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Disruptive Technology: Understanding the Risks and Rewards

A look into a new generation of disruptive technologies working their way into financial service firms.

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Part 1: An Appetite for Disruption

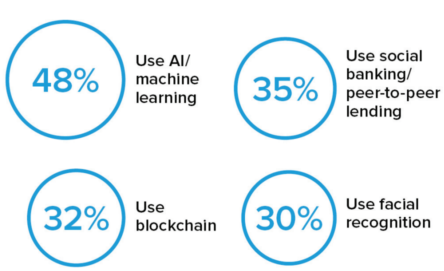
Legal Tech

The financial services industry has always been quick to embrace technology-based innovation, from ATMs to online banking. That trend continues, as fintech and a new generation of disruptive technologies, such as artificial intelligence (AI), blockchain, and biometric security, find their way into financial services firms.

Today, 73% of financial services companies are using one or more disruptive technologies, according to a recent survey of industry executives conducted by Corporate Counsel in conjunction with Winston & Strawn. The study found that companies are drawing on a variety of these technologies. AI, cited by 48%, tops the list, with respondents making use of AI technologies ranging from machine learning and chatbots to automated fraud detection, dynamic credit assessments, and algorithmic trading. In addition, 35% are using social banking/peer-to-peer lending technologies, 32% are using blockchain, and 30% are using facial recognition **(see Graphic 1)**.

Early Adoption

Financial services companies are engaged with a variety of tech.



While the use of these technologies is widespread, it is not uniform across the industry. Some companies have moved forward relatively quickly with the new technologies, while others have yet to get started. “Financial institutions in general have been early adopters of disruptive technology, but there is some disparity across companies in terms of comfort levels and how deeply they have embedded disruptive technologies into their businesses," says Susannah Torpey, a partner at Winston & Strawn.

The findings also show that financial services executives have high expectations for disruptive technologies and anticipate they will help their companies compete and grow. At the same time, however, they are not blind to the legal and regulatory risks they could bring. The potential impact of disruptive technology is expected to be widespread and deep, but it is not yet fully understood—and technology and the regulatory environments are both evolving. All of this increases concern about risk.

While the industry has dealt with evolving technology for decades, things are fundamentally different—and more challenging—this time around. "Technological change is not new. But that change is now faster, and the technology is more complex and more pervasive," says Basil Godellas, head of Winston's financial services regulatory practice. "So keeping up with evolving legal and regulatory risks is now more critical than ever."

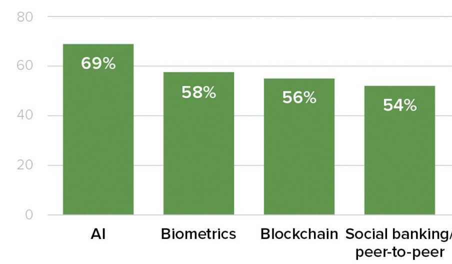
Putting Disruptive Technology to Work

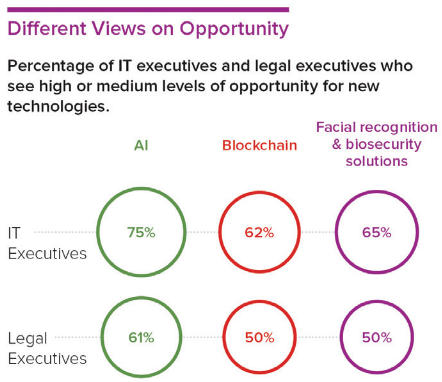
For financial services companies, customers are a key focus of disruptive technology initiatives, which is perhaps to be expected in an industry where customer experience is a key competitive factor. About four out of 10 say they are using it to improve customer service and provide easy access to products and services—witness the growing use of chatbots to assist customers. But companies are applying it to more back-office-oriented processes as well, with one-third citing each of three areas—increasing process efficiency, streamlining regulatory compliance, and creating new data-powered products. Altogether, more than three-quarters of companies are using disruptive technology in one or more of these areas. "We see they are using AI, for example, to do things like work with customers or in loan underwriting," says Danielle Williams, a litigation partner at Winston. "But they are also using it for fraud protection and surveillance. They are really embracing all facets of AI, on both the external and internal sides."

Companies' experience with the technology has presumably been fairly positive, given their expectations for the future. When asked what technologies will drive growth, 69% cited AI. But other technologies are not far behind, with 58% seeing growth potential in biometric security technologies, 56% in blockchain, and 54% in social banking/peer-to-peer lending. Disruptive technology will bring "better market share and higher customer service," said one respondent, while another saw broad benefits and noted, "I strongly feel that the current way things are done will change greatly in the near future" **(see Graphic 2)**. Interestingly, IT executives were more likely than legal executives to see high or medium levels of opportunity for AI (75% vs. 61%), blockchain (62% vs. 50%), and facial recognition and biosecurity solutions (65% vs. 50%), a reflection,

AI: Key Driver

Financial services companies see AI/machine learning as a key growth driver for FinTech, but other technologies are not far behind.





perhaps, of greater familiarity with the potential of disruptive technology **(see Graphic 3)**.

But not all financial services companies are jumping at these opportunities. Indeed, 27% report that they are not implementing disruptive technologies at all. Some respondents pointed to a lack of maturity with the technology as a deterrent. Many others cited regulatory uncertainty around the new technology. But the most-cited obstacle was the risk associated with cybercrime and data breaches, a long-standing and familiar challenge in the industry. "Technological disruption could cause huge issues with data security breaches and compromises," says one respondent. "This could cause businesses to be severely impacted and even fail."

In general, companies see a fair amount of legal and regulatory risk around disruptive technology. For many, this is based on real-world experience, with half the companies reporting that they have already encountered substantial legal or regulatory challenges on that front. Considering the guidance U.S. regulatory agencies have issued in the last year, this is not surprising. For example, the U.S. Securities and Exchange Commission, California Franchise Tax Board, Office of the Comptroller of the Currency, Financial Crimes Enforcement Network, Consumer Financial Protection Bureau, Internal Revenue Service and Federal Trade Commission have all addressed blockchain-based cryptocurrencies in the past 18 months, at least noting their consideration of whether and how to regulate cryptocurrencies and related activities. In addition, the DOJ Antitrust Division has filed several criminal enforcement actions alleging antitrust conspiracies related to electronic foreign exchange trading platforms.

"The uptick in the use of disruptive technologies is coming at a time when the antitrust agencies here and abroad, as well as class action plaintiffs, have pivoted to focus intensely on the banking and tech industries, which means increased risks relating to fintech are unlikely to escape scrutiny," notes Torpey.

This article is the first in a three-part series exploring executives' perspectives on disruptive technologies in the financial services industry. The next installment looks at where executives believe technology is driving increased legal and regulatory risk.

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