Fintech market enters a new stage of maturity

Fintech is gearing up, shifting away from the start-up world to mature big ticket transactions. Richard Woods, Clive Cunningham and Wendy Saunders of Herbert Smith Freehills review macro-developments in Europe

Fintech refers to the many ways in which businesses are using technology to change and improve the provision of financial services. There are many ways in which regulators are reacting to and supporting the continued growth of fintech, and how ambitious businesses are adapting to that regulatory landscape.

We see 2020 as being a year of consolidation as much as transformation, both in terms of firms' reaction to the regulatory environment, and in terms of transactional activity.

In the last two years, a number of fundamental regulatory developments took effect in the region and these are now an established part of the regulatory framework. In particular, the second Payment Services Directive (PSD2 – January 2018), Mifid II (January 2018) and the General Data Protection Regulation (GDPR – May 2018) established a new architecture in which fintech businesses must operate. Although the next phase of regulation is never far away (the Fifth Money Laundering Directive very recently took effect on January 10 2020) in 2020 fintechs will, for a while, have an opportunity to work within a relatively well-established regulatory framework.

2020 may well be the year in which open banking becomes more widely adopted. Open banking allows customers to authorise their banks to share their financial data with third party providers. It is designed to increase competition and innovation in favour of consumers. It is the best-known ambition of PSD2. Two years after PSD2, businesses are better able to deploy technology, are more familiar with other relevant laws (including GDPR), and in several cases have implemented significant commercial partnerships that are designed to capitalise on PSD2. All of this should enable open banking to become a greater part of daily life for many consumers.

There is an obvious exception to this: the UK. The UK left the European Union on January 31 2020 and, on the current timetable, will leave the European single market on December 31 2020. The last few years have repeatedly proved the unreliability of Brexit forecasting – so we will not attempt to do so here. Suffice to say, it is not clear how quickly and to what extent financial services law in the UK will diverge from EU law from January 1 2021 or, more particularly, to what extent a workable framework for UK-EU access in cross-border financial markets may be retained after January 1 2021.

The best-managed and best-advised businesses have been planning for the most challenging Brexit outcomes for some time. The loss of passporting will be fundamental for many UK headquartered but Europe-wide businesses, so many have been obtaining EU financial services licences to ensure continued access to EU markets. Businesses will need to move fast now that the outcome of Brexit is clearer.

The transactional landscape

Aside from the regulatory backdrop, what do we anticipate in terms of commercial legal activity in 2020?

Fintech businesses have attracted enormous levels of investment in recent years, driven by historically low interest rates, readily available venture capital funding, promotion of competition by regulators and concentrations of capital in ambitious investors (particularly in East Asia, such as SoftBank and Ant Financial). 2019 was another record year for venture capital investment in fintech: $37.4 billion was invested in the UK. Incumbent institutions (such as Goldman Sachs and RBS) are involved in investment activity too – and, when they are not taking stakes in growing fintechs, they are seeking to offer products with comparable user experience. Witness, for example, the success of Goldman Sachs' retail offering, Marcus.

Will the same levels of funding be sustained in 2020? The market might not be slowing, but it appears to be changing. Although capital has continued to pour into fintechs, the number of early-stage deals has been dropping year-on-year. This suggests that the explosion of brand new fintech businesses is slowing, and that the

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Clive Cunningham is a partner specialising in financial services law and regulation. He heads the non-contentious practice in London. With over 25 years' City experience, including time as a banking regulator with the Bank of England and in-house at Merrill Lynch (wealth management), Clive advises banks, asset managers and other financial institutions on a wide range of regulatory and compliance matters. Areas of special sector expertise are banking, asset management and securities regulation. Clive is recognised as a leading lawyer in IFLR1000, Chambers and Legal 500.

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Wendy Saunders is a senior associate specialising in financial services law and regulation. Wendy draws on four years of experience within the Financial Services Authority's Enforcement Division to provide informed and strategic advice and guidance to clients. Her banking experience includes secondments to the group regulatory team of a leading retail bank and as a senior regulatory risk lawyer to the central compliance team of a global investment bank. Wendy has advised a range of clients in relation to outsourcing, payment services regulations, ringfencing and operational continuity in resolution, client money, and more generally on Mifid II. She also advised on the Salz Review concerning culture and governance at Barclays. Wendy has developed a particular interest in cryptoassets and was a key contributor to the Financial Markets Law Committee working group on initial coin offerings. She has also co-authored several articles on related topics published on Thomson Reuters.

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market is focussing on more mature businesses which have a clear path to profitability. Indeed, the proportion of funding represented by mid-market fintech deals has grown year-on-year since 2014.

At the same time, the types of activity are changing. Along with major funding rounds, fintech is now a mature market for very large M&A transactions, particularly in the payments sector – for example, in the US, FIS' acquisition of Worldpay for $43 billion, Global Payments' $21.5 billion deal for TSYS, and Worldline's recent $7.8 billion deal for Ingenico.

The growing number of 'unicorns' in Europe – such as TransferWise, Revolut, Monzo, N26 and Klarna – suggest that this kind of activity is likely to occur in EMEA too. And, if these businesses do not seek an exit or become targets themselves (as iZettle was when it was acquired by PayPal for $2.2 billion), it seems likely that they and other highly-valued businesses will seek to grow inorganically, supporting the growing mid-size M&A market in EMEA fintech.

Aside from M&A, commercial partnerships will continue to be an active area in 2020. Many 'start-up' fintech businesses are now several years old and are partnering with each other and with incumbents. There have been several significant deals recently, including TransferWise's deals with N26 and Monzo, Starling Banks's deals with MoneyBox and PensionBee, and OakNorth's deal with ClearBank. We expect there to be more of this in 2020.

Looking ahead

All of these deals are part of a thematic re-alignment of the financial services landscape in Europe, in which growing businesses and incumbent institutions are battling to win and maintain market share – and ultimately, to become the rails on which Europe's financial services run for the foreseeable future. And of course, all of this is driven by public policy, financial regulation and by the commercial development which that has fostered. We look forward to another exciting year in European fintech.