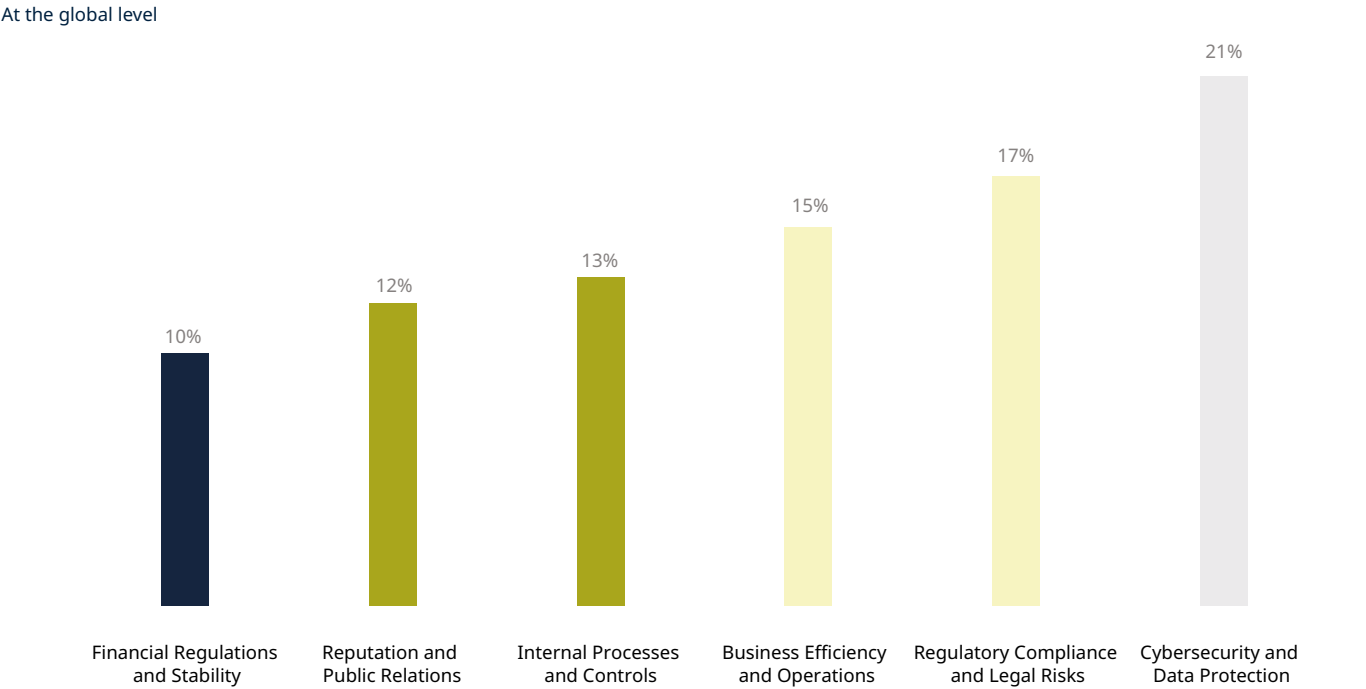


Fig 23: Aspects of managing wider regulation noted as having the greatest impact on respondents



Our experience demonstrates that clients are demanding greater support in horizon-scanning than ever before, as well as mapping out regulatory implications globally, explaining divergence and where global policies have to be gold-plated or adapted for a local market.

 **Paul Hopman**
Partner
Global Co-Chair – Litigation and Regulatory
Netherlands

In Spain, banks are calling for a review of the legal regulatory framework to strike a balance between financial stability and growth. Spain continues to see a concentration of its banking sector, with an appetite for mergers between key Spanish banks. Only a clear regulatory framework with effective supervision considering the specifics of each financial entity will enable this objective of stability and growth.

 **Natalia López Condado**
Counsel
Spain

The benefits of regulation

Despite the challenges and costs involved, financial services organizations around the world are accustomed to navigating new regulatory requirements. Many aspire to be leaders in managing regulatory compliance (Fig 24), especially in Western Europe (61%) and the APAC region (63%) (Fig 25).

One reason for this is the idea that regulation can foster innovation and provide credibility to the market and its regulated participants. Many large institutions recognize regulation as a source of support as they scale innovative business models. There is also recognition that regulation is necessary: it offers legal stability, stymies bad actors and facilitates investment. Even companies who say they struggle to navigate regulation are generally optimistic about the future of the sector, suggesting that they understand its importance.

Balanced and proportionate levels of regulation that support good business are a key concern for respondents in our survey. Current international examples of the benefits that new regulatory developments can bring include:

- Dubai’s Virtual Assets Regulatory Authority (VARA) which created the Emirate’s virtual asset specific regulatory framework. Published in February 2023, the Virtual Assets and Related Activities Regulations 2023 aims to further VARA’s objectives of fostering a vibrant virtual assets

ecosystem, promoting innovation and driving economic growth in Dubai while ensuring responsible market participation and consumer protection.

- From 2025, the Digital Operational Resilience Act (DORA) will come into force in the EU. It’s designed to strengthen the digital resilience of financial entities so the European financial sector can minimise the impact of a severe operational disruption if it occurs. This requires in-scope firms to implement governance and control frameworks to manage ICT risks effectively, carry out enhanced digital operational resilience testing, manage ICT third-party risks and report major ICT related incidents to competent authorities.

While many institutions are concerned that regulation can stifle innovation in the financial services sector, there is also recognition that it can be a source of clarity and support, and, in the case of regulation such as DORA, provide continuity of service and minimise disruption to critical services.

Regulatory compliance can also be viewed as a driver of opportunity: respondents across regions consider it to be the key opportunity for using AI over the next two years (fig 26). This is the consistent view held across all financial services sub-sectors, but especially the banking sector, with AI expected to transform areas including fraud detection and prevention, risk management and overall compliance efficiencies.

Proportionate regulation can be a competitive advantage in attracting business and investment. We see that in the UK it can aid growth by cementing the reputation of our financial markets as a safe and rewarding place to invest. Trusted capital markets attracting the leading financial professionals is key to its reputation and investment decisions.

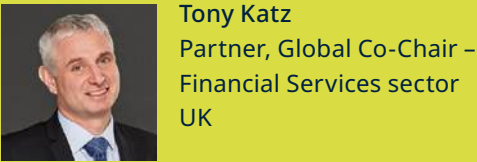


Fig 24: Respondents' position on managing regulatory/compliance requirements generally

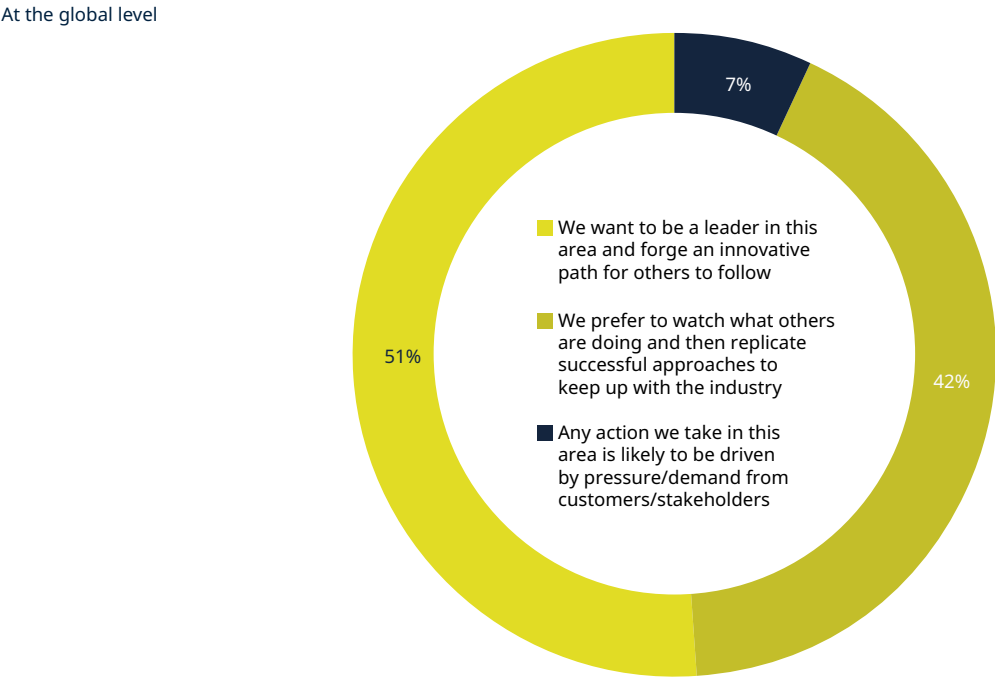
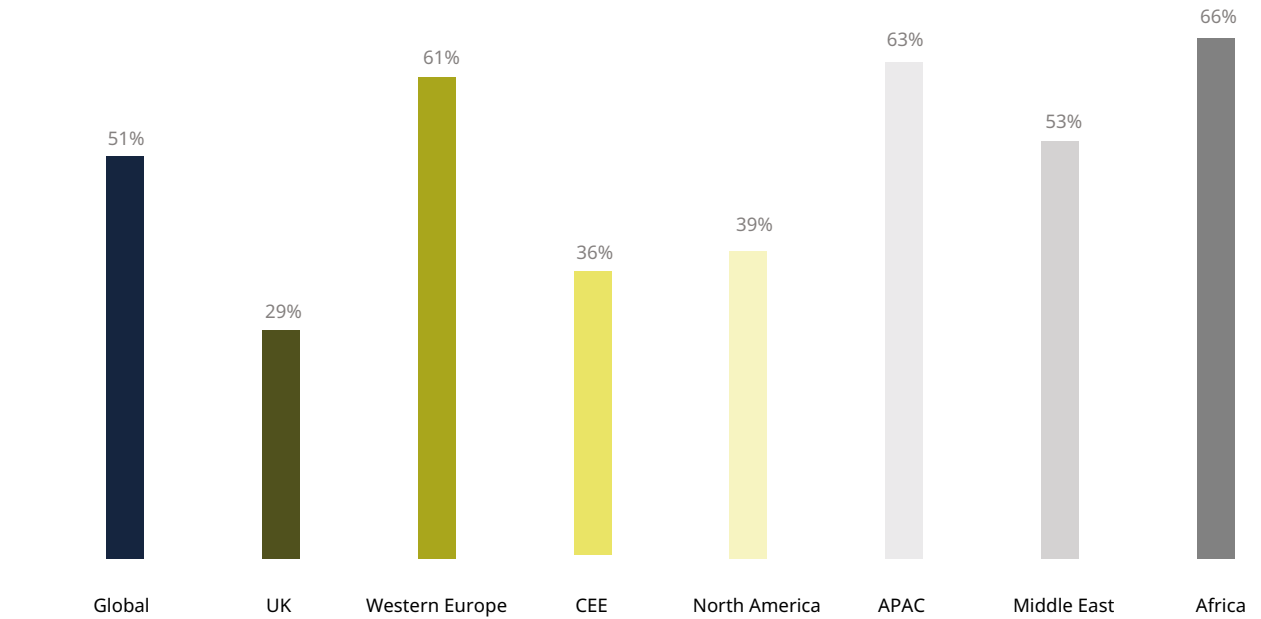


Fig 25: Respondents wanting to be a leader and innovator in managing regulatory/ compliance requirements generally



Regulation for new products

Almost all firms would like to see changes to the amount of regulation imposed in key areas, with very few believing that regulation is fine as it is (less than 1% for the key and developing areas of AI, digitalization and cybersecurity) (Fig 27).

But it’s important to note that the kind of change desired is not consistent across key areas. Generally, it’s felt there can be either too much regulation (around digitalization) or too little (around AI and ESG) and there are calls for regulatory requirements to be clearer with better guidance.

The size of an organization can also play a key role on its position. For example, the Markets in Crypto Assets Regulation (MiCA) in the EU sets out a comprehensive and harmonised framework for the regulation of crypto-asset markets across the region, regulating crypto-asset issuers and crypto-assets service providers. Larger firms are better able to weather the cost of such regulation, while for smaller and mid-sized firms – for example, smaller crypto firms – complying with MiCA requirements can seem nearly unaffordable. In the UK, the steps already implemented – including imposing money laundering regulations on crypto asset exchange and custodian wallet providers, banning the sale of crypto assets-backed notes and crypto derivatives to retail consumers and extending financial promotion restrictions to most crypto assets – has provided a material burden for new entrants.

Our research data suggests that complying with new regulation is particularly important in South Africa (70%), APAC (61%) and Western Europe (59%) (Fig 29).

There is already an indication that those in the financial services sector will be subject to more regulation on the use of AI than other sectors. In the UK, we are seeing regulators issuing specific guidance and/or extending existing regulatory regimes to cover the use of AI – with the UK’s Prudential Regulatory Authority and the Financial Conduct Authority stating that the existing Senior Manager and Certification Regime (SMCR) already applies to make certain senior managers personally accountable for the safe and responsible use of AI.



Jennifer Holyoake
Legal Director
UK

Fig 26: Respondents viewing regulatory compliance as a key opportunity for utilising AI

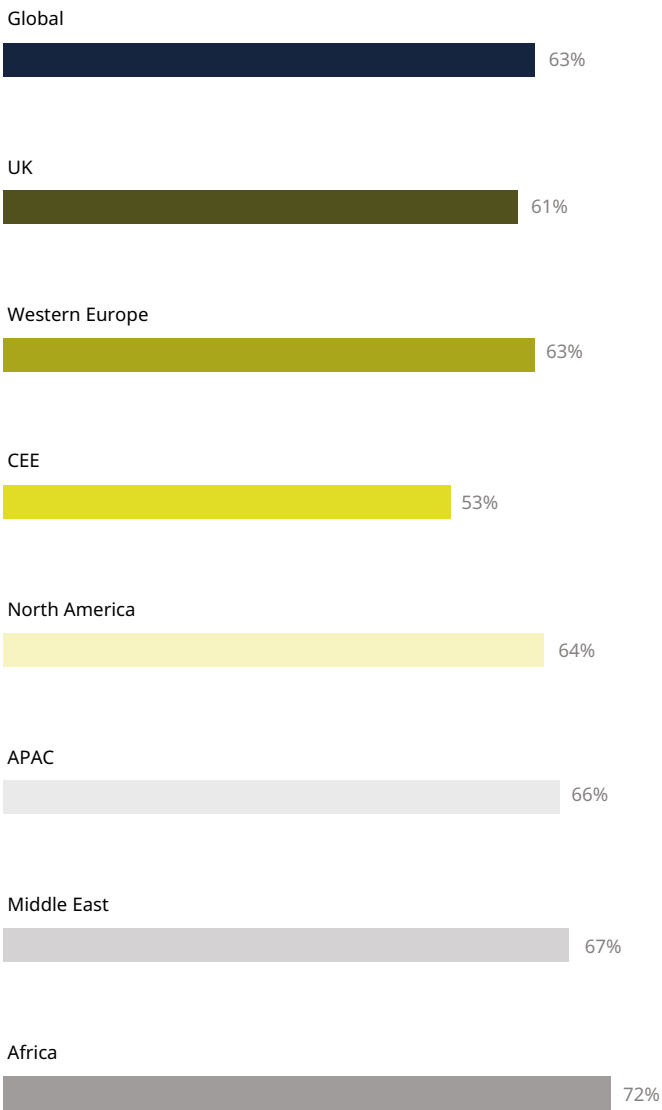
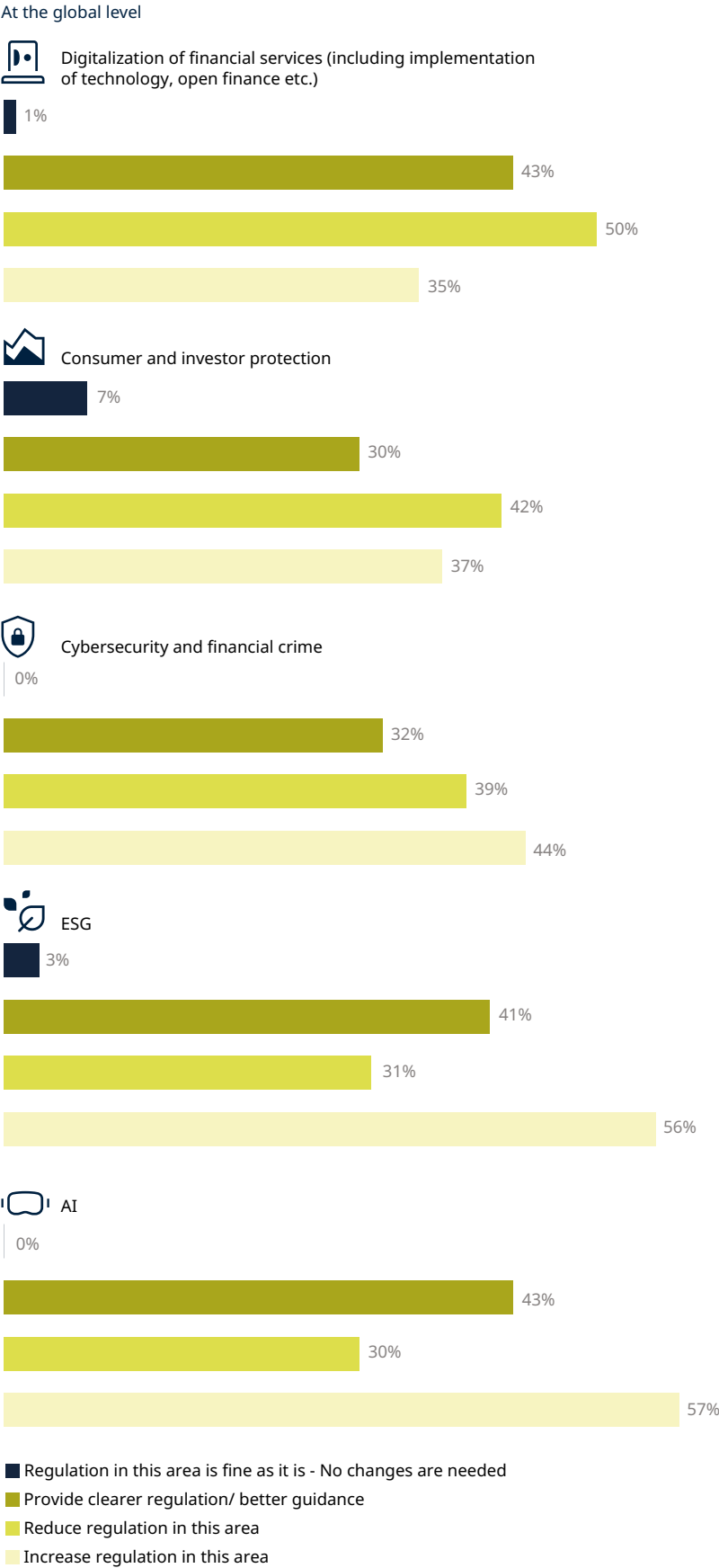


Fig 27: How should regulators be responding to help maximize opportunities/overcome challenges in the following areas?



In the US, many regulations imposed by the Securities and Exchange Commission (SEC) that have an impact on financial services are being challenged by organizations. As an example, organizations representing private funds and their managers have successfully challenged new private fund adviser rules based on regulatory overreach.



Deborah R. Meshulam
Partner
US

In a developing market it is always challenging to find a balance between adequate and over regulation. It is nevertheless important that regulation in South Africa keeps up with international regulatory developments in order to limit opportunities for regulatory arbitrage and to protect the integrity of the sector.



Johannes Gouws
Partner
South Africa

Focus on cybersecurity regulation

The challenges related to cybersecurity and financial crime risks are among the most concerning for our respondents. More than four in ten companies (44%) state they would prefer an increase in regulation in this area (Fig 27). Institutions are aware of their vulnerability where cybersecurity is concerned. Half (50%) state that the greatest impact on their business over the past two years has been managing risks related to cybersecurity and financial crime and 57% expect this issue to affect them in the immediate future.

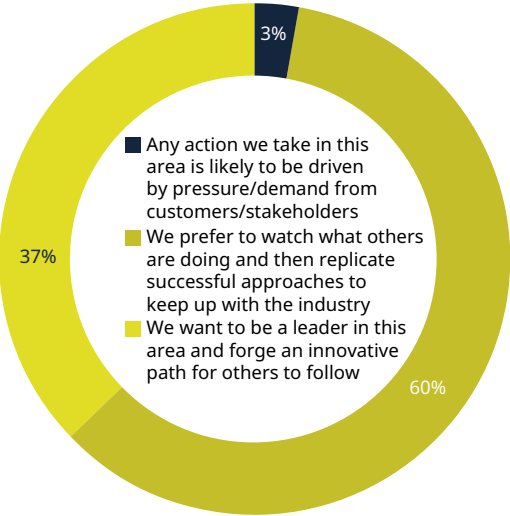
Despite the importance of cybersecurity, only four in ten organizations (37%) prefer to lead the way in this area, with most preferring to watch what others are doing with the intention of replicating successful approaches (Fig 28).

In the US, the concern for managing the risks relating to cybersecurity and financial crime has been felt the strongest, with 60% of US respondents highlighting this as being a key challenge over the last two years. The US Treasury Department issued a report warning financial institutions of the unique fraud and cybersecurity risks posed by AI technology and offering a series of still-emerging best practices to manage and combat them. The report, *Managing Artificial Intelligence-Specific Cybersecurity Risks in the Financial Services Sector*, released in March 2024, was prepared pursuant to President Biden’s October 2023 executive order on the safe, secure, and trustworthy development and use of AI by federal government agencies. The report outlines a series of next steps to address immediate AI related operational risk, cybersecurity, and fraud challenges.

Looking ahead, Middle East respondents are most concerned about this risk over the next two years (Fig 30).

Fig 28: Respondents' position on managing risks related to cybersecurity and financial crime

At the global level



Australian banks are especially concerned about cybersecurity. They are a key part of national infrastructure facilitating domestic and global trade and are cognisant of their role in maintaining resilience to constantly changing risks.



Hugo Thistlewood
Partner
Australia

In the US, we’re seeing an increase in federal and state legislation and potential regulation around the use of AI and deep fakes to conduct identity fraud and cyber financial crime, including unauthorized access to payments system and personal or financial related data. In addition, legislators and regulators are considering the use of sandbox protections to enable financial institutions to test AI technology tools to counter this growing threat.



Margo Tank
Partner, Global Co-Chair –
Financial Services sector
US

Fig 29: Respondents indicating complying with new regulation is a key business challenge in next 1-2 years

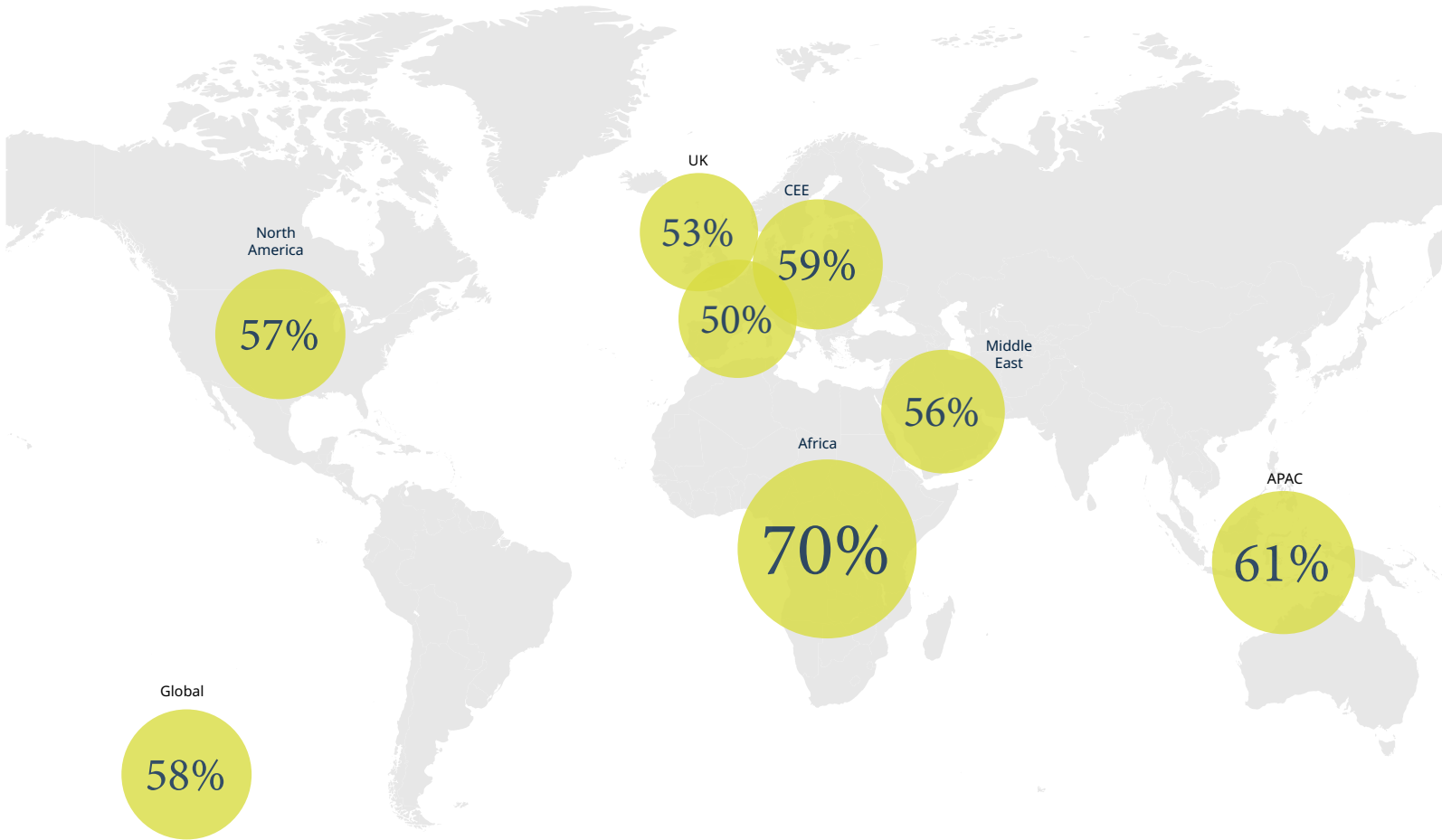
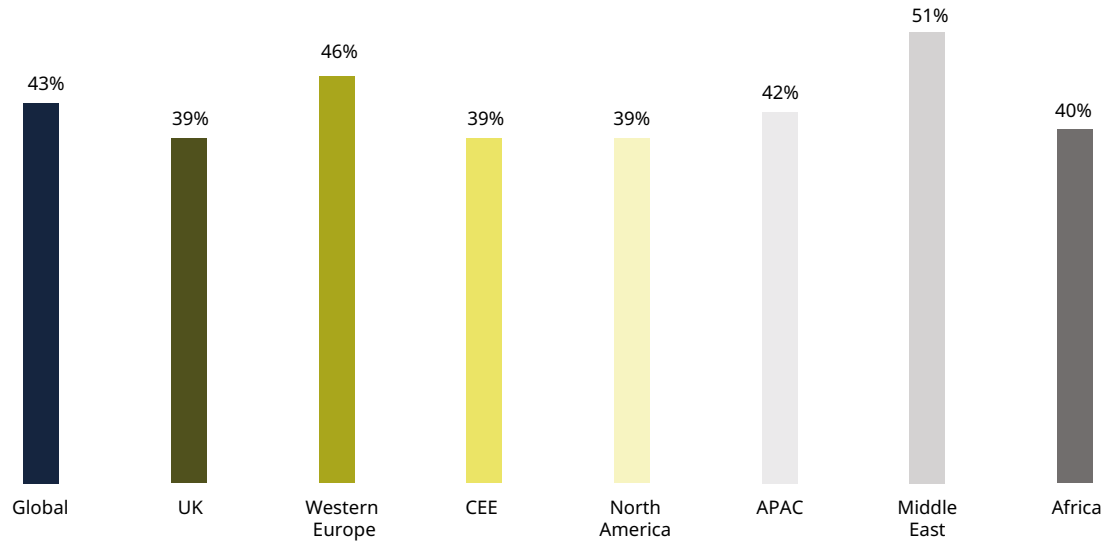


Fig 30: Respondents identifying cybersecurity and financial crime as a key risk in the next 1-2 years



07 Conclusion

Harnessing disruption: pathways forward

In the face of unprecedented geopolitical, social, technological, environmental and regulatory change, financial services organizations must make important strategic decisions to navigate this continued disruption to the sector globally. The ESG agenda and the emergence of AI, as well as digitalization more generally, are the most transformative developments – as such, organizations are engaging in these areas but must always be mindful of related regulatory concerns as well as the impact of wider regulation more broadly across the sector.

While there are regional differences across such a vast and diverse sector, financial services organizations are generally optimistic about the opportunities these developments present, even if they also present challenges. Respondents see opportunities for growth globally with AI, digitalization and sustainability driving new products, business models and investment. In doing so, they don't only consider financial opportunities. In the ESG space, a majority of organizations think opportunities to benefit the environment and communities are a significant driver. As a consequence, organizations are undertaking various activities in this regard, from developing new sustainability-linked products to creating financial inclusion initiatives. The key challenge and potential win in this area is regulation. While many organizations consider current regulation challenging to comply with, the majority would like to see more regulation that's proportionate and balanced, with a view to improving the harmonization of standards. Clarity is key.

Respondents see opportunities for growth globally with AI, digitalization and sustainability driving new products, business models and investment. In doing so, they don't only consider financial opportunities

Digitalization and AI present a different set of opportunities and challenges. Unlike ESG, these developments are market-led, with regulations following the latest trends.

Organizations broadly believe that these developments are transformative and see applications in product development and delivery, organizational efficiency and regulatory compliance. At the same time, the implementation of digitalization and AI present business risks, and most organizations are "following" and not proactively taking steps to seize these opportunities beyond investments and developing ethical frameworks. Besides business risks, regulation presents challenges – a majority of respondents would welcome more AI regulation (more than on further digitalization), but many of them want clearer regulation or better guidance. Just as with ESG, organizations are also concerned about social impact, specifically that greater use of AI could potentially widen inequality.

[Digitalization and AI] developments are market-led, with regulations following the latest trends. Organizations broadly believe that these developments are transformative

Considering financial regulation more broadly across the sector, financial services organizations paint a somewhat mixed picture. On the one hand, organizations feel that regulation is necessary as it provides stability (if regulation is clear with better guidance) and deals with bad actors. On the other hand, the vast majority believes excessive regulation is a key concern, with over half considering compliance as a significant challenge. Smaller businesses are generally more pessimistic about regulation

than larger organizations, but almost all firms would like to see changes to existing regulation – calls to reduce regulation are greatest in digitalization and consumer and investor protection, while organizations want more clarity and better guidance across all sub sectors.

the vast majority believes excessive regulation is a key concern

The global financial services sector has a markedly positive outlook, with change-driven opportunities as the basis for its optimism. The pace of this change shows no signs of slowing. The sector is also keenly aware of the challenges and risks that come with this and, as it navigates today's key disrupting forces, regulation can be both an ally and a foe. This sentiment underlines the importance of having proportionate and data-driven regulation that's informed by market developments, and where key stakeholders across the sector can contribute to the objectives of regulation. By doing so, global financial services will be best positioned to make the most of its opportunities and optimism, even as the sector continues to face uncertainty and significant disruption into the future.

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