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Approaches and developments

In the near term, one of the most significant developments for financial technology companies ("Fintechs") will be improved access to the use of certain Federal Reserve payment systems.[1] In addition, although it is still in the early stages of development, the potential implementation of a cybersecurity portal through which payments may be scrutinized to avoid significant cybersecurity issues will facilitate the ability of Fintechs to comply with current and evolving security and anti-fraud regulations.[2] These developments will have a significant impact on the use of imbedded finance applications.

The most material development on the horizon, which will impact the operation of payments and clearing systems across the board, will involve the digitization of all aspects of the financial system, including not only payments but other financial assets.[3] The ultimate implementation of a fully digitized system will likely take a few years and require major changes to current federal regulations. The digitization of payment and clearing systems will also require the re-engineering of imbedded regulatory compliance applications, particularly in terms of how such regulatory compliance applications would be integrated into typical distributed ledger technology.

The developments described above will have a significant impact on payment processors, ultimately requiring full digitization of all data, and direct access to certain Federal Reserve payment systems. The ultimate impact on consumer-based fintech products will depend upon the market's ability to incorporate consumer protection software into user-friendly digital platforms.

Fintech offerings in current practice in the United States

The application of "artificial intelligence" combined with real-time machine learning is widely used to flag irregular credit and payment transactions. While still in the process of development and validation, such applications are being tested to determine whether analysis of irregularities in payment activities can be used to accurately predict future financial problems. Both Plaid and Stripe represent leaders in the industry in this regard.

Commonly referred to as "Open Banking", the establishment of secure methods to integrate data available from multiple unrelated sources has expanded exponentially in the last few years. Many of the larger Fintechs have created subsidiary applications that enable the collection of financial data from unrelated sources to create a database of information that previously required the assembly of extensive written documentation (which also increased the risk of delivery of fraudulent written records). Plaid is an industry leader in this sector.

Peer-to-peer lending platforms have increased in popularity, particularly related to the provisions of funding solutions to higher-risk borrowers. Such platforms enable borrowers to apply for credit to a wider range of lenders, which include traditional credit providers as well as credit providers that are funded by alternative investments made by investment funds and private lenders. Sofi is an industry leader in this sector.

The use of Buy Now Pay Later ("BNPL") financing arrangements has expanded significantly over the last five years. Unlike typical lending platforms, BNPL point-of-sale credit products are offered in partnership between a loan provider and a retailer and are typically tied to a specific purchase. The repayment plan is usually selected by the borrower prior to checking out a purchase from a menu of BNPL plans and is subject to approval by the offering BNPL lender. Such lending arrangements are most commonly structured as "pay in 4 plans" (used to enable payment by the purchaser of four instalments to the lender) and longer-term instalment plans (used to enable the payment of up to 12 instalments by the purchaser to the lender (often requiring the grant to the lender of a security interest in the purchased item)). Since such arrangements are negotiated between a retailer and its primary lenders, funding sources include standard unsecured financing support by such lenders, as well as the securitization of the payment obligations to facilitate use of alternative investments made by investment funds and private lenders. Major non-proprietary providers of BNPL financing include Affirm, PayPal and Klarna.

Regulatory ("Regtech") and insurance technology ("Insurance tech")

An important trend in the area of Regtech is embedding regulatory and compliance solutions into the primary platforms of Fintechs. Historically, Regtech solutions were applied as a last step in the onboarding of new clients and transactions. While this approach is functional, it has delayed timely introduction of new clients, essentially imposing a secondary tier of approvals that is conducted after the initial onboarding processes have been completed.

The embedding of regulatory and compliance solutions involves the integration of the compliance process when initial onboarding occurs. By way of example, as an additional layer of due diligence, final data collected in connection with typical onboarding procedures is supplemented with a review of the applicant's transactional history and prior history of regulatory violations. If anomalies are identified, the regulatory software then requires further investigation into potential issues and identifies potential weaknesses in the applicant. By taking this approach, the initial regulatory analysis identifies any significant issues and provides a roadmap for the platform to resolve the issues or reject the applicant. The information obtained when additional investigation takes place also allows for the refinement of the ongoing screening transactions with respect to the applicant.

In the area of Insurance tech, expanded use of artificial intelligence combined with real-time machine learning has enhanced the capability of insurance providers and their customers to analyze changes in risk exposure, improving the accuracy of underwriting on a real-time basis, ultimately reducing losses for the insurance provider. The primary beneficiaries of such advances are insurance providers, and corporate sector entities that are required by regulation or risk profile to maintain significant insurance coverage. Due to the complexity of state-based insurance regulations *vis-à-vis* insurance provided to individuals and small and medium-sized businesses ("SMBs"), the expanded use of such advances has not resulted in significant innovations in the individual and SMB sectors.

Regulatory bodies

Fintech businesses are subject to regulation by numerous federal and state agencies:

- the Consumer Financial Protection Bureau and the Federal Trade Commission with respect to consumer lending practices;
- the Federal Deposit Insurance Corporation with respect to consumer protection and insurance of deposits;
- the Office of the Comptroller of the Currency insofar as the businesses operate under some form of national bank charter;
- the Securities and Exchange Commission and the Financial Industry Regulatory Authority with respect to platforms that offer securities, enable access of licensed broker dealers and investment advisors to platform users, and provide a platform for the exchange of digital assets;
- the Commodities Futures Trading Commission with respect to platforms that provide access to futures trading markets and financial derivative contracts; and
- the Financial Crimes Enforcement Network as to all aspects of anti-money laundering.

State laws that may apply to Fintechs include corporate and limited liability company laws, including state-chartered banking laws, securities laws, usury laws, and data privacy and security laws. State-based insurance regulations will apply to most Fintechs providing insurance-related products.

Going forward, the digitization of financial systems, both in the U.S. and beyond, is expected to impose a higher level of regulation at the federal level. Although current regulatory proposals have hinted at federal preemption of parallel or conflicting state regulations, initial feedback from state regulatory agencies has been negative. Any attempt at blanket preemption of state regulations is expected to meet with significant judicial challenges.

Functional challenges and regulatory restrictions

Functional challenges to the adoption of new technology will involve, in many cases, significant scaling of operational capacity and the implementation of new technologies on a timely basis. Such improvements will also require embedded regulatory compliance procedures. Smaller Fintechs are likely to face significant cost barriers to implementation of far-reaching improvements, which may result in the consolidation of such entities into larger Fintechs. The widespread digitization of payment systems will also involve the development of new methods to facilitate successful interaction with federal regulators with respect to improved anti-money laundering and fraud prevention.

Improved access to certain Federal Reserve payment systems will be limited to the establishment of special purpose "Payment Accounts" with a Reserve Bank. These accounts would be available only to institutions that are legally eligible under the Federal Reserve Act or other federal statute, including member banks, depository institutions as defined in 12 U.S.C. § 461(b)(1)(A), and other entities expressly authorized by statute such as U.S. agencies or foreign banks under 12 U.S.C. §§ 358 and 391. Funds held in such accounts would be limited to overnight balances for the express purpose of clearing and settling the institution's payments, and limits would be imposed on overnight balances. No interest would be payable on the funds held in Payment Accounts overnight. Entities lacking a qualifying depository charter (such as Fintechs that do not hold a banking charter) remain ineligible to hold any form of account directly with a Federal Reserve Bank. Since access will not be provided to Fintechs that do not hold a banking charter, the creation of such Payment Accounts will diversify the options that unlicensed Fintechs have for settlement and clearing of payments but will not create new methods of direct payment through a Federal Reserve Bank.

The anticipated regulatory challenges are much more complex. The digitization of payment systems (and certain assets) will require a restructuring of financial institution regulations – most of the current regulations rely on the maintenance of specified capital and liquidity levels based on reporting that is not structured to capture real-time changes to such criteria. In the context of real-time digital transactions, the regulatory monitoring of transactions will have to be updated to allow for real-time evaluation of capital and liquidity risk. In the securities and commodities markets, current systems track the risk exposures of participants on a daily basis. Similar tracking of risk exposures is probably necessary for the management of capital and liquidity risks in the banking sector.

The creation of cybersecurity portals at the federal level would involve the scaling of the related technology to enable real-time processing of all payment transactions. The creation of such portal will require congressional action to address privacy and data security issues. Prior to that, current and proposed anti-money laundering procedures will have to be updated to reflect the need for real-time evaluation of risks.

Cross-border business

The adoption of a fully digital payment system by the U.S. will ultimately improve the speed of cross-border payments made by Fintechs. That said, since the implementation process is likely to result in recalibration of capital and liquidity requirements on the part of U.S.-regulated financial institutions, such changes would have to be made in consideration of current and pending adoption of Basel III and IV standards and would require congressional approval before implementation.

The development of fully digital trade finance systems would significantly improve the speed of cross-border payments related to trade transactions. Most U.S. states have adopted the new Article 12 to the Uniform Commercial Code, providing guidance as to how digitized trade finance instruments should be treated under the Uniform Commercial Code.

The European Union ("EU") has not fully implemented the regulations required to permit fully digital transactions. That said, the EU began implementing regulations to facilitate digital transactions in 2024, when it adopted the Instant Payments Regulation (which enacted regulations enabling EU-based payment service providers within the eurozone to receive instant payments by January 9, 2025. The adoption of the Revised Consumer Credit Directive, which will become fully effective on November 20, 2026, will enable Fintechs to enter into the BNPL market (subject to appropriate evaluation of creditworthiness).

The EU has not addressed the need for full digital trade finance systems, largely due to the reluctance on the part of individual Member States to implement changes that would result in major changes in the day-to-day processing of common trade finance transactions within the EU.

Current geopolitical conflicts, considered in tandem with the scope of financial sanctions impacting payment transactions in the U.S and the EU, suggest that near-term developments in the area of further digitalization of transactions are unlikely.

Endnotes

1 "Federal Reserve Board requests public comment on a proposal to establish a "payment account", which legally eligible financial institutions could use for the specific purpose of clearing and settling their payments", Board of Governors of the Federal Reserve System (May 20, 2026), https://www.federalreserve.gov/newsevents/pressreleases/other20260520a.htm

2 "White House Launches Gold Eagle initiative for Unprecedented Cybersecurity Vulnerability Coordination" (White House Press Release, July 14, 2026).

3 The Digital Asset Market Clarity Act (H.R. 3633), also known as the "CLARITY Act of 2025", was introduced on May 29, 2025, by Representative French Hill ("R-AR") and passed the House on July 17, 2025. It is currently under review by the Senate. The legislation seeks to define "mature blockchain systems", facilitating a significant expansion of distributed ledger technology, and outline the manner in which current federal banking regulations will be applied.

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Justine M. Clark is Of Counsel in Moses Singer's Banking & Finance and Corporate practice groups. In the banking sector, she has advised various money center banks and large foreign banks on structured finance, leasing, securitization and aircraft financing. She has also advised various foreign banks on an ongoing basis as their "outside" counsel, supporting the work of the internal legal department. She advises banks and investors in connection with bank regulatory issues affecting the acquisition of substantial interests in bank holding companies. Justine has appeared before the Board of Governors of the Federal Reserve Bank and the Controller of the Currency in connection with the approval of various banking combinations. She advises both banks and borrowers in connection with derivative transactions.

In the corporate sector, she advises companies in connection with start-up formation, advising and structuring from the initial venture capital stage through to private placement and ultimately public offering. She has experience in advising companies in the growth mode with respect to the various regulations (and exemptions) promulgated pursuant to the Commodities Exchange Act, the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940.

In recent years, she has focused on the Fintech sector, which brings together her knowledge of securitization, structuring, regulatory matters and derivatives. While counterintuitive, both banking and securities regulators are receptive to innovative solutions that expand access to the US financial system, and are open to exemption of appropriate structures from direct regulation.

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