ALLEN & OVERY

Fintech

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"If you're building something new, something creative, you want someone innovative who will be interested in helping to build the ecosystem. Everything thats done in Luxembourg is part of the political mission of the country. I felt they understood this at Allen & Overy."

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"Some lawyers work like Wikipedia, which doesn't work in a new business area like FinTech – you need to think ahead. Allen & Overy help you find solutions. They're willing to speak up for new ideas to solve your needs."

Chambers Global 2019

What is Fintech?

Fintech is the term coined to describe the intersection between finance and technology. It may refer to technical innovation being applied in a traditional financial services context or it may refer to innovative financial services offerings which disrupt the existing financial services market. It is one of the most exciting and dynamic segments of the financial services marketplace.

Global investment in Fintech ventures has tripled over the last five years and will double again to an estimated USD6 billion by 2018, according to a recent report by Accenture and the Partnership Fund for New York City. A number of factors are driving Fintech growth. The continued expansion of digital connectivity is a primary driver – with more and more connected devices in the hands of businesses and consumers and greater and greater internet connectivity available, the march towards mobility is unstoppable. The economic downturn also played a part. Financial institutions turned to technology as a way of improving the effectiveness of their processes while reducing costs. At the same time, incumbent institutions may have failed to invest in technology and innovation, opening the door for more nimble alternatives.

Finally, the range of new regulation introduced in recent years and the penalties associated with getting it wrong have created demand for new and innovative ways of managing compliance and reducing risk.

With a track record of providing high-quality and innovative legal advice, Allen & Overy is ideally placed to guide market participants through business and legal issues in the rapidly evolving financial technology sector. As a recognised banking powerhouse, we have a huge knowledge base and experience of advising on financial services regulation. In addition, our strong connections with the leading financial services authorities mean we can support our clients in all their dealings with local regulators. We marry this regulatory expertise with a strong offering in the technology sector with experience that spans the market from growth companies to established market players.

Fintech market segments

Some of the most active areas of the market are:

Data and analytics

Many Fintech companies have seen significant opportunities in exploiting the vast amount of data created by the financial services sector. Some use data in a way that is customer facing (to segment customer populations, identify opportunities for new products and services and optimise pricing) while others are using data to help manage risk (spotting outlier transactions that may indicate fraud or cybersecurity breach, or validating credit-worthiness decisions); but confidentiality of sensitive personal data is a top priority for regulators and consumers and data protection concerns are therefore a critical consideration for Fintech companies working with personal data. Privacy issues in the financial services sector are not "new", but current concerns may be exacerbated by stricter regulations and by new business models in which data from external sources may be used for purposes which might not have been anticipated by the consumer at the time the information was provided. Fintech companies will also need to be aware of fundamental questions around who owns/controls the data (and whether any licences are required to use it) and how to protect the intellectual property in data outputs. Increasingly, antitrust regulators are also taking an interest in the market share that owners of big data sets may enjoy, particularly when these companies merge or strike up other alliances.

Artificial intelligence

Closely linked to the area of big data is the related field of artificial intelligence. Products in this area may use data and analytics to automate decision-making processes, technology that may be particularly valuable when the speed and/or volume of information mean that real-time human analysis is unfeasible. Artificial intelligence is also at work in "recommendation engines" – the most well-known e-commerce example being Amazon's "people that bought that, also bought" purchase recommendations. However, there are several potential legal considerations around the use of artificial intelligence in financial services. Imagine a case where an individual applies for a personal loan online. The website uses algorithms and automated credit searching to provide an immediate yes/no decision on the application. In such a case, in some countries (eg the UK) data protection legislation requires that an individual: (a) must be given notice where automated decision-making is being used in respect of his or her personal data; (b) must be able to give written notice requiring that automated decision-making may not be applied to their personal data; and (c) must be able to ask for the decision to be reconsidered by a human.

Payments

Payment systems underpin the services that enable funds to be transferred between people and institutions. Innovative start-ups, retailers, established banks, card companies and other payment services providers are all seeking to offer new payment solutions to meet consumer demand for payment instruments that are more secure, efficient and convenient. One consumer-friendly example of emerging companies in this area is in currency exchange. Peer-to-peer (P2P) currency exchanges take payments out of the international banking network. The customer pays the P2P exchange the amount he or she wants to transfer internationally and the exchange matches this payment with people sending money in the other direction. However, payments are carefully regulated and the pace of change in this sector means that market players may struggle with a rapidly changing regulatory environment and, potentially, regulatory "surprises" that may significantly impact business plans.

Digital currencies

While traditional currencies are issued by central banks, virtual currencies (also known as crypto or digital currencies) have no central monetary authority. Instead, virtual currencies are generated across P2P computer networks. These networks are also used to monitor and verify the transfer of currency (a "distributed ledger"). There are various narratives associated with cryptocurrencies, one (espoused by the Bank of England in a recent Quarterly bulletin) is that distributed ledgers open up the possibility of transforming the financial system more generally, while another is that virtual currencies are little more than a tool for criminals, terrorists and tax avoiders to move and store funds. Regulators are taking a variety of views on digital currencies, but most are approaching with caution and are stressing that potential investors should make themselves aware of all the risks before making an investment. With KYC and AML concerns so prevalent, many businesses whose business plans involve digital currencies are finding it hard to execute relatively simple aspects of their operations, such as opening a corporate bank account.

Crowdfunding and other forms of P2P financing

As with traditional forms of lending, those providing crowdfunding and other forms of P2P financing must be aware of the regulatory framework in which they operate. Regulation of the specific area of P2P has been patchy, but in the UK, for example, the FCA has published its approach to regulation and has distinguished between investment-based crowdfunding and loan-based crowdfunding (or P2P lending). The European Commission has also launched consultations on the topic. Particularly since the financial crisis in 2008, many governments have been concerned by the funding gap experienced by SMEs as established banks became more risk averse in their lending decisions. The policy dynamic is to embrace models that mean more money is available to SMEs in particular – while still preserving stability and consumer protection.

Legal and regulatory issues

Regulatory requirements

It is clear that one of the main challenges for Fintech companies is navigating regulation. While political sentiment towards Fintech is largely favourable (governments are typically keen to be seen to be encouraging innovation; they have also seen the potential for Fintech to progress other policy objectives like increasing the accessibility of financial services and reducing the size of the unbanked or under-banked population), regulatory approaches have been slower to catch up.

A key requirement for most Fintech companies will be a detailed analysis of their business model against applicable financial regulation to fully understand what can be achieved without becoming a regulated entity, or, conversely, to help them seek appropriate licences or approvals. If they are consumer facing, Fintechs will also need to be aware of the necessary consents and applicable regulation designed for consumer protection. A challenge is that regulation in matters such as payment services and consumer protection continues to evolve.

Data protection and cybersecurity

Data has become a hugely valuable asset, but data comes with real risks that are multiplying as the volume of data being collected grows – not least the risk of illegal access and processing. These are risks that can seriously damage a company's reputation and call into question the way it behaves towards its customers and employees. There are also threats from outside the organisation. Cyberattacks can not only cause direct financial loss for companies and consumers but the reputational damage for those targeted by cyberattacks can be costly. Companies will have to ensure that they have adequate data security procedures in place, know how to respond in the event of a crisis, comply with any breach notification requirements (which may mandate the involvement of both data protection and financial services regulators) and provide sufficient training for employees. Some companies may also consider cybersecurity insurance to mitigate the risks of an attack.

Protecting innovation

The development of innovative software and technology by Fintech companies has been key to the rapid expansion in this sector. Legal protection of this software and the business methods which are integral to the success of Fintech companies varies from jurisdiction to jurisdiction. Business methods are capable of being patented in the U.S. but in Europe they are per se unpatentable unless they can be shown to solve a 'technical problem'. If the software or business methods cannot be patented, Fintech companies should consider the availability of other IP rights such as copyright, and the protection of their ideas or trade secrets through contractual arrangements with their employees, suppliers and/or other third parties.

The importance of intellectual property to Fintech companies may also make them a target for patent trolls, which may cause business disruption unless the Fintech enters into licensing discussions or is prepared to fight a patent claim in the courts.

Contractual collaborations, licensing and alliances

Sitting as it does at the intersection between the worlds of financial services and technology, commercial agreements will be an essential part of the growing Fintech market. A key feature of these agreements may be the very different types of companies that are entering into partnerships. The negotiation styles and priorities of a nimble digital start-up and an established financial services or technology multinational are likely to be markedly different which may introduce challenges into negotiating these agreements. What will add a further layer of complexity into these arrangements is the regulatory uncertainty that still covers the market.

M&A and IPOs

We are already seeing high levels of M&A in Fintech as market players consolidate to take advantage of synergies and traditional big players buy up talent and technology. Trade sales have been busy for some time, and IPOs appear to be taking off since Lending Club, the P2P lender, got away at the end of 2014. Private equity groups and investors are also being attracted to the growth potential of Fintech companies.

Ultimately, the challenge faced by all those in the Fintech market is how to capture innovation while preserving the stability of the banking network. Facebook's mantra, "Move fast and break things", is a great one for many emerging companies – but perhaps more problematic for companies operating in highly regulated areas such as financial services. Within the Allen & Overy team we have the unique combination of resources to help market participants successfully navigate this path.

Our experience

Worldpay
a leader in global payments, on its potential IPO.

Barclays Banks, Goldman Sachs, Credit Suisse and Liberum Capital
as the underwriters' counsel on Equiniti Group plc's ("Equiniti") prospective initial public offering (IPO) and admission to the premium listing segment of the Official List and to trading on the London Stock Exchange (LSE).

Crédit Mutuel Arkéa
on its acquisition of an 86% stake in Leetchi.com, a France-based Fintech group providing a digital solution to collect money for group gifts and events and an API solution to accept online payments and manage e-money for marketplaces, crowdfunding and collaborative consumption (Mangopay).

BACS and Faster Payments
the UK inter-bank payment systems, on their scheme rules, settlement arrangements, technology development and maintenance contracts for processing of payments in the UK.

VimpelCom
on international laws applicable to mobile payment schemes.

A supplier of cashless transaction technologies
in relation to data protection officer reports and various other data protection issues.

Innovate Finance
the UK trade body for Fintech, on policy issues relating to KYC requirements.

Telenor, Telenor Financial Services and Telenor Myanmar
on the establishment of a mobile financial services provider in Myanmar by way of a joint venture with a local Myanmar bank.

National Bank of Abu Dhabi
on a service agreement with Oxigen Services (India) in relation to mobile banking services to be provided in India by Oxigen for NBAD customers.

BNP Paribas Fortis
on the development and roll-out of an innovative mobile payments platform in Belgium. The platform, which is a market-first, was developed together with Belgacom and Accenture.

Western Union LLC
on the terms and conditions of the MyWU Card loyalty programme.

Deutsche Bank
as trustee and agent of the Funding Circle variable funding notes issued by Dorset Rise, managed by KLS Diversified Asset management.

Telenor
on its joint venture with MicroEnsure Holdings, a provider of insurance products in Africa and Asia, to form MicroEnsure Asia, which will distribute insurance products to low- and middle-income customers in Asian markets using, among others, mobile phone technology.

Microsoft
on the Belgian and international regulatory restrictions applicable to cloud computing in the financial sector.

Worldpay Group
on the acquisition of Brazilian payments provider Cobre Bem Tecnologia, a gateway provider of payment solutions in Latin America.

RBS
on a transaction to provide a currency exchange platform for Amazon's online retail transactions.

A retail bank
on commercial agreements, including with PayPal, and on exclusive branding and technology arrangements with a transport authority for adding ticketing functionality to payment cards.

Network International
on the English and U.S. law aspects of its acquisition of a majority stake of TimesOfMoney, the Indian e-payment giant.

Rabobank
on the acquisition of a stake in Fin-Force, a third party processor of cross-border payments on a white-labelling basis, from KBC.

An international service provider
on an electronic KYC compliance tool.

A global financial institution
on a loss of sensitive customer data, including advice on appropriate notifications to the data protection and industry regulators and on an internal investigation.

"The main thing they bring for clients is their international reach, and their compatibility and experience with startups. For banking and cryptocurrency matters A&O is one of the best."

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Our Luxembourg team

Catherine Di Lorenzo
Partner – IP, Data & Tech
Tel +352 44 44 5 5508
catherine.dilorenzo@allenovery.com

Yannick Arbaut
Partner – Funds & Asset Management
Tel +352 44 44 5 5521
yannick.arbaut@allenovery.com

Jacques Graas
Partner – Corporate and M&A
Tel +352 44 44 5 5415
jacques.graas@allenovery.com

Baptiste Aubry
Head of Financial Services Regulatory
Tel +352 44 44 5 5285
baptiste.aubry@allenovery.com

Global presence

Allen & Overy is an international legal practice with approximately 5,800 people, including some 590 partners, working in more than 40 offices worldwide. A current list of Allen & Overy offices is available at www.allenovery.com/global_coverage.

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