The Digital Imperative: Reflections from the roundtable series

Executive Summary

The City of London Corporation (CoLC) conducted a roundtable series from September 2023 to January 2024, exploring the increasing convergence between the financial and professional services (FPS) sector and large tech firms (LTFs). This phenomenon, observed in major markets worldwide, presents both opportunities and challenges for regulators and the private sector. The series, involving diverse stakeholders from over three dozen firms, aimed to identify shared perspectives and provide recommendations to maintain London's global competitiveness in FPS and tech.

Key findings:

1. **Clarity in definitions**: Precise terminology is crucial for effective regulation. Ambiguous terms like 'BigTech' and 'Fintech' can lead to regulatory inconsistencies, potentially over-regulating some entities while under-regulating others. Legislators and regulators must also more clearly define the risk, and tolerance for such risk, they seek to address before they can develop effective risk assessments.

2. **Outcome-based regulation**: An outcome-based regulatory approach focussing on risk identification and mitigation is favoured. A data-centric, entity-based regulation tied to firms' characteristics, e.g. size, data access and sophistication, and business models is worth further review. This hybrid approach combining entity-based and activity-based regulation would differ from current methods by considering factors such as a firm's ability to scale rapidly and its access to non-financial data.

3. **Reskilling and diversity in tech roles**: Both FPS and tech sectors face skills gaps, particularly in AI and machine learning. A recent Financial Services Skills Commission report showed that 71% of its members reported reskilling programs in 2023, up from 50% in 2022, yet demand still outstrips supply.[1] Initiatives fostering a growth mindset, clear learning pathways, and inclusive environments are recommended. Failure to address this gap could cost the UK economy billions in unrealised productivity gains.

4. **Technical expertise**: While maintaining the principle of tech neutrality in regulation, regulators must enhance their technical expertise, particularly in supervisory roles. This balance is critical to ensure effective oversight without stifling innovation or favouring specific technologies.

5. **Regulatory coordination**: Greater coordination among regulators, both domestically and internationally, is necessary to prevent regulatory arbitrage and promote a level playing field. Strengthening the Digital Regulation Cooperation Forum's (DRCF) mandate to lead cross-sectoral coordination efforts aligns with CoLC recommendations in our Vision for Economic Growth report.[2]

6. **Stakeholder engagement**: Improved regulator-industry engagement, especially with small and medium-sized enterprises, is needed. Transparent, digital engagement platforms could support gathering diverse insights on regulatory proposals. This could include online forums, regular digital roundtables or even AI-powered feedback systems to make participation less resource-intensive for smaller firms.

[1] FSSC-Future-Skills-Report-2024.pdf (financialservicesskills.org)

[2] Our global offer to business (theglobalcity.uk)

While challenges are anticipated, particularly in aligning international regulatory approaches, successful implementation could significantly boost the UK's competitiveness, aligning with secondary objectives. Addressing the AI skills gap alone could increase productivity in the FPS sector by up to 12% by 2025, potentially worth billions to the UK economy.

The series underscored the need for a balanced, forward-looking approach to regulation that promotes innovation while addressing potential risks in the rapidly evolving global FPS and tech landscape.

We very much thank all participants for their time and expertise. We believe that the findings and recommendations contained below support our aims to make London, and the UK, the global hub for financial and professional services and technology innovation, setting an example for other financial centres worldwide.

Key Recommendations:

- ***Clearly define risks:*** *FCA and PRA should consider a compromise between entity-based oversight and activity-based views to ensure regulatory efficiency without stifling innovation.*
- ***Embrace outcome-based regulation:*** *FCA and PRA should develop risk assessments using a hybrid activity-based/entity-based approach defined by a tech firm's data.*
- ***Invest in reskilling and diversity****: With policy support from Department of Education, the private sector should Implement initiatives that foster a growth mindset, provide clear pathways for learning and development.*
- ***Maintain Tech Neutrality but with specialist supervisory understanding****: digital upskilling of regulators is essential to provide sufficient supervision. This will require regulators actively mapping skills and working with DfE and the private sector to address those skills gaps.*
- ***Regulatory coordination and industry engagement:*** *the DRCF should strengthen its mandate to establish platforms for information sharing (including by supporting digital engagement with industry, especially SMEs), harmonise standards, and align regulatory priorities to prevent regulatory arbitrage and promote a level playing field.*

Introduction

From September 2023 to January 2024, the City of London Corporation (CoLC) ran a roundtable series called *The Digital Imperative.* The series explored the impacts of the financial and professional services (FPS) sector and large tech firms increasing convergence. Each roundtable centred around a variation of that theme. Discussion topics included future-proofing regulation, meeting evolving skills demands and improving domestic and international coordination.

The aim of the series was to identify shared perspectives from a diverse stakeholder base. Participants included national regulators, government departments, global institutions, industry participants from investment, retail and challenger banks, law firms, consultancies, asset management, the tech sector (including Large Tech Firms, henceforth LTFs) and third sector organisations. In identifying common ground, we hope to provide clear next steps and recommendations to ensure that London remains a globally competitive and innovative hub for FPS and tech.

This aim aligns with CoLC's 2023 report *Vision for Economic Growth – a roadmap to prosperity*[3], which sets out our ambition for the UK until 2030. In this report, we identified several themes including 'Becoming a digital-first economy'. The desire to be digital-first is the very embodiment of the convergence of the FPS and tech sectors. The roundtable series identified measures that government, regulators and the private sector must work together on to ensure our regime is robust, agile, and fit for purpose.

A key part of London and the UK remaining an internationally competitive financial centre is to leverage its strengths in tech. London has the potential to be the world's capital for tech and innovation in financial services. It is already the leading fintech hub in Europe. In 2022, more than 3,200 fintechs were headquartered in the UK. The UK has seen consistent growth in the number of fintechs based here since 2017, demonstrating the attractiveness of the UK environment to these innovative firms.[4]

Against the backdrop of a successful and growing UK tech cluster, the world is witnessing an increasing convergence of financial services and technology. To better understand global developments, CoLC commissioned two internal research reports in 2022. Those papers identified what the FCA would publish a few months later in its October 2022 Discussion Paper[5] – this convergence is not only happening at an accelerated rate, but also taking different forms in different global markets.

Well-known international tech firms have expanded their presence in finance, leveraging a vast customer base, technological capabilities, and data analytics. While their entry into finance brings benefits such as enhanced customer experiences, increased accessibility, and innovation, it also raises concerns regarding market concentration, data privacy, and financial stability.

CoLC hosted a half-day conference in March 2023 to explore the risks and, importantly, the rewards of FPS converging with LTFs. The event confirmed industry views that the convergence had a positive

[3] Vision for Economic Growth — a roadmap to prosperity (theglobalcity.uk)
[4] Why the UK is one of the best locations for fintech companies (theglobalcity.uk)
[5] DP22/5: The potential competition impacts of Big Tech entry and expansion in retail financial services (fca.org.uk)

role to play in increasing innovation, competition and consumer benefit and that the trend of convergence was only accelerating. That fast pace, perhaps unsurprisingly, also raised cautionary flags.

Recent years have seen heightened regulatory scrutiny and enforcement actions against tech companies in the financial services sector. Antitrust investigations and lawsuits were initiated to address concerns about market dominance and unfair competition practices. Data privacy and security incidents have also raised alarm bells, leading to penalties and increased focus on regulatory compliance. Consumer protection concerns and potential risks to financial stability have spurred government and regulators to take a closer look at tech's activities.

In relatively quick succession, we have seen a series of legislative and regulatory changes both domestically and internationally. For the UK these included, among others, themes around Operational Resilience and Critical Third Parties (CTPs), AI and machine learning, and specific legislation via the Digital Markets Act (DMA), Digital Markets, Competition and Consumers (DMCC) Bill, and the Data Protection and Digital Information (DPDI) Bill. It is clear that the perceived risk to financial stability is driving jurisdictions to review ways to apply financial regulatory mechanisms on non-financial corporates.

In a digital-first society, a simple extension of existing rules may not adequately resolve stability risks. The UK's CTP regime aims to allow financial regulators to oversee the way in which third party suppliers provide critical services to financial institutions to protect the position of financial institutions, but do not currently envisage new rules to regulate the financial condition of the supplier and its group to ensure the supplier's resilience against financial shocks that might impair its continued performance of services. New regulatory mechanisms also have to address the complexity of group structures and to be clear on the risks that they aim to address.

Defining the problem is critical. Without very clear definitions of risks that regulators seek to address, changing existing regulatory regimes will create high potential for divergence and impact secondary mandates of competitiveness. Differing mandates and objectives of regulators will shape how they identify and define risks, and this is further complicated by cross-border jurisdictional issues, as tech operates globally. Regulatory coordination and collaboration among different authorities will become crucial for effective oversight, both in defining risks but also in addressing them.

Equally critical to new approaches for managing financial stability risks and coordinating those effectively is the demand for new tech skills required to develop, operate and manage the innovative digital-first FPS offering. There is no more prevalent an example of this than within Artificial Intelligence (AI) and machine learning. The Financial Services Skills Commission's recent *Skills for the future of Financial Services 2024* notes that machine learning/AI has the biggest supply-demand gap for its members.[6] However, regulators and public sector bodies, with a growing responsibility to create and enforce AI regimes, are similarly wanting in AI skills. This may not need to shift a 'technology neutral' stance of our current outcome-based approach to regulation, but it will increasingly put pressure on evaluating the technical understanding needed in terms of supervisory roles.

[6] FSSC-Future-Skills-Report-2024.pdf (financialservicesskills.org)

In short, the sectors are converging with increasing speed. This brings potential benefits, but increasingly the focus has shifted to the potential risks. To ensure the UK regime is fit for purpose, we must consider several overlapping and complex issues at pace, from diverse points of view. This paper captures insights and discussions on just those issues.

Core Themes from discussions

Clarity in definitions

Perhaps as a consequence of the speed of convergence, terminology was regularly questioned both at a conceptual level, but also at a technical and legal level. From a conceptual level, LTFs challenged the usefulness of the terminology of 'BigTech'; it was simultaneously confrontational and too broad to usefully apply public policy with clarity. 'Big' may have shifted from 'Too Big to Fail' to 'Too Big to Regulate' but mostly in advanced economies.

Similarly, 'fintechs' muddied waters. The definition of fintech may be generally accepted as 'computer programmes and other technology used to support or enable banking and financial services'. However, those who apply such programmes or technologies vary significantly, from start-ups to non-financial services institutions to established financial services institutions. Business models matter. Regulators have different mandates. Applying a term too broadly, such as fintech, contributes to divergence in different markets' approaches to regulating for risk, if not divergence internally due to differing regulator mandates.

Additionally, regulators must more clearly define risk and the acceptable levels of risk. They should not aim for risk reduction to zero as it could stifle innovation. Rather, the primary goal of regulation should be to manage risk to a level that society, government, and regulators find acceptable. Stating what risk specifically regulators are looking to address helps to better clarify the policy intent. Despite several attempts through new legislation both domestically and internationally, current approaches often do not manage to articulate what risk legislators are trying to address through traditional financial regulation tools, e.g. overall financial stability, consumer protection, operational resilience, etc. Where intent for regulating risk may initially be clear, scope creep in applying regulation aims can muddle objectives. Here, the UK's creation of the Digital Regulation Cooperation Forum (DRCF) was held up as a positive example of how the UK could be effectively overcoming scope creep.

The UK, through the DRCF, should focus discussions on the limitations of traditional entity-based regulation (EBR) and the importance of incorporating nuanced assessments of tech firms' activities, such as their ability to scale, customer base, and access to non-financial services data.

> **Recommendation**: Consider a compromise between entity-based oversight and activity-based views to ensure regulatory efficiency without stifling innovation.

Risk assessment and outcome-based regulation

There is a clear preference for an outcome-based regulatory approach focusing on identifying and mitigating risks rather than prescribing specific processes. That is why clarifying risks will play such a critical role.

For example, EBR has not been applied outside of financial services, and even then, mostly within banking and insurance through prudential regulations. To assume it could be applied to tech may show a forced application of tools no longer sufficient Almost certainly it shows a failure to clearly define the problem regulators are solving for, e.g. capital requirements do not solve for operational resilience. EBR would need to recognise that these are firms operating beyond just the financial services sector and so need to adopt new tools or force restructuring of firms.

Therefore, EBR may need to be more directly tied to data when applying it to tech. A strong data framework is a foundational element for effective regulation, despite its initial onerous nature. Defining the entity through certain characteristics, such as volume and sophistication of its financial services and non-financial services data, regulators may be better able to target appropriate firms they feel pose financial stability risk due to their ability to scale.

This alone is not sufficient as too many firms might still be captured under such rubrics. Instead, once entity-wide rubrics are set, firms might then need to be assessed on their business models to establish whether the day-to-day activities are those which pose risk. An entity-based/activity-based hybrid may therefore provide the path forward to establishing risk assessments and maintain the UK's outcome-based approach.

Fair, transparent and consistent approaches are required from regulators. This is especially true moving forward in any attempt to create and imbed the hybrid approach. Legislators have increasingly provided regulators with more power, in some instances to avoid needing to legislate more polemic issues. Firms note application of powers isn't always consistent and when seeking to develop new frameworks, trust in both directions will be critical.

> **Recommendation**: Develop clear and adaptive regulatory frameworks that balance the need for innovation with maintaining financial stability and consumer protection.

<u>Reskilling and Diversity in Tech Roles</u>

In an area of rapid change, both FPS and tech, private and public sectors were experiencing skills gaps. For FPS, this is most acutely felt in AI and machine learning. Although the sector is improving efforts to reskill more broadly, with 71% of firms reporting reskilling programmes in 2023 compared to 50% in 2022[7], AI and generative AI is accelerating timelines.

In a recent CoLC report, we found across seven FPS subsectors that AI could boost productivity by as much as 12% by 2025, to a maximum of 50% by 2030, worth £35bn.[8] But to realise those maximum values, firms needed to, among other things in our ten-step framework, provide training and support as well as encourage collaboration and experimentation and foster a learning culture. It is less about wholesale job displacement, and more about how delivering today's job will be done through new tools and different skillsets tomorrow. AI is a tool. In order to maximise productivity, people will need to learn how best to wield that tool.

Fortunately, there are a few commonalities for these jobs across both sectors. For example, tech jobs (in FPS or LTFs) require people with a growth mindset who are curious to learn new things and adopt and continuously update new skills. Company culture, inclusive of open communication and the

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[7] FSSC-Future-Skills-Report-2024.pdf (financialservicesskills.org)
[8] Financial & Professional Services: The Future of AI and the workforce (theglobalcity.uk)

ability to ask questions are all vital. Improving understanding and building confidence is essential. On AI, this can be achieved by embedding different teams on open plan floors to learn from each other, and by red-teaming exercises to show people they can be an effective contributor on projects.

The rapid evolution of technology and the challenge of keeping skills up to date poses a serious problem for firms and the workforce. Investing in training for a skill which becomes obsolete costs money and time. However, tech roles benefited from skills training beyond just the technical. Even the most technical roles like AI algorithm development were dependent on teams with balanced skills to ensure there was a useable product and to generate business.

Government and firms must focus on the importance of reskilling and upskilling the workforce, particularly in tech-related roles, to address the skills gap and promote diversity.

> **Recommendation**: Implement initiatives that foster a growth mindset, provide clear pathways for learning and development, and create inclusive environments to attract and retain diverse talent.

Tech Neutrality

Government must not only support firms to invest in their workforce, but it must put equal emphasis on upskilling and reskilling its own workforce, including the regulators. Although neither the FPS nor tech sectors suggested that the principle of 'tech neutrality' should change, they recognised that developments in AI and quantum technology required a careful reconsideration of technical skills.

Regulators must understand underlying technologies to effectively oversee them, challenging the concept of tech neutrality in regulations. However, the existence for the potential of AI bias, for example, shouldn't prejudge the use of AI in financial services products. Instead, technology puts an increased focus on differences in roles between regulatory and supervisory functions. Technical expertise will become increasingly important under supervisory duties for enforcement.

AI may be just a tool, but technology isn't neutral. Firms still need layers of accountability, audits, checkpoints, governance etc. to ensure their products are not harming their consumers. Equally, regulators need a clear approach, provided in the UK's *AI regulation: a pro-innovation approach*.[9] But to enforce those principles, regulators will need upskilling in technical knowledge to be able to assess whether the technological outputs are meeting those standards.

> **Recommendation**: Emphasise continuous upskilling and education for regulators to keep pace with technological advancements and ensure effective supervision.

Coordination and cooperation among regulators

As already mentioned, the fast pace of change, combined with cross-border jurisdictions, difference in mandates, and lack of clarity on definitions and risk tolerances is leading to divergence. Greater

[9] Defined as: safety, security and robustness; appropriate transparency and explainability; fairness; accountability and governance; and, contestability and redress. AI regulation: a pro-innovation approach - GOV.UK (www.gov.uk)

coordination and coherence among regulators, both domestically and internationally, is required to address overlaps in regulatory frameworks and ensure consistency in approaches.

CoLC recommended in its *Vision for Economic Growth* report that the DRCF be given a stronger mandate.[10] Discussions reaffirmed that position, citing the DRCF's unique ability to usefully provide greater clarity on the prioritisation of topics and with a view to multi-year horizons. Increasingly, the DRCF looks best-placed to lead cross-sectoral coordination efforts in areas like AI and other emerging technologies. Their workplan helps firms understand not just thematically what is of interest, but the order and pace at which regulators think they can achieve it.[11] This speaks to the transparency required for new frameworks.

However, we must be aware regulators only have domestic domain and that they do not operate in vacuum. As other markets quickly develop rules, we must avoid the desire to do things differently for the sake of being different. We should not try to immolate the 'Brussels effect' but instead be mindful that there are benefits to interoperability of systems.

When diverging, the UK must be clear for its reasons of differentiation. First-mover is not always an advantage. This is particularly true with respect to data localisation, where differentiation risks benefits of scale and access. Instead, the UK should consider the 'platform-isation' of industry regulation – bringing not only more domestic voices to bear, but also leading international discourse.

Nevertheless, global standards for LTFs may never be practical in the way they are for financial services, e.g. Basel. If home jurisdictions of the largest firms are unwilling to regulate their national champions, there can be no uniform standards. There is already a noticeable gap in payment services (not payments) regulation across markets. Recent studies from the Gates Foundation showed that in at least 11 markets, there was greater risk from payment services than banking services. Participants noted that payments systems were admitting greater numbers of non-banks and that the lack of an emoney equivalent in the US left a void in global leadership on standards.

> **Recommendation**: Give DRCF a stronger mandate to establish platforms for information sharing, harmonise standards, and align regulatory priorities to prevent regulatory arbitrage and promote a level playing field.

Engagement with industry and stakeholders

Building on the idea of platform-isation, there is a clear need to engage with industry stakeholders, especially small and medium-sized enterprises (SMEs), to gather insights and feedback on regulatory proposals.

By strengthening their mandate, the DRCF could play a more significant role and broaden its audience. Currently, there is a lack of awareness particularly among SMEs regarding the purpose and remit of DRCF, and its potential impact on innovation and creativity. Ironically, roundtables, although useful, can be segmented and lack transparency.

[10] Vision for Economic Growth — a roadmap to prosperity (theglobalcity.uk)
[11] DRCF Workplan 2024/25

The current approach to gathering input asks too much, too often. SMEs are not able to contribute as often as they should. Bandwidth is stretched, particularly for start-ups. Regulators must, and indeed the DRCF can, open engagement in a more transparent way by supporting digital engagement. This could include, but is not limited to, online forums, regular digital roundtables or even AI-powered feedback systems to make participation less resource-intensive for smaller firms.

> **Recommendation**: Foster transparent, collaborative, and ongoing engagement with industry stakeholders to create a regulatory environment that supports innovation and growth.

Conclusion

The convergence of FPS with LTFs presents both unprecedented opportunities and challenges for London and the UK. As this paper illustrates, the pace of change is rapid, and the stakes are high. The findings from our roundtable series underscore the urgent need for a coordinated, forward-thinking approach to regulation, skills development, and industry engagement.

Crucially, we must recognise that this is not a challenge unique to the UK. As other financial centres grapple with similar issues, there is an opportunity for London to lead the way in developing innovative, balanced approaches that foster innovation while safeguarding financial stability and consumer interests.

The proposed strengthening of the Digital Regulation Cooperation Forum (DRCF) could serve as a cornerstone for these efforts, providing a model for effective cross-sector regulatory coordination. Similarly, the emphasis on addressing the skills gap, particularly in AI and machine learning, is vital not just for the FPS sector, but for the UK's broader economic competitiveness.

The convergence of FPS and tech is not just a challenge to be managed, but an opportunity to be seized. By seizing this opportunity, the UK can forge a future where it not only adapts to the digital age of finance but defines it. The stakes are high, but so too is the potential reward: a more innovative, resilient, and globally influential financial centre.