

**Baker
McKenzie.**

2024: What's on the Radar for Financial Institutions?



Introduction



Emmanuel Hadjidakis
Singapore
Chair – Global Financial Institutions



In 2024, financial institutions will continue to face challenges from new technology, climate change and increasing scrutiny of their operations, all against a background of economic and geopolitical risk.

Another year of uncertainty and disruption is drawing to a close. Join our financial institutions experts on a brief survey of the changes 2024 might bring for the industry.

The Financial Institutions Industry Group at Baker McKenzie regularly updates three risk radars that describe the forces transforming the financial sector: fintech and digital transformation (DT), sustainability, and regulatory scrutiny. Thanks to fintech and DT, the business models of financial institutions are reshaping how these institutions deliver services, earn revenue and monetize value.

Market and investor expectations and commitments around sustainable finance and environmental, social and governance (ESG) considerations are changing global businesses' operations and are now at the very heart of decision-making.

At the same time, regulators are increasing their scrutiny of every operational aspect of financial services and markets as they hold businesses to account. In this publication, we build on our risk radars to look selectively at what to expect in 2024.

Risk Radars help you to get Ready for Change



Our partners would be pleased to share the full documents and to introduce the experts in the areas of most value to you.

Message your regular Baker McKenzie contact or [click here](#) to get started.

Key takeaways



Sustainability's honeymoon period, when aspirational statements were sufficient and ESG funds outperformed traditional ones, is now well and truly over.

Regulation is replacing voluntary standards, and next year should see continued progress toward greater interoperability with international baseline standards. The incidence of climate change and ESG litigation together with enforcement will continue to grow, requiring financial institutions to strengthen their governance, due diligence and compliance tools to mitigate risks such as greenwashing.

Transition finance, a tool to move high and hard-to-abate emitters to net zero will very much come to the fore in the new year.



Regulators' scrutiny is very much focused on institutions' resilience to cyber risk and their due diligence of third- and fourth-party risks with new regulation next year.

Sanctions compliance is another area that has grown in complexity given recent geopolitical events, with the authorities increasing their cooperation and focus on compliance and enforcement.

While conventional financial misconduct continues to be an important priority, regulators' expectations of the sector's diversity and equity standards are growing, as is action for nonfinancial misconduct.



Artificial intelligence (AI) has increasingly emerged as the driver of technological change in financial services and markets. While AI is not new to financial institutions, generative AI will offer additional and potentially

transformative use cases to boost productivity and cut costs, albeit bringing increased risks. Separately, the use of blockchain and DLT technology is also driving the development of new products and services, particularly in tokenisation.

Although the glow has diminished from payments, we can expect to see developments with central bank digital currencies, stablecoins and quicker, cheaper, cross-border payments. New regulation on outsourcing, crypto and AI will also be at various stages of implementation.

Banks will see alternative finance competing for a greater market share in 2024 against the background of a likely subdued transactional market, while the cost of capital continues to rise.

Private capital will, in turn, face further scrutiny from the authorities. Both traditional banks and private capital will need to follow closely their evolving tax obligations in the light of OECD reforms on taxing rights and heightened public awareness.



The OECD is continuing to address the tax challenges of the digitalized economy by modernizing the **global tax landscape** under its two-pillar approach.

While exempt from the proposals made under BEPS 2.0 Pillar One, 2024 will see multinational financial institutions having to contend with the implementation, across a number of jurisdictions, of the OECD's Pillar Two minimum effective tax rate of 15%.

The impact of Pillar Two gives rise to many interrelated elements: strategy, detailed legal analysis, modeling and system changes to enable Pillar Two compliance processes. It will significantly increase complexity, nullify the benefits of certain tax incentives, and require many multinationals to redesign their financing and IP-holding strategies.

Multinational financial institutions will also need to consider how the Pillar Two rules impact the life cycle of **M&A transactions**, including acquisition structuring, due diligence, pricing, risk allocation and post-acquisition integration.



ESG & Sustainability

From fragmentation to greater cohesion

Financial institutions have become increasingly concerned about managing fragmented (and at times conflicting) ESG reporting and disclosure standards, which are reinforced by legal requirements in some jurisdictions, especially the EU. This complexity increases the cost of compliance and the risk of reputational damage, litigation and enforcement. There is good reason to believe that we will see greater cohesion in 2024 given the recent publication of global minimum standards by the International Sustainability Standards Board. These new standards build on the recommendations of the Taskforce for Climate-related Disclosures, which they supersede, and are intended to allow for greater co-operability and interoperability of jurisdiction-specific disclosures. Jurisdictions internationally appear to be coalescing around these standards.



Eva-Maria Ségur-Cabanac
Vienna



Regulation is replacing voluntary standards, and next year should see continued progress toward greater interoperability with international baseline standards.

and more will likely do so. Such regulatory findings often lead to civil litigation, both because they attract attention to potentially actionable conduct and because claimants can use adverse regulatory decisions to help establish liability in civil proceedings. Expect to see litigation and regulation growing in more financial centers.

Transition finance

To achieve net-zero carbon emissions, significant investment is required annually in the 2020s, the majority of which needs to come from private funding. Transition finance as a concept has emerged, as the requirements for green and sustainability-linked financing products are often not met in the context of high-emitting sectors looking to reduce emissions. Nonetheless, its uptake to date has been slow with few financial institutions referencing it in transactions and contractual documentation. This is likely to change in 2024. Financial institutions now have the benefit of the European Commission's recommendations for businesses and the financial sector on the adoption of transition finance. This has been followed closely by the publication of the UK's Transition Plan Taskforce disclosure framework and implementation guidance.

Among other advanced economies, Singapore and Japan are also leaders in this field. As we approach the net-zero milestone of 2030, financial institutions armed with this guidance will likely make greater use of this tool.

Marc Thorley
London



Regulators as far apart as the US and Australia have brought enforcement action for greenwashing, and more will likely do so.

Rise in climate change and ESG litigation

Litigation and enforcement represent a key risk for financial institutions with respect to climate change and ESG generally. In 2024, besides strategic litigation — claims that seek to influence strategy or business activities with respect to ESG issues — financial institutions face increased exposure not only when their statements are misleading or incomplete, but when their products and marketing do not align with public ESG goals. Additionally, in the EU, the anticipated adoption and implementation of the Corporate Sustainability Due Diligence Directive will lead to a proliferation of ESG-related civil liability regimes in EU member states, increasing exposure to ESG litigation risk for all businesses based or operating in the EU. More broadly, regulators as far apart as the US and Australia have brought enforcement action for greenwashing,

Fintech / Digitalization

Regulation of cloud providers

Financial institutions are transforming their business models and operations to compete in today's digital world. A key aspect of this digital transformation is the transition from traditional mainframe IT services to cloud-based solutions. Aside from compliance challenges under local laws, including in relation to data privacy and security laws, cloud use by financial institutions often constitutes regulated outsourcing. Concern over the concentration of cloud service provision and the increasing systemic risk posed by such arrangements is leading governments and regulators to impose further regulation. The UK will introduce a critical third-party regime, and the EU under its Digital Operational Resilience Act (or DORA) will bring major outsourcers into scope. While US regulators have taken a more hands-off approach, many believe that direct regulatory oversight is not far off. Regulation will impose costs that cloud providers will inevitably seek to pass on to customers. On the flip side, it may improve financial institutions' ability to achieve more balanced outsourcing agreements that better reflect their own (and regulators') requirements.



Alessandro Celli
Zurich



Regulation will impose costs that cloud providers will inevitably seek to pass on to customers.

However, detailed and in-depth preparations by many central banks are underway, so that they will be ready when governments consider the circumstances appropriate. 2024 will see initiatives in the EU, India, Brazil and Mexico, plus a joint project by Hong Kong SAR, the UAE and Thailand to offer an alternative to Swift. The impact on financial stability and the business models of private banks will depend on the design of CBDCs e.g., whether they pay interest and have limits on holdings. Banks will likely continue to be the distribution channel for money into the economy including CBDCs. Retail banks would therefore be well advised to update their technology to process CBDC transactions at scale and to support electronic wallets and other end-user interfaces.

Payments

Banks and traditional wire transfer services have been joined by a plethora of agile, tech-savvy competitors such as e-money institutions, payment initiation services and outsourced payment processors. Digital wallets and account-to-account payments have become everyday payment options. Through open banking APIs, third-party providers are slowly but surely gaining traction in the market. With competition and choice growing, 2024 will see the downward pressure on costs and margins continue, with data monetization growing in importance as a result. Separately, the world of slow and expensive cross-border payments may be ending. Interlinking arrangements between the growing number of new fast payment systems offer an effective way to improve cross-border payments, by promising a much quicker and transparent service to users. The task is to overcome multijurisdictional governance and oversight challenges, including effectively managing sanctions and anti-money laundering/counter-terrorist financing (AML/CFT) compliance checks, where AI is both a risk and a tool. While generative AI could improve fraud detection by continuous anomaly detection to identify abnormal transactions, it might enable criminals to use deepfakes to circumvent security.

Gabriel Gómez Giglio
Buenos Aires



Interlinking arrangements between the growing number of new fast payment systems offer an effective way to improve cross-border payments.

CBDCs

The widespread adoption of central bank digital currencies (CBDCs), especially in the world's major economies, is not imminent. Nigeria is currently the largest economy to have done so. After a pilot in late 2022, the Monetary Authority of Singapore concluded that the use cases for a retail CBDC were unclear. This was because electronic payments are pervasive, and households and firms can already transact digitally in a fast, secure and seamless manner.

Growing Regulatory Scrutiny

Cyber resilience / risk

Escalating cyber risk is ranked by many financial institutions and regulators as preeminent. It is the unintended consequence of the move toward greater interconnectedness in the financial ecosystem, the growth in partnerships with tech providers and the rapid adoption of new technologies and processes. Traditional financial institutions may be at additional risk when transitioning from legacy infrastructure. In comparison to the wider economy, the financial sector has been subject to a disproportionate number of attacks in recent years. Again, there are recent and numerous examples of cyber incidents on market participants that are not themselves large, but which have had a large-scale ripple effect with potentially systemic implications. In future, the rapid development and take-up of AI will make cyber threats more difficult to identify and protect against. Insurance will be more expensive and conditional in coverage. There is growing complexity in legislation and regulation worldwide, placing further obligations on the financial sector, which means that investment in operational resilience and the due diligence of so-called fourth-party risks will be more important than ever.

Christoph Kurth
Zurich



“ Cyber resilience and sanctions compliance will be at the top of regulators’ agendas; therefore, strong risk governance frameworks are key to pre-empt exposure to enforcement.

Sanctions

Sanctions compliance used to be the poor cousin of AML and CFT. Recent geopolitical events, including US-China economic rivalry and Russia’s invasion of Ukraine, have led to significant growth in the breadth and complexity of trade and financial sanctions. Additional compliance issues arise when several countries impose the same sanctions but apply them differently or grant licenses on distinct criteria. Difficult questions can arise over how certain financial instruments such as structured products should be treated. Even when transactions are permitted, the choice of currency or routing bank can generate unexpected risk.



Karen Man
Hong Kong

“ Financial misconduct and crime will continue to be a priority for many regulators in 2024, alongside growing expectations around diversity and equality standards.

In addition, expect to see more sanctions requirements conflicting with other regulatory obligations, such as an entity’s customer duties. In other words, the compliance environment for financial institutions is becoming more challenging. In 2024, we will see increased litigation from sanctions-related disputes with counterparties; the importance of reviewing terms and conditions for contractual protection is critical. Additionally, be prepared for more enforcement and better coordination by the authorities, especially across G7 jurisdictions, with some moving in the direction of US-style enforcement with higher fines and strict liability.

ID&E / non-financial misconduct

In recent years, employees, institutional investors, shareholders and regulators have been holding businesses to account over the degree of inclusion, diversity and equity (ID&E) in the workplace, in the C-suite and at the board level. This can be especially exacting for the financial services industry, which is often (fairly or unfairly) considered to combine a traditional and rigid culture with a formal, hierarchical and extremely competitive workplace. 2024 is unlikely to see any relaxation in this demand for more accountability. The UK’s financial regulators are consulting on rules that, for instance, will cover nonfinancial misconduct in assessments of fitness and propriety for individuals working in financial services. Other measures would require larger firms to disclose inclusion and diversity data and to recognize a lack of ID&E as a nonfinancial risk. Meanwhile, in the US, despite similar regulatory expectations, employers must contend with recent supreme court decisions striking down race-conscious admission programs. Management will need to be nimble and nuanced toward ID&E policies and duties and their implementation in creating better workplaces, while remaining compliant with their wider legal obligations.

Asset Management and Financial Sponsors

Increasing scrutiny of private capital

Alternative finance now makes up around half of the global financial system and, for this reason, this diverse sector is increasingly drawing regulatory attention. There are concerns over systemic risks such as channeling long-term insurance funds via private credit into financing leveraged buyouts. Globally, the Financial Stability Board is studying the implications of leverage in nonbank financial intermediation and making recommendations to regulators to better monitor risks. There is also the potential abuse of dominant position in the market through "roll-up" strategies. On antitrust, the US Federal Trade Commission is paying close attention to strategies that consolidate previously unconcentrated industry sectors through multiple acquisitions to the detriment of competition. Perhaps most importantly, there are perceived weaknesses in disclosure and conflict of interests regarding investors. The industry is litigating proposed US rules that would require private capital to disclose more information to investors on performance and costs. The EU is also strengthening risk management obligations, especially for underwriting loans, and expanding pre-investment disclosures to investors.



Chuck Magerman
Toronto



Alternative finance now makes up around half of the global financial system and, for this reason, it is increasingly drawing regulatory attention.

Taxation

The focus on tax havens and anti-tax avoidance initiatives continues to create additional legal, compliance and reputational risk. This is an issue of tax obligations not only for entities and, where relevant, their portfolio companies, but also for their investors. Financial institutions must balance customer relationships, expectations of privacy, information security and their public reputation. International tax and transfer pricing structures in one jurisdiction are now more likely to be challenged by tax authorities elsewhere, with demands for even more data to substantiate their calculations. While exempt from the OECD proposals made under Pillar One, multinational financial institutions will have to contend with the changing international tax landscape resulting from the implementation of Pillar Two, bearing in mind the growing "social" element of ESG and "Pay Your Fair Share" campaigns. Separately, private equity fund managers themselves have long benefited from an advantageous treatment of "carried interest" where it is taxed not as income, but as a capital gain. This provision is under scrutiny, and should it end in one major financial center, other centers may be tempted to follow.

Stephanie Pantelidaki
London



International tax and transfer pricing structures in one jurisdiction are now more likely to be challenged by tax authorities elsewhere.

In 2024, the sector will need to contend with these challenges against a backdrop of higher interest rates, uncertain market conditions and global geopolitical risks that impact deal flow and exits. While investment banks and other investors operate in the same environment, alternative finance can pivot to use its resources to take advantage of these conditions, keeping pricing at attractive levels.

Investment Banks

AI

Developing AI and machine learning technology has seen gradual adoption in banking. Generative AI that can create new content has turbocharged interest, whether for internal use cases or consumer relationship enhancement. A significant productivity boost is expected, and there is the potential for efficiency savings. The adoption of AI calls for the recruitment of specialists and robust technology change management to mitigate the potential operational, reputational and legal risks. Concern over AI's inherent risks is, however, especially acute for banks operating within a regulated environment. 2024 will see banks double down on governance (including data management) and compliance to address risks such as IP infringement, lack of explainability, bias and discrimination. As a corollary, managers will need to ensure that its use by employees is properly controlled. There is currently little financial-sector-specific AI regulation; the UK, Singapore and Hong Kong are adopting light-touch, industry-led approaches. However, this may change. The US has been market-led, but the likelihood of federal legislation is growing, and China is expected to introduce restrictive rules. For AI legislation of general application, the EU is furthest ahead in adopting a consumer protectionist stance. Given their size, these markets may set the tone elsewhere, and financial institutions should be prepared. Externally, expect to see banks increase their financing of AI across the economy, especially in healthcare and life sciences.

Transactional challenges

Although investment banks should see deal growth in 2024, they face various headwinds. Rising interest rates, higher levels of inflation and a more challenging macroeconomic environment with increasing defaults have helped subdue market activity. There is also competition from private capital. Most banks are unable to match the speed and flexibility of the nonbank finance providers. Institutions such as credit funds do not operate under the same restrictions (e.g., on leverage) and capital requirements as regulated banks and, as such, are often in a better position to win market share. Moreover, new capital requirements enacted under Basel III are expected to increase the cost of capital. This will further impact the sector's competitiveness — particularly for US banks — whether over proprietary trading on capital markets or in lending. Against this economic backdrop, there will continue to be demand for restructuring services and, with debt financing more expensive, the market may turn to increased equity issuances with the associated opportunities for fee generation.



Christoph Kurth
Zurich



2024 will see banks double down on AI governance including data management and compliance.

It will be essential to ensure that sustainable finance is embodied in such transactions and that these comply with applicable KPIs and reporting and disclosure requirements, including impending standards and regulations.

Helping you to get the best results

Baker McKenzie's global reach, strong connections with regulatory authorities, and experience make us the ideal adviser to guide financial institutions through the panoply of issues in a rapidly changing environment.

Contact us today to discuss your concerns:

Emmanuel Hadjidakis

Chair – Global Financial Institutions

emmanuel.hadjidakis@bakermckenzie.com

+65 6434 2781

Baker McKenzie helps clients overcome the challenges of competing in the global economy.

Complex business challenges require an integrated response across different markets, sectors and areas of law. Baker McKenzie's client solutions provide seamless advice, underpinned by deep practice and sector expertise, as well as first-rate local market knowledge. Across more than 70 offices globally, Baker McKenzie works alongside our clients to deliver solutions for a connected world.

[Sign up to our newsletter](#), providing you with expert analysis from around the globe on an ongoing basis.



bakermckenzie.com/financialinstitutions

© 2023 Baker McKenzie

Members of Baker & McKenzie International are Baker McKenzie law firms around the world. Following usual terminology in professional service organizations, reference to a "partner" means a professional who as shareholder, executive employee or in a comparable function works for us or a member of Baker & McKenzie International. Similarly, reference to an "office" means an office of any such law firm. This may qualify as "Attorney Advertising" requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.