2022 Regulatory Outlooks
Global Foreword
The macro picture
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The macro picture
As we head into 2022, the defining features of the global macroeconomic environment are marked regional differences in economic performance combined with significant fragility in the outlook. Following a global contraction in 2020, much of the global economy returned to growth in 2021 and is forecast to continue to grow (albeit somewhat slower) in 2022 (Chart 1). However, global aggregate figures mask significant variation between countries, and the global economy faces what the International Monetary Fund (IMF) has called a “dangerous divergence in economic prospects” between countries.¹

Chart 1: Percentage change in world output (estimated)

Source: IMF, World Economic Outlook October 2021.²

Inflationary pressures have, in some parts of the world, proved more persistent than central banks had previously anticipated (for instance running at 6.8% in the US³, and 5.4% in Germany—its highest level for 29 years) (Chart 2). Central banks still generally envisage inflation returning to lower levels in 2022, though potentially remaining above targets, and it is increasingly clear that monetary policy will tighten earlier than previously anticipated through a combination of cuts in asset purchases and rises in interest rates. Meanwhile, some fiscal tightening has already begun, but looks set to proceed at different speeds between countries.

Chart 2: Global inflation rates vs. targets, percentage change year-on-year

Source: Refinitiv Datastream.

In general, there remains a high degree of uncertainty in current economic projections, and even the tentatively positive economic outlooks are predicated on assumptions that lockdowns and supply chain disruptions continue to ease. The very nature of these supply chain shocks indicates the fragility of the economic recovery - the highly intertwined global economy means that the emergence of problems anywhere could potentially threaten recovery everywhere.

The challenges confronting financial regulators
Looking beyond the general social and economic upheaval of the last two years, the financial services industry and its regulators face major challenges. First, financial services firms must play their part in global efforts to address climate change, to halt biodiversity loss, and to respond to other social and environmental challenges.

Second, it is increasingly clear that the current sector-focused framework governing and regulating financial services will struggle to address the shifting risk landscape as a result of a wave of technological innovation. In what follows, we identify particular challenges around technological and operational resilience, the proliferation of novel forms of digital assets, and the increasingly blurred boundary between financial services, technology firms and other unregulated players.

Regulators are aware of these issues in all regions and are working together to address aspects of them through various fora, although national approaches and priorities vary and some countries may also have to contend with misalignments between the views of legislators and regulators on the way forward for certain issues. Given that these issues are shared across regions, we observe some broad commonalities in the solutions being adopted...
and the outcomes they are seeking. But these global issues have thus far generally not led to the creation of correspondingly global, coordinated, or cross-sectoral standards. This may well reflect the rapidly changing, complex, and highly technical nature of the challenges facing the sector and its regulators. As we begin 2022, this means that financial services firms will continue to have to deal with an evolving and still fragmented regulatory framework, within which authorities in different parts of the world explore different approaches. We take each issue in turn, beginning with climate, followed by three trends in technological innovation.

**Climate change and sustainability**

Climate risk is a (and some would assert the) top priority for the global standard setters, with the Financial Stability Board (FSB), Basel Committee on Bank Supervision (BCBS), International Organization of Securities Commissions (IOSCO), International Association of Insurance Supervisors (IAIS) and Financial Action Task Force (FATF) all highly engaged, and new bodies having been incorporated in the form of the Network for Greening the Financial System (NGFS) and more recently the International Sustainability Standards Board (ISSB). A huge amount of regulatory work is also in train across all regions. Regulators are broadly in agreement that climate risks have the potential to generate financial stability risks, that the industry needs to disclose and manage its exposures to these risks, and that the regulatory regime should be used to facilitate the emergence of green finance and eliminate forms of ‘greenwashing.’

The consensus that has been forged on these principles is translating into a wide range of initiatives affecting banks, insurers, and investment managers. Financial risk management tools such as scenario and stress testing are being adopted in many parts of the world, particularly for banks, but in some instances are also extending to the insurance sector. There is ongoing work to construct regulatory taxonomies for sustainability which have significant implications for investment management, particularly given the substantial increase in sustainability-linked assets under management in recent years (Chart 3). And there are various initiatives designed to improve disclosure across all sectors – voluntary in some jurisdictions, but increasingly mandatory in others.

**Chart 3: Total sustainability-linked assets under management by fund label (USD trillion)**

As a consequence, the industry faces a classic ‘future proofing’ challenge. It will need to put in place solutions that satisfy its stakeholders in the near term—for instance in relation to measuring climate risks or screening investment portfolios—in the knowledge that the rules will change over the next few years. In general, firms will need to accept that similar ‘green’ products may require different sets of disclosures and other documentation in different parts of the world and prepare
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Accordingly. Furthermore, while climate change is an archetypally global issue, global firms will need to remain attuned to variations in local interpretations of the umbrella term ‘sustainability,’ putting a premium on intra-group dialogue and flexible frameworks for sustainability plans more broadly.

**Coming to terms with technological upheaval**

The second set of major challenges stems from the increasing complexity of the financial services ecosystem as regulated firms digitize, unregulated technology firms enter the market, and new products such as cryptoassets, Decentralized Finance (DeFi) and non-fungible tokens (NFTs) are developed. Delivery increasingly straddles regulated financial services firms and unregulated technology and FinTech firms, blurring boundaries across the industry, making it clear that the existing financial regulatory framework is in need of realignment. We see several sets of shared concerns across regions, but also varying solutions.

There is a strong supervisory focus across all regions on **operational and technological resilience.** The increased complexity of service delivery, client focus, and the intertwining of financial services with third-party (or even fourth- or fifth-party) technological service providers combine to introduce new points of vulnerability in the system and increase the challenges of overseeing and managing risk. It has become increasingly difficult to understand where risks lie in this highly interconnected system, not only for regulatory authorities but for firms themselves, and the focus on technology risk and operational resilience has heightened accordingly. In the EU, this is encapsulated by the Digital Operational Resilience Act. US regulators are modernizing supervisory guidance, for instance across core information security and cybersecurity. They are also bringing examinations in line with these technological innovations with a focus on FinTech partnerships and digital assets, and generally heightening their scrutiny of technology risk and controls and innovation frameworks. Cybersecurity and operational resilience remain key areas of focus across APAC, although differences in approach are evident between countries in the region.

The direction of travel, if not the details of national approaches, is clear: third-party services will be subject to more scrutiny, implying a need for rigorous assurance work on the resilience of service providers while the extension of regulations and guidance could affect their role as providers of services to financial institutions. The variations in national approaches create challenges for global firms, as individual national regulators may be interested in different aspects of global relationships that exist between firms and their suppliers.

Elsewhere, **novel forms of digital assets—primarily cryptocurrencies and ‘stablecoin’ variants—remain outside the regulatory perimeter in much of the world, and regulators are considering ways to bring them in, or in some cases seemingly to regulate them out of existence. Coordination work on stablecoins is taking place at the global level through the FSB, the Committee on Payments and Market Infrastructures (CPMI) and IOSCO, but as yet has not led to consistent national or regional actions. Some countries and regions—notably the EU and UK—intend to forge ahead with the regulation of stablecoins, while a great deal of uncertainty about the way forward persists in numerous other countries, including Australia and the US. Meanwhile, standard setters have had less to say on other crypto assets, and national approaches look set to diverge considerably. These differences create challenges for firms looking to understand how best to service the increasing investor demand for crypto assets and services (indicated by the significant rise in the overall value of the market during 2021 – see Chart 4) and the regulatory authorizations needed to provide them. One unintended consequence of these regulatory differences is that regulated firms are taking conservative approaches to developing crypto offerings while unregulated players move to jurisdictions with the fewest restrictions. It has also become more difficult to protect and regulate consumer activity in an environment where retail investors can use...
VPNs to exploit national differences in rules, trading unregulated products overseas on platforms that may otherwise be banned in their home countries, sometimes on the advice of unregulated social media ‘finfluencers.’

**Chart 4: market value of crypto assets (USD billion)**

![Chart](image)


With respect to the position of ‘Big Tech’ firms, the waters are muddied by the fact that they sometimes act as competitors to financial services firms, sometimes as strategic partners, and increasingly as critical third-party service providers. Regulatory debates continue as to whether and how to regulate these firms and the services they provide, focused particularly on the balance between activity-based and entity-based regulation which looks set to vary between regions. Activities-based regimes that may have been deemed suitable for Big Tech firms in their roles as providers of services to financial services firms are increasingly seen as insufficient for Big Tech provision of financial services direct to consumers. This has prompted bodies such as the Bank for International Settlements (BIS) to suggest the need for more entity-based rules. Activities-based approaches have predominated to date, with regulators extending regulatory frameworks and supervisory work to scrutinise activities such as cloud services provision (e.g. under the EU’s Digital Markets Act) and the processing of consumer payments data (e.g. via the work of the US Consumer Financial Protection Bureau). However, the Chinese approach of requiring tech firms to ‘ring-fence’ their financial services activities under an in-house financial holding company could inspire similar approaches elsewhere. In general, we expect a widening of the regulator perimeter to capture critical third-party services that technology firms provide to financial services, and to capture the financial service those technology firms provide directly to customers, with a particular focus on the payments industry.

This cocktail of technology-related change creates significant challenges for financial services policymakers and firms alike. Many regulators recognize the need to walk the fine line of enabling innovation while protecting consumers and safeguarding financial stability.

Moreover, the blurred boundaries of service delivery are bringing together the domains of financial services and other regulators, principally data and competition authorities – most evident in debates around the collection, use and mobility of consumer data. In general, we see a case for policymakers to adapt their current regulatory and supervisory frameworks—including both the contents of regulation and the institutional architecture within which it is applied—to these new circumstances. However, this will inevitably take time.
Conclusion
These issues are shared global challenges: neither climate risk nor technological risk respect national or regional boundaries, any more than COVID has done over the past two years. It is clear that regulators in all regions recognize these problems and are working to address (aspects of) them, but in most areas we see little prospect of common solutions emerging in the short to medium term.

For firms operating across borders, the result is a complex picture of different rules and shifting targets. On current trajectories, it will be increasingly difficult for firms to maintain common systems or common controls in relation to climate and technology risks across different regions. We point out these differences in approaches not as a criticism, but simply as the reality of what is facing an industry and its regulators as they grapple with major and complex upheavals for which there are not yet widely agreed-upon solutions.

These challenges highlight the need—now more important than ever—of linking general strategy with regulatory strategy. The nature of the current environment implies a need for cross-border firms to double down on the tracking of regulatory change and industry trends, for instance through risk sensing; it may be particularly advisable for firms to keep their fingers on the pulse on what is happening in countries that might be considered ‘leaders’ on certain topics (for instance the UK and EU on sustainability, or Singapore on cryptocurrencies). But given that resolutions to these challenges will not be swift to emerge, industry needs to be prepared to navigate the evolving environment. Multinational firms will likely have to live with fragmentation and should be prepared to adapt programs to local approaches. With many of these issues being highly complex, there is also a clear need for ongoing and constructive engagement between industry and the regulatory community: with both sides needing to adapt to a rapidly changing external environment, there is scope for sharing of leading practices and lessons learned.

These significant shifts provide the context for our regional Regulatory Outlooks for the year ahead. In this document, we explore the major themes and details of regulatory strategy for the United States, but readers with an interest in understanding the landscape in APAC or EMEA can find them in the corresponding Regulatory Outlooks from our teams in those regions.

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Endnotes

2. Ibid.
6. EU regulation of stablecoins will be delivered through the Markets in Crypto-assets Directive (MiCA). UK regulation of stablecoins is in development through HM Treasury and the Bank of England.
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