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**FINTECH:
LATEST UK
LEGAL AND
REGULATORY
TRENDS**

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Introduction

“We’re known in this country not just for our openness – but our ingenuity and inventiveness, too. We are building on our existing strengths as a leading global destination to start, grow and invest in Fintech.”

A lot has happened since Rishi Sunak delivered these words six months ago, but the sentiment behind them remains as strong as ever. As it finally starts to emerge from Brexit, the UK is seeking to capitalise on its new-found freedom. Covid-19 continues to act as a catalyst for the rapid development of innovative financial solutions. And the UK remains one of the most receptive markets for Fintech – with record levels of investment and a consumer adoption rate that exceeds the global average.

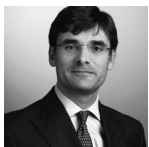
So far, so good. But while the longer-term horizon will be dominated by the UK’s reform agenda – exemplified by the recent publication of the Kalifa Review – there will be no shortage of more immediate issues to consider.

This briefing highlights some current key trends for Fintech. It will be of interest to anyone involved in Fintech in its broadest sense – including Fintech providers (scale-up and incumbents) as well as those looking to invest or make acquisitions in the Fintech sector.

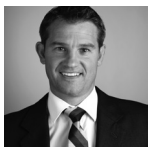
The fact that the list of trends could have been much longer – covering everything from the impact of ESG through to the lessons arising from the GameStop saga – shows just how much is happening in this area.



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£11bn

value of Fintech to the UK economy



37

number of “Fintech 50” firms headquartered in London



71%

UK Fintech adoption rate, compared to a global average of 64%¹

1. Source: City of London; theglobalcity.uk



Reshaping the legal and regulatory regime for Fintech

Following Brexit, the UK had already started exploring changes to the legal and regulatory regime for Fintech and there is now a broad range of ongoing consultations and reviews. Engaging in the reform debate will be crucial.

Recently, HM Treasury (**HMT**) published the Kalifa Review of UK Fintech, an independent review focussing on the UK Government's overall Fintech strategy. But there are a number of other important reviews taking place, including the HMT Payments Landscape Review and the HMT consultation on the regulation of cryptoassets and stablecoins. Meanwhile, the Bank of England continues to explore the utility of central bank digital currencies and the UK Payment Systems Regulator (**PSR**) is continuing its market review into card-acquiring services.

Dovetailing these reviews is the UK's ongoing New Payments Architecture project – which has the potential (like Open Banking) to create significant innovation in the infrastructure within which Fintech operates.

Across the various reviews, some of the more challenging questions that policymakers will need to consider include:

- how to balance the need for consumer protection and market stability with promoting innovation and competition;
- regulatory over-and-underlap – whether new technologies, products and actors should be regulated using existing concepts, or new, bespoke regimes are required;

- location requirements – as tech enables an ever-increasing range of products to be provided to UK customers on a cross-border basis, whether overseas providers should be regulated in the UK or required to have a UK presence;
- the “level playing field” – the need to achieve a balanced regulatory outcome between banks, fintechs, and technology companies engaging in similar activities.

While currently focussed on high-level policy, the reviews will rapidly start to feed down into detailed legal and regulatory proposals. The reform debate will be wide ranging and is likely to have an impact on everything from how products are structured and marketed through to risk management and underlying market infrastructure.

Engaging in the debate – whether directly or through other options such as industry associations – will be key for those looking to influence the outcome, and all firms should be carefully monitoring the horizon.

The Kalifa Review of UK Fintech

An overarching, independent strategic review commissioned by the UK Government, focussing on identifying key areas to ensure that fintechs in the UK have the resources to grow, to create the right conditions for widespread adoption, and advance the UK's global reputation for innovation in financial services.

Key recommendations include:

- amendments to UK listing rules to make the UK a more attractive location for IPOs
- creating a regulatory Fintech ‘scalebox’ to provide additional support to growth-stage fintechs
- visa improvements to attract global talent
- a Centre for Finance, Innovation and Technology, to enhance coordination across the Fintech ecosystem

HMT Payments Landscape Review: call for evidence

A review focussed on ensuring that the UK regime keeps pace with the rapidly changing payments landscape.

The Call for Evidence touches on a variety of topics, including the New Payments Architecture, the dynamic between account-to-account payments versus card schemes, cross-border payments, and the regulation of new actors. Feedback from HMT is expected later this year.

HMT consultation and call for evidence: UK regulatory approach to cryptoassets and stablecoins

HMT's consultation and Call for Evidence on designing a new regulatory regime for stablecoins and cryptoassets. The consultation sets out HMT's proposal for a staged approach to regulation, focussing first on a regime principally for stablecoins.

See also:

- HMT Cryptoassets promotions consultation
- Bank of England Discussion Paper on Central Bank Digital Currency
- PSR Market review into the supply of card-acquiring services: Interim report

M&A: consolidation and collaboration

We expect the increased collaboration and consolidation seen across the sector in recent years will continue. We anticipate a continued appetite for the acquisition of digital businesses which offer incumbents an attractive alternative to developing in-house technology.

Wholesale acquisition can offer a time-efficient way to (potentially exclusively) access established systems and capabilities that could otherwise take years to develop, as well as talent and expertise which may be difficult to attract. However, given lingering economic uncertainty, buyers may scrutinise potential targets more intensely than before and may focus their acquisition efforts on established Fintech rather than potentially more risky early stage start-ups.

As well as acquisitions of full control, there has been a trend towards the establishment of partnerships and

joint ventures between incumbents and scale-up fintechs. These can be effected via contractual alliances or agreements for the development of software or other technological solutions and are often combined with a strategic equity investment.

Such arrangements can offer similar access to technology and resources as an acquisition, whilst avoiding the need for full structural integration and exposure to the target business' risks. We expect these to be particularly attractive to investors with limited capital to spend or which want to create a portfolio of investments in sectors relevant to their business.



£3.6bn

amount of investment attracted by UK fintechs in 2019, with the highest deal volume of any European country



82%

of global financial services firms expect to increase fintech partnerships in the next 3-5 years²

Merger control and killer acquisitions

On a global scale, competition authorities have in recent years been concerned to prevent so-called 'killer acquisitions' – the acquisition by an established participant in a particular market of a new or potential entrant which would have become a significant competitive force absent the transaction.

As the Fintech sector continues to mature, founders, incumbents and investors may look to M&A as a route to realise exit opportunities or to consolidate, in some cases where this is necessary to achieve efficiencies and access future growth opportunities. Many Fintech providers may be relatively small players viewed through the lens of the wider industry, and their emergence has triggered

pro-competitive disruption in many markets, but it will be important to be alive to the risk that M&A may not be straightforward from a competition law perspective – particularly in the case of an acquisition by a larger established player. We believe a merger control analysis will therefore be viewed as an essential part of transaction planning from the outset.

Visa's proposed acquisition of Fintech platform Plaid was recently abandoned following intervention by the US Department of Justice. In the UK, the transaction had already obtained merger control clearance from the Competition and Markets Authority, demonstrating the risk of divergent merger control results when engaging in international transactions.

2. Source: City of London; theglobalcity.uk

Data ethics, customer trust and the minefield of international data transfer

Greater public awareness of the issues surrounding data privacy and protection has raised questions over who can be trusted with our data. A key part of the trust debate is not just ensuring data is not compromised, but also that it is only used for the purposes allowed by customers.

We therefore expect to see data ethics remain at the forefront for Fintech as it comes under increased pressure, not just from customers demanding greater transparency around how their data is handled, but other stakeholders such as regulators and industry bodies. The use of Open Banking, artificial intelligence, machine learning and automated decision-making in Fintech to improve the customer experience, make decisions, and manage risk, will only exacerbate this pressure.

There is already an acute awareness of the importance of ensuring trust and transparency, particularly with less established providers as they seek to close the “trust gap” with the larger, established financial institutions. With this brightened spotlight on data ethics, we expect Fintech providers will focus on actively promoting transparency and ensuring fair development of the technologies used to harness the power of customer data strictly for the benefit of customers, both to maintain, enhance and leverage customer trust and loyalty.

We also expect uncertainty over international data transfer to continue to be a dominant theme, affecting all UK and EEA-based organisations transferring personal data outside of the UK or EEA.

Following the end of the Brexit transitional period, the free flow of data from the EU to the UK might continue until the middle of 2021, but there is uncertainty about this timing and an adequacy decision granted to the UK. There is also continuing fallout from the European Court of Justice's Schrems II judgment, which raised the bar for transfers relying on the European Commission Standard Contractual Clauses and has laid down a road to compliance that will require focus and considerable effort. On top of this, the European Commission's publication of the new draft Standard Contractual Clauses is expected to be finalised in 2021. This will set the timer ticking on a one year grace period for implementation and get the ball rolling on yet another mass repapering effort.

We expect Fintech providers will be forced take a closer look at data flows and supply chains. After GDPR the investment this requires will not be particularly appealing, but this is a regulatory minefield that must be navigated, not least because privacy and data protection is at the forefront of customers minds.

Sustainable business models and non-bank risk management

Regulators are starting to ask more searching questions about the long-term sustainability of some Fintech business models, particularly scale-ups that have rapid growth but remain loss-making. We expect to see increasing engagement on this issue.

In a banking context, the PRA has started to take a more structured approach to this issue by setting clear expectations around the "path to profitability", the strength of governance, and the development of more mature risk management for new and growing banks. See the PRA's [Consultation Paper on new and growing banks](#).

But we expect this will only be part of a wider trend for regulators increasingly to scrutinise the long-term viability of business models, particularly for firms with a sizeable and rapidly growing customer base. Part of this will inevitably involve more focus on how such firms fund their growth.

Closely linked to this, the FCA has been underlining the importance of prudential risk management by non-bank firms, particularly in the payments space. See, for example, the [FCA's guidance on safeguarding customer funds](#). Concerned about the economic fallout from Covid-19 and an increasingly crowded market, the FCA is focussing on ensuring firms are properly following rules designed to ensure they can fail with minimal customer harm.

In a broad sense, these issues are not new. But increasing expectations and attention from regulators means that Fintech providers - particularly those scaling-up or seeking rapid expansion - should be anticipating this topic.

"Often, [new banks] are focused on the ambition of becoming authorised and lose the longer term focus of becoming a sustainable business, or fail to appreciate the ongoing need to invest in systems and controls to ensure they remain commensurate with the evolving needs of the business."

NON-SYSTEMIC UK BANKS: THE PRA'S APPROACH TO NEW AND GROWING BANKS (CONSULTATION PAPER 9/20)

The evolution of operational resilience...

Operational resilience will continue to be a priority for regulators as they seek to enhance the current rules. This will be more evolution than revolution.

In December 2019, the Bank of England, the PRA and the FCA published coordinated consultation papers on operational resilience proposing new rules affecting a range of firms, including banks, payment service providers and e-money firms. The key proposals are that firms should:

- Identify their important business services that, if disrupted, could cause harm to consumers or market integrity, threaten the viability of firms or cause instability in the financial system.
- Set impact tolerances for each service, which quantify the maximum tolerable level of disruption.
- Identify and document the people, processes, technology, facilities and information that support services.
- Take action to be able to remain within their impact tolerances through a range of severe but plausible disruption scenarios.

The regulators recently published policy statements further to their earlier coordinated consultation papers.

Fintech providers will need to think, in particular, about the need to assess and manage the risks posed by third party technology and infrastructure suppliers. The new rules underline a shift away from focussing on contractual protections with suppliers towards proactively avoiding risks from crystallising in the first place. Due diligence of suppliers, the ability to obtain appropriate management information across the project lifecycle, governance and access rights will all become much more important. A review of existing contractual arrangements is likely to be necessary, and we expect a shift in bargaining power as regulatory expectations make it increasingly difficult for suppliers to offer their terms on a "take it or leave it" basis.

Amongst these broader changes, we expect a potential trend for some Fintech providers to manage operational risk through collaborating with or taking a stake in other firms that might otherwise be seen as competitors. This might, for example, see one payments provider entering into backup arrangements with another to enable continued access to payment systems in the event of an operational failure.

Find out more:

- [Bank of England and PRA consultations on operational resilience](#)
- [FCA consultation on operational resilience](#)
- [PRA policy statement \(PS6/21 - Operational Resilience\)](#)
- [PRA policy statement \(PS7/21 - Outsourcing and Third Party Risk\)](#)
- [FCA policy statement \(PS21/3 - Building Operational Resilience\)](#)
- [HSF Operational Resilience Hub](#)

...and grappling with evolving cyber threats

The continually evolving range of cyber security threats will remain one of the most significant operational resilience risks.

The rapid growth of digital platforms has made Fintech providers and customers uniquely vulnerable; cyber is now the tool of choice for financial crime. We see two particular trends in this area, which focus on the risks associated with:

- ransomware attacks – these are increasing in frequency and severity. Fintech providers will need to focus on planning specifically for such attacks, including their policy towards paying ransoms and the legal and regulatory issues associated with this;
- cross-practice malware infection – Fintech providers often use multiple digital platforms for

distinct purposes, such as cloud services from one vendor and website building services from another. It is increasingly common for threat actors to develop malware that infects one platform and propagates to another. We therefore expect to see Fintech providers looking to minimise reliance on multiple suppliers and moving towards a one stop shop.

Given that UK regulators see cyber security as an integral part of operational resilience, Fintech providers will need to have a crisis response plan which covers the full range of potential service interruptions and is continually adapted, enabling accelerated decision-making in a critical moment.

"The financial system is under almost constant cyber-attack... Individual institutions cannot prevent all attacks, yet in our connected world a paralysing attack on one firm could potentially cause loss of confidence in others."

THE FUTURE OF FINANCE REPORT, CHAIRED BY HUW VAN STEENIS

Remote working and the war for talent

There is broad consensus that regular remote working will be a feature of the workplace post-pandemic. It is less clear how that will disrupt the market for talent.

Having operated successfully during the pandemic, employers may well be more open to employing individuals on a purely (or predominantly) remote basis. Doing so may allow businesses to recruit from outside of the standard London/Manchester-based talent pools, and may support efforts to broaden and diversify workforces. Such an approach may also have benefits for the bottom line, by allowing reduced spend on corporate real estate.

However, over the long-term, a shift to a largely remote workforce will likely present new challenges, including with respect to maintaining culture and developing an appropriate remuneration strategy for employees with different cost-of-living considerations.

To address the first issue, it may be that head office savings need to be reinvested in smaller, regional office spaces to provide a hub for collaboration and teamwork amongst local networks within the workforce. As for remuneration, while there will clearly be room for nuance, for many the starting question will be whether to take a cost of living based approach (which could result in further operating costs savings), or opt for value-based salaries to attract the best talent.

Fintech providers (particularly scale-ups) will also be keenly awaiting the outcome of the Department for Business, Energy and Industrial Strategy's consultation on the use of non-compete provisions by employers. Key options under consultation include a ban on employee non-competes (emulating the position in California) or introducing requirements for compensation to be paid during any period of restraint (as is common across Europe). This is the second time in the last few years that the Government has sought views on this topic. Last time, nothing came of the consultation - there seems a greater chance of reform this time round.

105,000

number of people expected to work in Fintech in the UK by 2030³

Find out more:

Department for Business, Energy and Industrial Strategy's consultation on the use of non-compete provisions

3. Source: UK Fintech State of the Nation; Department for International Trade

National Security and Investment Bill: a live issue on Fintech transactions

The National Security and Investment Bill was published on 12 November 2020 and proposes an enhanced notification regime and governmental call-in powers for some transactions in specified sectors. There is also a retroactive ability to review transactions.

There are 17 specified sectors and those focussed on technology are widely construed: artificial intelligence, communications, computing hardware, cryptographic authentication, data infrastructure and quantum technologies are all included. The current definitions of many of these specified sectors are widely drafted and could potentially catch a number of Fintech businesses.

Whilst the UK Government continues to consult on the exact definitions for these specified sectors, we anticipate buyers and sellers of fintechs including contractual protections in transaction documents, in particular completion conditions, to address ongoing uncertainty regarding the scope of the final legislation.

Find out more:

- How will investors be affected by the new regime under the NSI Bill?
- UK Gov publishes revised sector definitions for notifications under the NSI Bill

Financial crime controls and the focus on cryptoassets

We anticipate continued focus on AML/CTF compliance given recent financial crime scandals and focus by regulators and law enforcement agencies on targeting the gatekeepers of the financial system – including Fintech providers.

The EBA has recently recommended a review of the list of firms currently within scope of 5MLD, including reviewing the status of virtual asset service providers and crowdfunding service providers; and clarifying the coverage of account information service providers. If implemented, providers in these areas may see an increased AML/CTF compliance burden if their internal systems and controls are not already 5MLD-compliant. Although there is some uncertainty about the extent to which the UK will follow any EU changes, the UK has in any event already taken a wider approach than the EU in some respects; for example, UK coverage of cryptoasset businesses for AML purposes.

Fintech providers will also need to be mindful of the MLD-based obligation for firms to have policies and controls which ensure that, when new products, practices or technologies are adopted, appropriate measures are taken to assess and if necessary mitigate AML/CTF risks.

There will be continued opportunities for Regtech to support firms in their compliance with AML/CTF requirements. KYC and related utilities, more sophisticated transaction-monitoring techniques and information-sharing utilities are all areas of potential focus, presenting the possibility of reducing cost and/or enhancing the fight against financial crime.

This is a fast-moving area. Monitoring the changing regulatory position, and ensuring that internal AML/CTF controls are fit for purpose, will be key.

Find out more:

[EBA Consultation on Revised AML/CTF Guidelines](#)



+11,000.00

Identifying the risks and opportunities of competition interventions and investigations

The UK Competition and Markets Authority (**CMA**) has expressed a desire to establish itself as a leading global competition regulator following Brexit (having previously been constrained in some regards by the superior jurisdiction of the European Commission). Based on the CMA's recent practice, we anticipate that financial services and digital technology will continue to be two areas of significant enforcement priority for the CMA.

Fintech often involves unique product propositions. This poses challenges for competition law enforcement, as business models may raise potential issues that do not fit within the existing competition law framework. Competition regulators worldwide are grappling with this issue in a number of sectors, partly due to increasing digitalisation at the intersection between digital technology and more traditional industries, and are continuing to dedicate significant resources to improving their understanding in these areas. For example, the European Commission has recently launched a sector inquiry in respect of the 'Internet of Things'.

In the UK, both the CMA and the FCA have the power to conduct market studies, enabling them to gather more information on how markets work and to identify whether there are any market features harming to competition. The CMA's recent practice indicates a willingness to study nascent developing markets with a

view to preventing competition problems before they become embedded. Going forward, the CMA may make greater use of market studies, particularly where the flexibility of that regime helps it in assessing the competitive impact of innovative business models, and addressing any competition concerns which may arise.

Being alive to the possibility of regulatory intervention is not just a question of risk management. For firms looking to enter or expand in new markets, active engagement with regulatory intervention may provide opportunities to advocate for the removal of barriers to entry and expansion, and help to facilitate effective competition. We believe Fintech providers should have both of these perspectives in mind should regulators focus on investigating markets in which they are (or plan to be) active.

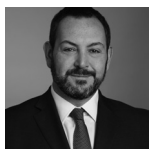
The continuing growth of InsurTech

Within the Fintech sector, InsurTech businesses see particular opportunities as they seek to both disrupt and enable the traditional insurance value chain; each part of this value chain (from product innovation to distribution, from pricing to back-office functions) is being reassessed to see if new approaches can improve efficiency, allow new risks to be written or provide access to new customers.

In addition to interest from incumbents in the insurance sector, we expect to see larger non-insurance sector corporates continuing to pay close attention to InsurTech businesses, particularly those servicing individual consumers and SMEs. Some are considering whether trust in their brand, coupled with technological innovation, may mean that they can sell insurance products through existing supply chains in a way that previously would not have been credible.

Transaction activity is picking up as early investors seek to exit maturing businesses and larger corporates consider how proven InsurTech companies might fit in to their wider service portfolio. We expect to see an increasing trend for investors and founders to revisit exit terms in articles of association and shareholders' agreements, with a particular focus on restrictive sale provisions (for selling shareholder(s)) and controls over the requirements to pay out cash in circumstances when cash flow is uncertain (for remaining shareholder(s)/ the business).

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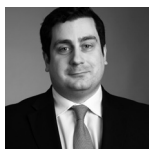
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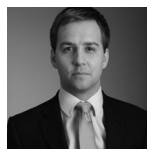
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