

# Regulation of FinTech

August 2015

FinTech concerns a breed of new companies that combine traditional financial services with the use of new technologies. This Briefing Paper flags up for those in the FinTech sector how the Government is recognising the prospects for growth of businesses in this sector in the UK and the particular interest of the FCA in developing appropriate regulation.

Although all businesses are subject to the same regulation and over the years regulation has always had to cope with how new technology has affected business models, there is recognition of the need to look at how regulation is formulated given the extraordinarily fast moving developments in technology and digitalisation.

## The Government's constructive approach

*HM Treasury is certainly keen to ease the path for FinTech firms – note "Fixing the Foundations: creating a more prosperous nation" published in July 2015 by HM Treasury, with Section 12 indicating that the Government will champion the development of new and innovative technologies and ideas including through the appointment of a special envoy for FinTech – it wants to promote the most productive forms of investment.*

Consequently it has indicated that it is vital that regulation remains proportionate and that regulators support effective competition. The Government is requiring departments to work with regulators to publish innovation plans by Spring 2016 which will set out how legislation should work and enforcement frameworks can adapt to emerging technologies and disruptive business models.

It will be interesting to see the digital transformation plan expected in the Autumn setting out the concrete actions the Government is to take to support the adoption of digital technologies across the economy, including in financial services, and the ways in which the Government will assist in tackling barriers to new businesses entering and creating new markets.

This though does not make it easier for FinTech firms. Perhaps it might be expressed as *making regulation cope better with FinTech firms, and in such a way as not to impede their development.*

The Government is setting the FCA an objective to have regard to encouraging business and particular new business models to develop, but the intention is not to make an easier regime for FinTech firms rather than, say, traditional business models.

To take an example, the FCA has so far sought to address "gaps" in regulation so as to provide a new regime for loan based crowdfunding platforms, and worked to accommodate investment based crowdfunding platforms under the existing provisions. What the FCA has been doing though is trying to proceed on a constructive basis so as to secure an *appropriate degree of protection for consumers and promote effective competition in the interests of consumers.*

## The FCA's Project Innovate

The FCA's Project Innovate is designed to assist those who are developing innovative approaches that are not explicitly addressed by current regulation or where guidance may be ambivalent. Whether regulated or unregulated, the Unit could be dealing with any form of innovative business model. In scope are a number of areas including digitalisation, big data analytics, venture capital, virtual currencies, crowdfunding and peer to peer.

One interesting point to note is that the Unit does not automatically assist on any request.

The published statistics so far are that the Innovation Hub is providing ongoing assistance to 91 firms, has provided informal steers in 34 cases, but has actually turned down 137 requests which it says did not meet the criteria. So it is not entirely an open door proposal. Having said that, particularly for

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unregulated business, we do hear of some propositions which are so under-developed - or far off the level of detail of which the FCA would expect to hear - that it is probably fair for the FCA to reject various proposals and seek that they should be further developed before the Unit considers them.

Also the Unit deals with both regulated firms and unregulated firms. Given the lack of Supervision team contact at the FCA for numerous small businesses who could actually benefit most from such, the Project Innovate team can therefore usefully provide some assistance particularly to a smaller authorised firm which has an innovative proposal to discuss.

## How will barriers to innovation be resolved?

The FCA is certainly willing to consider how better to regulate FinTech sectors. Note for example the FCA's June 2015 Call for Input on regulatory barriers to innovation and digital and mobile solutions where they are asking for comments by 7<sup>th</sup> September 2015.

Note though that the FCA is not seeking to remove barriers: it is seeking to identify them and work to resolve these without compromising consumer protection.

There is inevitably considerable emphasis on investor protection in recent FCA rule changes and more which are in the pipeline. Also note that in large measure the FCA is not in charge of its own Rule Book given EU overlays (and for example note MiFID II is in the pipeline for introduction in January 2017), and it also is concerned with the consumer protection angle. This key concern will inevitably have to be accommodated by FinTech firms:

- Some firms simply need to recognise that they need relevant Part 4A permissions and become mainstream authorised firms with the relevant FSMA regulated activity permissions in order to do their innovative business models. Typically, the appointed representative routes will not support a full scale platform once it is established and nor will some of the technically applicable work arounds which limit the scope of the Part 4A permissions potentially. Open engagement with the FCA as to the nature of the business model and then agreeing the appropriate permissions is usually a productive process rather than trying to work around regulation.
- Crowdfunding propositions are now increasingly looking at various pooled fund structures (a particular specialist area in which we are involved and so you might be interested to discuss this further). Some are looking at quite traditional fund models such as investment trusts. Some, if the prospective investments are EIS qualifying companies, might offer EIS funds of which we devised some of the first ones.

In neither case is it necessarily a case of needing to change the rule book. It is a case of adapting existing product structures to fit with FinTech Funds purposes.

There is however certainly recognition of a need to look at the rule book in relation to some aspects, notably in relation to customer communications on which the FCA's DP15/5 (which indeed is somewhat based online) provides an interesting insight into the FCA's willingness to look at new approaches – please follow this [link to our briefing paper on DP15/5](#).

Also, there may be some new products coming through because of innovative FinTech proposals. One example is the proposed third ISA type: the Innovative Finance ISA which will be subject to different rules re withdrawal, transfer and ownership due to the nature of the investments so that ISA savers can invest in peer to peer loans in addition to cash and stocks and shares. (HM Treasury's response to the Consultation was published in July. Draft legislation is expected to be published for technical consultation later this year, with a view to allowing peer to peer loans to be held in ISAs from 6 April 2016.)

The UK FCA in its response to the European Commission's Green Paper on "Building the Capital Markets Union" (published on 27 May 2015) emphasises that one of the priorities for action should be the need to harness the benefits of digitalisation. As ever though, the FCA is already seeking to embed digitalisation issues in its own regulatory approach, recognising that there is a movement away from the predominant model of paper based disclosure regimes which have underpinned the development of European disclosure requirements such as provision of KIIDs in PRIIPs and KIIDs in UCITS so far. One of their themes is that communication and disclosure models should accommodate a range of channels and formats to match consumer preferences.

The FCA's Discussion Paper 15/5 on Smarter Consumer Communications is intended to kick start a debate around how the FCA industry, consumer groups and other stakeholders can work together to deliver information to consumers in smarter and more effective ways, including adopting innovative techniques, as there is a move away from the paper based mind set.

A Consultation is expected later in 2015 on proposed changes to some of the Handbook disclosure provisions.

## **A positive attitude to regulation**

**Developing appropriate regulation is not just for the regulators.** It involves a two-way street of firms within the scope of regulation not seeking to try and circumvent it but to work with the regulator to decide how best to fit within it.

For those firms who are, or may be, carrying on regulated activities within the scope of the UK's Financial Services and Markets Act 2000, it is important that at an early stage they seek specialist assistance on how best to embrace the relevant regulation. If one has a starting point of trying to decide how best to fit within regulation, then typically this frees up the range of options as to how best to accommodate regulation – and eases the path to productive co-operation with the regulators.

## How can Fieldfisher help?

Fieldfisher is a full-service law firm with over 160 partners, with its head office in London and with a strong European presence.

For FinTech companies themselves, our detailed understanding of innovative technologies and the regulatory landscape allows us to support entry and growth into the financial services market. We advise on compliance issues, regulatory white papers for customers and customer negotiations. This close operational understanding also allows us to help when it comes to funding and growth, with our corporate specialists very much part of our FinTech team.

With Fieldfisher's leading expertise in financial services regulation and technology law, we are ideally placed to assist innovative FinTech business models navigate their way through the relevant legal and regulatory issues involved, and devise practical solutions so they can meet their commercial objectives in a compliant way.

Fieldfisher combines class leading regulatory, technology and corporate skills for FinTech focussed businesses. We act for a wide variety of financial institutions, FinTech businesses, new start-up and crowdfunding platforms, helping them develop and exploit new markets.

We help firms stay at the forefront of new technologies from mobile applications and mobile payment through to data analytics and on-line issues. We advise from regulatory feasibility stage to the development and testing of new technologies and ensure all aspects of compliance are covered. Our expertise in identifying and managing risk and our understanding of how to navigate the regulatory maze enable our clients to deploy advanced technologies faster and more securely

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