CLIFFORD CHANCE

FINTECH IN 2022: FIVE TRENDS TO WATCH

— THOUGHT LEADERSHIP

JANUARY 2022

FINTECH IN 2022: FIVE TRENDS TO WATCH

With the COVID-19 pandemic ongoing, technology continues to revolutionise financial services at a rapid pace. Following the bold predictions we made **last year**, we highlight the five key trends for fintech in 2022.

1

Crypto regulatory scrutiny

There is increasing investor focus on cryptocurrencies and crypto tokens and many traditional financial services providers and investors seem eager to become involved. However, increased investor interest has drawn greater regulatory scrutiny around the world, which we expect to continue in 2022.

What's next?

- The UK is expected to publish responses to the consultation on the **UK regulatory approach to cryptoassets and stablecoins** and has recently published its consultation response for the regime governing **promotions of cryptoassets**. In the EU, the focus will be on the adoption of the **Markets in Cryptoassets Regulation** and, in the US, where over 30 bills were introduced in Congress addressing cryptocurrency or blockchain policy in 2021, we expect the pace of Congressional engagement and lobbying of lawmakers by the crypto industry to continue and accelerate into 2023. Similar trends can be expected in other jurisdictions, with Hong Kong and Singapore developing their relevant frameworks.
- With the development of individual regulatory regimes, global standard-setting bodies, in particular the Financial Action Task Force (FATF), will have an important role in influencing local regimes. We expect that jurisdictions will continue strengthening their existing AML/CTF frameworks to adhere to the **revised guidance from 2021**, which will include implementing the dreaded travel rule requiring crypto companies to share specified customer information alongside a transaction. Regulators are increasing their understanding of the capabilities of next generation analytics tools and will expect institutions to use them.
- Enforcement actions involving crypto businesses are likely to increase. The creation of new regulatory regimes, or the expansion of existing ones, may give regulators additional enforcement powers to pursue breaches of their regulatory frameworks. Even without new or expanded regulatory regimes, the position of regulators may harden as crypto becomes increasingly mainstream. For example, in the US, since taking over as Chairman of the US Securities and Exchange Commission (SEC) in 2021, Gary Gensler has regularly expressed the view that the crypto industry requires greater oversight and US state regulators are very focused on US and non-US crypto lending platforms that provide services to retail users. With recent reports suggesting that crime involving cryptocurrencies reached US$14 billion in 2021, we have also observed significant activity in the crypto space from US AML and sanctions regulators, with that trend also expected to continue this year.

2

NFTs on the rise

Increased investor focus on crypto has also propelled investor interest in areas of decentralised ledger technology such as non-fungible tokens (NFTs), i.e., cryptoassets representing proof of title to a unique digital version of an underlying asset. In 2021, we saw the market for NFTs grow rapidly, particularly in the sports and digital arts sectors, with NFT issuances selling out in record time and generating millions of dollars.

What's next?

- Additional use cases for NFTs beyond the creation of collectibles or art. For example, it is not hard to imagine the use of NFTs in a Web 3.0 environment (see below). A metaverse, where users collaborate and trade virtual goods, is likely to make use of NFTs as a means of owning virtual property. The legal ramifications of this will be interesting, because the regulatory frameworks being developed generally do not include metaverse assets.

- The emergence of new financial products recognising these tokens as a new asset class. There are already proposals to use NFTs as collateral for financing transactions and we expect traditional financial providers and incumbents to begin offering such products. This will trigger novel operational and legal challenges, such as determining the appropriate security mechanism for these assets. In the UK, the work of the **Law Commission on digital assets** may bring us closer to answering these issues. However, we expect that inevitably, in this fast-moving environment new questions will arise.
- Greater focus on consumer risks. As organisations and individuals look to NFTs as an opportunity to generate new revenue streams, there is concern that consumers may not be fully aware of the specific rights (if any) that are being acquired via the NFT. With very little regulatory framework specifically dealing with NFTs currently in place, potential NFT issuers should be aware of reputational and mis-selling risks which could affect their brand and lead to legal challenges down the line.

For more, watch our international expert panel discussion on **NFT – The Rise of the Non-Fungible Token** or read our briefing **Non-Fungible Tokens: The Global Legal Impact**.

Web 3.0 and financial services

3

Web 3.0 is often used to refer to the next generation of the Internet, which many expect to be decentralised and run on distributed infrastructure developed on open standards (including blockchain or distributed ledger technology), in contrast to the perceived shortcomings of the present version of the Internet, in which centralised authorities and gatekeepers mediate and control the flow of information. With an extremely wide range of activities programmable on blockchains using smart contracts that enable the implementation of sophisticated logic, even complex financial transactions and e-commerce can be enabled through Web 3.0.

What's next?

- In 2022, expect the Decentralised Finance (DeFi) sector, which some proponents view as a way to conduct financial transactions or achieve trading profits without relying on traditional financial institutions or the government, to continue expanding and attracting capital, particularly from the growing "crypto-native" community. At the same time, we anticipate more traditional financial institutions, financial services providers, and even governments, will test and experiment with Web 3.0 technologies in an effort to discover whether processes for delivering financial services can be improved.
- The metaverse – an immersive three-dimensional Internet experienced through virtual reality devices which allow participants from around the world to interact with each other in real time – will provide a significant use case for Web 3.0 technologies in 2022 and beyond. NFTs representing "skins" (clothing or visible displays on a user's character, or avatar) or other items in the metaverse will be built on Web 3.0 technology, and in-metaverse payments could be made directly between users on a peer-to-peer basis without relying on a bank or payment processor to route the payment through the traditional financial system.
- Governments and regulators around the globe will continue to catch up. As smart contracts are increasingly used to deliver financial services, expect regulatory frameworks to continue to develop and adapt to circumstances in which there may not be an intermediary on which to impose registration, licensing, or supervisory obligations. In 2021, for example, in the US, both the SEC and the Commodity Futures Trading Commission brought their first enforcement actions against DeFi actors for violations of existing financial regulations and we expect similar activity to continue to occur in other jurisdictions as the relevant legal and regulatory guardrails are established or clarified.

4

DLT in debt capital markets

There is global recognition that distributed ledger technology (DLT) has the potential to transform how debt securities are issued, traded and settled and 2021 saw a number of experiments relating to blockchain bond issuances.

What's next?

- The expected publication in the Official Journal in the first half of 2022 of the much-anticipated pilot regime for market infrastructures based on DLT should give rise to the preparation of a number of experiments by market participants who wish to operate a DLT market infrastructure. The pilot regime, expected to be live from 2023, will test the development of the European infrastructure for the trading, clearing and settlement of DLT-based financial instruments and the European Commission hope that the pilot regime will allow a market consensus to emerge as to what a permanent EU regulatory regime for the use of DLT in capital markets should look like.
- Further analysis of settlement options. As central banks and financial market infrastructures across the globe explore the possibilities offered by Central Bank Digital Currency (CBDC) and decentralised technology, market participants continue to examine the benefits of settlement on DLT ledgers using CBDC. The most recent trend, explored in R3's recent white paper on a "settlement choice model" for securities settlement and seen in the Bundesbank's 'trigger' solution experiments has been to explore a hybrid model for settlement, preserving the important roles of existing mechanisms and market infrastructures, whilst offering the ability to settle both gross and netted trades in real-time using CBDC and digital assets on a DLT infrastructure. There have even been suggestions that the market could move towards having several settlement options existing in parallel, to be selected by the transaction participants according to the financial product in question and general circumstances of the deal.
- Digital issuances on the SIX Digital Exchange (SDX). In September 2021, the Swiss Financial Market Supervisory Authority FINMA authorised SDX to establish a regulated trading, settlement and custody platform based on DLT for digital securities. The inaugural digital bond was issued on the SDX in November 2021, with the digital bond being listed and traded on SDX Trading Ltd and centrally held by SIX Digital Exchange Ltd. The issuance was marketed as the 'first digital bond in a fully regulated environment', and we expect to see the wider adoption of digital exchanges using regulated market infrastructure to allow many more digital securities issuances in 2022.

For more, read our briefings **Digital Developments in the Capital Markets – Summer 2021** and **How data and DLT can accelerate sustainable finance**.

5

Digital trade finance

COVID-19 and consequent disruption to supply chains has accelerated the use of electronic transferable records as an alternative to paper-based transactions in international trade finance. However, the international trade finance community continues to grapple with the gulf that now exists between the opportunities offered by technological developments and what is legally permitted or recognised in respect of that transferable record. Efforts to address that legal reform are outlined in our briefing **Paperless International Trade: Achieving harmony between the law and technological potential.**

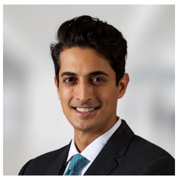
What's next?

- An increased use of electronic transferable records as a result of the removal of legal impediments. Countries such as Bahrain, Singapore and Abu Dhabi have now adopted the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Electronic Transferable Records (2017) (MLETR). Other countries, such as the UK, are looking at alternative approaches to reform their legal frameworks so as to accommodate for recognition of electronic transferable documents. In parallel, efforts are being made to promote and reform the Uniform Rules for Digital Trade Transactions as well as other eRules. Successful removal of legislative hurdles will rely on continued cooperation across the international community to ensure that their efforts dovetail to ensure consistency in approach.
- Continued focus on the use of platforms to facilitate trade finance with various international platforms being developed to create online forums, for example, facilitating the connection of financiers with traders. For the most effective results these will need to develop and offer:
  - more inter-platform API connectivity and partnerships to counter the emergence of "digital islands" by ensuring cohesion and integration of end-to end paperless trade processes including financing, logistics, customs and insurance;
  - the embedding of RegTech Solutions for "know your customer", anti-money laundering and other compliance and regulatory requirements;
  - counterparty verification (through the adoption of verifiable legal entity identifier (LEIs) or alternatives) in onboarding for more streamlined risk management in eradicating fraud while accelerating payments and goods flows.
- Greater development of data highways linking transport hubs, customs departments and logistics players with banks and insurers in order to facilitate sustainable supply chains and wider governance. The instantaneous exchange of connected data streams is widely recognised as being important for reducing administration and bureaucracy and enabling large trade flows.

CONTACTS

Marian Scheele
Senior Counsel
Amsterdam
T: +31 20 711 9524
E: marian.scheele@
cliffordchance.com

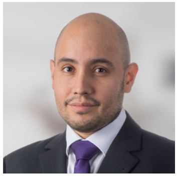
Jack Hardman
Counsel
Dubai
T: +971 4503 2712
E: jack.hardman@
cliffordchance.com



Rafe Khokhar
Senior Associate
Dubai
T: +971 4503 2695
E: rafe.khokhar@
cliffordchance.com

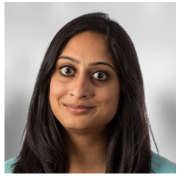
Christian Hissnauer
Counsel
Frankfurt
T: +49 69 7199 3102
E: christian.hissnauer@
cliffordchance.com

Rocky Mui
Partner
Hong Kong
T: +852 2826 3481
E: rocky.mui@
cliffordchance.com



Diego Ballon Ossio
Senior Associate
London
T: +44 207006 3425
E: diego.ballonossio@
cliffordchance.com

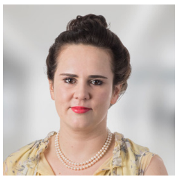
Simon Crown
Partner
London
T: +44 207006 2944
E: simon.crown@
cliffordchance.com



Puja Patel
Senior Associate
Knowledge Lawyer
London
T: +44 207006 3351
E: puja.patel@
cliffordchance.com

Monica Sah
Partner
London
T: +44 207006 1103
E: monica.sah@
cliffordchance.com

Kate Scott
Partner
London
T: +44 207006 4442
E: kate.scott@
cliffordchance.com



Rebecca Shepherd
Senior Associate
London
T: +44 207006 4806
E: rebecca.shepherd@
cliffordchance.com

Kate Vyvyan
Partner
London
T: +44 207006 1940
E: kate.vyvyan@
cliffordchance.com

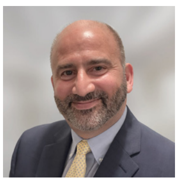
Jesse Overall
Associate
New York
T: +1 212 878 8289
E: jesse.overall@
cliffordchance.com

Alexander Tollast
Avocat
Paris
T: +33 1 4405 5157
E: alexander.tollast@
cliffordchance.com

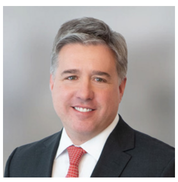
Paul Landless
Partner
Singapore
T: +65 6410 2235
E: paul.landless@
cliffordchance.com

Lena Ng
Partner
Singapore
T: +65 6410 2215
E: lena.ng@
cliffordchance.com

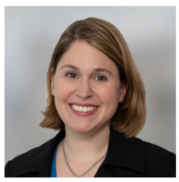
David Adams
Associate
Washington DC
T: +1 202 912 5067
E: davidg.adams@
cliffordchance.com



Jamal El-Hindi
Counsel
Washington DC
T: +1 202 912 5167
E: jamal.elhindi@
cliffordchance.com



Steven Gatti
Partner
Washington DC
T: +1 202 912 5095
E: steven.gatti@
cliffordchance.com



Megan Gordon
Partner
Washington DC
T: +1 202 912 5021
E: megan.gordonn@
cliffordchance.com

C L I F F O R D

C H A N C E

2201-001648