Financial services and fintech firms hope to collaborate more in the coming years. Will regulations or geopolitical volatility hold them back?
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Foreword

Three dimensions of change

The financial services sector has always been at the forefront of innovation, from new products and services to developing new markets and harnessing new technologies. Banks, insurers, asset management firms and investment professionals continue to push boundaries.

Yet even in this dynamic industry, external forces and events are currently driving change that poses a challenge for incumbent players. Financial services firms are used to shocks, of course, but three forces are now posing serious questions for both individual firms and the sector as a whole.

The regulatory environment has certainly become more constricting. Both nationally and internationally, the rules of engagement within financial services have become more demanding, in terms of operational requirements, financial stability and consumer protection.

Over the past five years, technology has also taken a great leap forward. Cloud computing, big data analytics and web-based platforms have fundamentally shifted interactions with consumers. Cognitive technologies, high-speed processing and algorithmic trading have altered the market landscape. As a consequence, “fintech” has become a critical sector in its own right.

Add to those developments the recent Brexit vote, and it’s clear that the leaders in financial services firms have a three-dimensional strategic and tactical challenge to overcome.

Of all these drivers of change, however, it is the emergence of fintech that presents the most interesting and potentially long-lasting opportunities. Fintech is underpinning the companies that are challenging incumbent players. Technology is creating new markets and new ways of delivering products and services. Fintech start-ups are investing in technologies such as blockchain and machine learning, which hold out the promise of radical change to both back-office processes and market-facing activities.

It is only natural that established financial services firms, while conducting their own research and development into the application of new technologies, should seek to collaborate with this highly innovative part of their ecosystem.
This is not a one-way street, however. Fintech firms defined by experimentation, innovation and disruption often find it hard to develop scale, create reputation and ensure regulatory compliance in what remains a tremendously complex arena. For them, working closely with established players brings benefits, too.

In order to understand how these relationships are developing, Mayer Brown commissioned a survey of 120 senior industry leaders in the UK, 50 in fintech firms and 70 in financial services companies. This survey forms part of Mayer Brown’s focus on the digitisation of business. It’s called *Lexicon of Next* – a focal point for businesses seeking to understand how their opportunities and risks are changing in a transformed business world.

The survey results show that collaboration between fintech businesses and established financial services firms is well underway. More importantly, our research suggests that over the next three years, this cross-pollination will increase, with significant interest in partnerships, joint ventures and mergers to deliver efficiencies, new products and improved customer experience.

Optimising these collaborations, particularly in the light of regulatory change and the impact of the UK’s decision to leave the EU, is a critical task. Both sides feel that regulatory barriers are holding back further collaboration and that there needs to be greater clarity around regulation for fintech firms. And, often for different reasons, a significant proportion of both groups expect Brexit to pose major challenges in their structure, staffing and freedom to operate.

No less important will be the structure of the deals and partnerships between fintech and corporate financial services in a way that addresses the complex cultural, legal and operational differences between the two groups.

This report lays bare what those look like now – and will help decision-makers on both sides understand how to better handle them in the next three years.

“Fintech start-ups are investing in technologies such as blockchain and machine learning that hold out the promise of radical change to both back-office processes and market-facing activities.”
Methodology

In H2 2016, Mayer Brown commissioned Mergermarket to survey 70 respondents at UK-headquartered financial services companies and 50 respondents at UK-headquartered fintech companies.

The 70 financial services respondents comprised 30 banks with global revenues (net income, fees and other income) greater than US$10bn, 20 insurers with gross written premiums greater than US$5bn and 20 asset managers with assets under management greater than US$50bn.

The 50 fintech company respondents were drawn from a variety of subsectors including payments; data, analytics and modelling; investment; advisory; security; and lending. Twelve of the respondent fintech companies have annual revenues greater than US$100m.

All respondents are senior executive level and above, with job titles including chief operating officer, chief investment officer, chief information officer, head of technology and chief risk officer.
Part 1: Acquisitions and Collaboration

Finding common ground

Potential cost savings and improved customer experience are driving closer relationships between financial services and the nascent fintech industry, prompting collaborative projects and M&A activity. But behind these opportunities lie some threats: disruption of existing markets, culture clash and the potential for regulatory problems.

One thing is clear: the financial services sector is taking fintech very seriously. According to the bankers, asset managers and insurers in our survey, all but one has purchased a product from a fintech provider in the past three years.

A third of respondents say they expect to acquire a fintech business in the next three years, up from 11% over the past three. And while joint venture and investment activity between the two sectors has been relatively modest – around a quarter of financial services institutions say they have done such deals of late – the intention is to step up activity markedly in both areas.

**FINANCIAL SERVICES: HOW HAS YOUR FIRM ENGAGED WITH FINTECH FIRMS OVER THE PAST THREE YEARS? HOW DO YOU EXPECT TO ENGAGE WITH FINTECH FIRMS OVER THE NEXT THREE YEARS?**

*Respondents asked to select all that apply.*
“Larger financial services firms are having to get more flexible with their models,” says Mark Prinsley, Business & Technology Sourcing partner in Mayer Brown’s London office. “They have shown a willingness to invest in, or at least expose themselves to, new types of business that they would not have considered even a few years ago. Certainly the ‘not invented here’ syndrome has become a lot rarer, and there is a definite appetite to buy in expertise in new technologies and approaches.”

That view is echoed by survey respondents across the board: “We started slow with fintech over the past three years,” explains one financial services executive. “But now we are open for virtually any technology that will give us an edge against our competitors. We don’t see fintech companies as direct competitors; instead, we see them as partners.”

Friends at arm’s length?
This view is shared widely in the industry. In the survey, 87% of financial services respondents report positive experiences working with fintech firms (30% of them “very positive”). And while fintech executives are slightly more polarised, with higher proportions in both the “very positive” and “somewhat negative” camps, the picture right now seems mutually beneficial.

“We have been able to improve our services and there has been a noticeable decrease in the cost thanks to the innovative ideas from fintech firms,” explains one financial services executive – though he adds that such relationships are not without challenges.

“There were cultural issues and also differences in the operating model. But both the firms were able to discuss these problems to come to a mutual understanding – and this debate has helped us uncover growth opportunities as well.”

“Financial services firms are well aware of the challenges involved in working across cultures,” says Prinsley. “We’re seeing, for example, moves to seed development of open source technologies to support the entire sector. There are also examples of banks looking to create their own utility providers to a number of institutions for particular functions.”

In an era of disruptive business models – and in an industry where many incumbent leaders struggle with layers of legacy systems – it would be surprising if financial services executives did not also see threats from new players.
Respondents in banking were most likely to say that fintech posed a “significant threat”.

“Long-standing financial services players do want to ensure that new entrants play by the same regulatory rules,” says Guy Wilkes, partner in Mayer Brown’s Financial Services Regulatory & Enforcement practice. “That’s entirely understandable: they have the personal and institutional memories of the risks that light-touch regulation can bring. Many in the fintech world don’t bear those scars.”

Meanwhile in insurance, 35% of respondents say they feel little or no direct threat from fintech.

As one financial services leader points out: “Most fintech firms are either start-ups or young firms, while we are well established in the market and already have a roadmap designed to manage any kind of threat.”
Collaboration: benefits and beyond

Despite any potential threats, fintech also offers tremendous opportunity, in the form of technology unencumbered by legacy systems; an entrepreneurial culture; and a focus on customer experience. For financial services firms partnering with or buying fintech, these positives far outweigh any perceived negatives.

When asked about the top benefit of collaboration, for example, 33% of financial services respondents and 42% of fintech respondents cite greater efficiency or cost savings. Financial services respondents also highlight new product development, improved customer service and better data, which suggests they are looking to fintech to solve a wider variety of problems.

**WHAT IS THE GREATEST BENEFIT FOR FINANCIAL SERVICES COMPANIES OF COLLABORATING WITH FINTECH FIRMS?**

- Increased efficiency/cost savings: 42%
- Delivery of new, alternative products/services: 24%
- Improved quality of customer service: 19%
- Improved quality of data: 19%
- Access to new customers in developed geographical markets: 12%
- Improved access to customers in emerging geographical markets: 6%
- More agile brands: 2%
- Improved regulatory compliance: 2%

*Where no square/pentagon appears, the percentage is zero.*
But such benefits come with a note of caution, warns Mayer Brown’s Prinsley. “Fintech is more than providing technology services to financial services firms. For example, most financial services businesses have been adopting big data, a family of technologies perfectly suited to entities with millions of customers and billions of transactions.”

This may explain why, for fintech respondents, “improved quality of data” sits so much lower down the scale than it does for financial services executives when it comes to collaboration.

As for which financial services sector is ripe for collaboration, the majority on both sides point to finance and lending, while insurance and fund management seem less likely. Interestingly, just 1% of financial services respondents believe “financial advice” will be the area for the richest collaborations – while 8% of fintech respondents agreed. It is possible the financial services industry is underestimating the potential in areas such as robo-advice.

When asked specifically which business functions are expected to be the most active areas for collaboration, both sides rank customer engagement near the top (just edged out by the development of digital channels among fintech respondents).

Blockchain is cited as the number one focus for 14% of respondents for both financial services and fintech. Blockchain has been much hyped, due in part to the rise of Bitcoin, which is built on the technology. It’s essentially a highly secure shared or open ledger, which makes the recording of transactions cheaper and faster – an attractive option for any financial services business.

As one fintech respondent explains: “Senior individuals working at a bank over the past 10 to 20 years will have followed a finance-dominated career path. In the technology space, such a path will be fairly limited.” That will change, according to this executive – but until then, collaborating on deep tech like blockchain will remain the norm.

For fintech, a sizeable minority of firms seek to use a larger partner’s scale and brand to gain access to new markets. Among financial services firms, driving down cost and boosting customer engagement are the chief gains.
WHICH FINANCIAL SERVICE SECTOR WILL SEE THE MOST COLLABORATION BETWEEN FINTECH AND TRADITIONAL FIRMS OVER THE NEXT THREE YEARS?

Finance and lending: 60%
Insurance: 18%
Fund management: 19%
Financial advice: 18%
Retirement planning: 2%

WHICH BUSINESS FUNCTIONS WILL SEE THE MOST COLLABORATION BETWEEN FINTECH AND TRADITIONAL FIRMS OVER THE NEXT THREE YEARS?

Better engagement with customers: 22%
The development of non-physical and virtual channels: 26%
Streamlined product application processes: 20%
Blockchain applications: 14%

Big data and analytics for sales and marketing: 8%
Back office solutions that improve and simplify operations: 7%
Improved underwriting or credit referencing: 10%
Robo-advice: 2%
Wearables and other devices: 2%

“Fintech is more than providing technology services to financial services firms. For example, most financial services businesses have been adopting big data.”
And while the vast majority of financial services respondents agree that collaborations with fintech firms have yielded cost savings (87%) and an opportunity to refresh their brand (83%), it’s worth noting that only half (54%) believe they have delivered enhanced revenues. Time will tell how such collaborations will continue to benefit the bottom line.

<table>
<thead>
<tr>
<th>Financial Services: To what extent do you agree with the following statements?</th>
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<tbody>
<tr>
<td><strong>We have already cut our costs as a consequence of collaboration(s) with fintech providers</strong></td>
</tr>
<tr>
<td>Agree strongly</td>
</tr>
<tr>
<td>13%</td>
</tr>
<tr>
<td>17%</td>
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<td>8%</td>
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Fintech pop-ups or establishment stalwarts?

Despite its often trendy reputation, fintech is not the sole preserve of start-ups. Many established financial services firms have their own fintech programmes and collaboration in this area is often between these larger incumbents.

“Established banks, as the survey shows, are using fintech products and services – but we’re also seeing consortiums of banks using fintech products to build shared platforms to address cost and competition issues,” says Peter Dickinson, partner in Mayer Brown’s London office and co-head of the firm’s global Business & Technology Sourcing practice. “Much of the smartest fintech quickly becomes a standard and it pays all the banks to be able to use it.”

This may also help address another significant issue raised by both fintech and financial services respondents around collaboration: system compatibility. Around a third of financial services executives say this is their biggest barrier to working with fintech.
Acquisitions: buying the best
Purchasing products and services from fintech firms is one thing, but joint ventures are something else altogether. A quarter of respondents say they have entered into a joint venture with a fintech firm in the past three years, with almost half intending to do so in the next three.

“Many businesses want something more flexible than a joint venture if they’re not going to make an acquisition,” says Peter Dickinson, co-head of Mayer Brown’s global Business & Technology Sourcing group. “Joint ventures have to be carefully crafted, with clear goals, demarcations and agreements around scope of business, governance, funding and exit. In a fast-moving tech environment, where it’s not always clear what the final goal is going to be, softer, more flexible collaborations usually work better.”

Outright acquisitions have not proven a popular option, with 89% of financial services respondents saying they have done no relevant deals in the past three years and two-thirds saying they don’t plan on any M&A activity over the next three.

“M&A levels generally are pretty low right now,” explains Dickinson. “That’s certainly had a dampening effect on these particular markets – although it is now lifting. But, of course, macro issues will always be a huge factor in deal activity.”

**FINANCIAL SERVICES: HOW MANY FINTECH ACQUISITIONS HAVE YOU MADE IN THE PAST THREE YEARS? HOW MANY FINTECH ACQUISITIONS ARE YOU LIKELY TO MAKE IN THE NEXT THREE YEARS?**

![Chart showing fintech acquisitions](chart.png)

- **Past three years**: 89%
- **Next three years**: 67%
M&A deals in this sector are also subject to plenty of regulatory influences: “Applications for a change of control when you’re dealing with regulated businesses take time, and the FCA needs to take a look at each one,” says Mayer Brown’s Wilkes. “Acquirers can be tripped up if the due diligence is anything other than forensic. And we have seen regulated entities incur fines for non-compliant activities or processes in businesses they have acquired.”

Given both the macroeconomic risks and the sector-specific challenges, why bother buying fintech firms at all?

The main reason financial services respondents cite for purchasing companies is to gain full access to their intellectual property (IP) (49%) and to reduce the competition (23%). A further 14% want to acquire fintech firms to prevent other companies from harnessing the technology.

These objectives require delicate handling. IP, for example, is notoriously difficult in fintech; a combination of open source tools and code, rival firms competing in similar areas and international claims can leave unwary acquirers with less valuable assets than they had assumed.

Personnel are also instrumental in these transactions, says Mayer Brown’s Dickinson: “Often you have people whose vision, attitude and skills are a key part of the value of the business. When their firm is acquired by a larger financial services firm, there can be a culture clash.”

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financial services firm, there can be a culture clash. We see key individuals being given incentives to stay for significant periods post-acquisition (through earn-outs and other deferred consideration mechanisms). But if an individual has made a significant amount of money from the original transaction itself – and they find the ‘big bank’ culture challenging – they may leave and return to a more entrepreneurial environment.”

Finally, it’s worth bearing in mind the objectives of fintech founders/investors. In the survey, 38% of fintech respondents express a preference for flotation as an exit – but 62% reckon acquisition by a financial services firm is the best way to realise value.

For that majority, a key priority must be adopting the processes and disciplines that will stand up to scrutiny.

“Large financial services firms are understandably risk averse and will want to carry out detailed due diligence in relation to any fintech target company,” Dickinson points out. “They want to make certain everything is in order – not just now, but historically. The problem for many vendors in fintech is that they have often prioritised growth and innovation over internal infrastructure and processes, which can negatively impact on financial services firms’ appetite for a deal or the price they are willing to pay.”

FINTECH: WHAT IS THE EXIT STRATEGY OF YOUR FOUNDERS/INVESTORS?

62% Acquisition by a financial services firm
38% IPO
Part 2: Regulation

Waiving the rules

Are regulations blocking further collaboration and M&A between financial services and fintech firms? Regulators such as the UK’s Financial Conduct Authority (FCA) seem keen to find ways to offer suitable accreditation to new fintech players. But compliance risk looms large in the financial services industry and, for fast-moving fintech businesses, the rigours of regulations designed for another era demand attention.

Despite their obvious overlaps in terms of the customers they serve and their areas of expertise, there remain clear divisions between financial services and fintech. One clear example is in their view of the regulatory environment. Technology-driven businesses favour self-regulation; financial services firms – with their deeper experience in compliance issues and perception of regulation as a bulwark against disruptive new entrants – prefer clear regulatory oversight.

Most respondents also feel that fintech companies have an advantage over financial services firms because they are not burdened by legacy businesses that are restricted by regulatory compliance.

WHAT TYPE OF REGULATORY ENVIRONMENT IS BEST SUITED TO THE FINTECH SECTOR?

<table>
<thead>
<tr>
<th>Entirely self-regulated</th>
<th>Generally self-regulated with some limited regulatory oversight</th>
<th>Clear regulatory oversight but with some self-regulation</th>
<th>Tightly defined regulatory regime with little/no self-regulation</th>
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<tbody>
<tr>
<td>1%</td>
<td>60%</td>
<td>76%</td>
<td>13%</td>
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Where no square/pentagon appears, the percentage is zero.
“Regulators say they’re technology neutral, that the platform is not a factor,” says Wilkes. “But it’s undeniable that some regulations are not suited to some of the technology we’re seeing emerge. It may well be that a greater emphasis on competition could deliver the regulators’ objectives better than trying to secure consumer protections in the areas being developed by fintech.”

The survey respondents agree: more than half believe that, in the UK at least, removing regulatory barriers would encourage greater collaboration between the two sides.

The pros and cons of regulation

The vast majority of respondents (83% of those in financial services and 80% of fintech) say the biggest barrier to fintech progress is having the multiplicity of regulatory authorities. Both a perceived lack of understanding of fintech by officials and general inappropriateness of the system to new technologies rank almost as high.
TO WHAT EXTENT DO YOU AGREE WITH THE FOLLOWING STATEMENT: “FINTECH START-UPS SHOULD BE GIVEN ‘SANDBOX’ PROTECTIONS THAT ALLOW THEM TO TRIAL NEW TOOLS AND TECHNOLOGIES WITHOUT HAVING TO SUBMIT TO FULL-SCALE REGULATION”?

TO WHAT EXTENT DO YOU AGREE WITH THE FOLLOWING STATEMENT: “FINTECH START-UPS HAVE AN ADVANTAGE OVER ESTABLISHED FINANCIAL SERVICES COMPANIES BECAUSE THEY DO NOT HAVE LEGACY BUSINESSES THAT ARE CONFINED BY REGULATORY COMPLIANCE”?
“Regulators have traditionally been concerned mostly with downside risk,” says Wilkes. “But fintech firms are driven by the potential to open new avenues and sweep away the old ways, exploring possibilities and finding new upsides.”

That is a cultural gap that’s difficult to bridge. But there are signs that both sides are trying.

“The FCA seems to recognise that it has been very risk averse in the past,” says Wilkes. “It’s encouraging that it is starting to see competition as a more important part of its remit. True, the FCA is still mainly focused on its consumer protection agenda. And there are limitations, imposed by domestic and EU legislation. But there is a growing sense that fintech is unstoppable and ought to be a force for good. We see opportunities for fintech to have richer conversations with the regulators than ever before.”

The FCA’s regulatory “sandbox” and its Innovation Hub project are great examples of that commitment to adapt to the pace of fintech change, and the industry is reacting positively to these moves. For example, 98% of fintech respondents and 72% of financial services respondents agree that fintech start-ups should be given those sandbox protections to test new products and services without the burden of full-scale regulations.

While they agree in principle, it’s worth noting that 60% of fintech respondents “strongly agree” that should be the case, compared with just 23% of financial services respondents – and 29% of financial services executives say they disagree with sandbox schemes.

In fact, many established players view regulatory compliance – and regulations themselves – as a barrier to entry they would rather not see lowered quite so easily. It’s a matter of commercial competition: 99% of financial services respondents agree that fintech start-ups have an advantage over established financial services companies because they do not have legacy businesses that are confined by regulatory compliance. And fintech firms aren’t blind to this advantage – 94% say the same.

But there’s also evidence of genuine concern for systemic risks of light-touch regulation, as one financial services executive points out: “Most of the fintech firms are start-ups, and they need to be monitored thoroughly to prevent security breaches or other errors happening. For this reason it is essential to have a tightly defined regime with no self-regulation at all.”
Navigating the regulatory environment

For financial services businesses buying in discrete products or services, the compliance process is relatively straightforward. Tighter collaborations such as joint ventures and acquisitions present their own challenges.

When financial services and fintech firms collaborate, the majority implement new processes and protocols to protect themselves from regulatory exposure. Almost two-thirds of financial services firms (59%) and fintech respondents (60%) set up third-party companies, free from legacy compliance issues, to protect their parent businesses from regulatory exposure.

HOW HAS YOUR BUSINESS SOUGHT TO PROTECT ITSELF FROM REGULATORY EXPOSURE DURING ITS COLLABORATIONS WITH FINTECH PROVIDERS/FINANCIAL SERVICES SECTOR COMPANIES?*

- Implemented new processes and protocols to govern the venture: 76%
- Set up third-party companies free from legacy compliance issues: 60%
- Made use of existing compliance procedures: 54%
- Built redress and compensation procedures into agreement with venture partners: 36%
- Outsourced responsibility for regulatory compliance to the fintech providers/financial services sector companies: 50%

*Respondents asked to select all that apply
But half of fintech businesses say they are effectively reliant on their financial services counterparts to show compliance: “We outsource the responsibility for regulatory compliance to the financial services sector companies,” one fintech executive explains. “They have a better understanding of the regulations, know all the required actions and how to manage the risks arising out of the application of our technology.”

Should regulations be reduced? If the compliance burden was to get lighter, slightly more than half of respondents on both sides say there would likely be a flourishing of collaboration. “Increased competition” is a distant second, with “enabling smaller providers to grow” sitting surprisingly low in third place (though it may have been assumed that smaller fintech providers would see fewer controls as a growth driver).

Only 13% of financial services and 12% of fintech respondents think fewer regulatory barriers would attract international providers. This is hugely important, particularly in the context of Brexit: thinning out the rulebook, as has been suggested by some economic and political commentators, may not be an optimal strategy after Article 50 is invoked.
“The UK regulators set the tone for many others around the world,” Wilkes points out. “In its approach to fintech, Singapore, for example, follows it pretty closely. The US is, of course, a major centre of fintech innovation and development. But in many ways it’s a more complex regulatory environment, not least because there are more bodies – with 50 states, federal agencies and law enforcement – to deal with.”

The UK, meanwhile, is the fintech capital of the world in terms of practical application of the technology. In 2014, an estimated 51,000 people were employed in the sector in Greater London alone, compared with 48,000 in Greater New York. But cities such as Berlin, Stockholm and Amsterdam are also significant players. For example, according to Cornelia Yzer, Berlin’s senator for Economics, Technology and Research, her city has 70 fintech firms out of 250 in Germany.
With this in mind, respondents see Germany, the UK, the Netherlands and Sweden as the regulatory environments most conducive to fintech. But given that 80% of fintech respondents think the US (despite its regulatory complexities) is a more conducive regime than the EU to their sector, regulators in all of these markets must play their hands carefully.

“In our survey, it’s clear that established financial services players understand the regulatory picture a bit more than some in fintech,” says Wilkes. “That would explain the differing views on what happens next. For companies doing deals – whether they’re in financial services or fintech – having a deeper insight into regulatory evolution is incredibly valuable.”

Fintech: global perspectives

In the ongoing search for the ideal fintech environment, it often comes down to a question of support versus regulation. The US, for example, “has some of the most innovative thinkers in fintech working closely with financial services to create the technology that will define both sectors for the foreseeable future,” says David Beam, Financial Services Regulatory partner in Mayer Brown’s Washington office. But, he cautions that “the regulatory environment can be a challenge – parties on both side will need to tread carefully if they want to avoid long-term hurdles.”

According to Rod Brown, a corporate partner with Mayer Brown in Singapore, some might want to look east for inspiration: “Singapore offers a competitive tax regime, proximity to the fast growing developing economies in South East Asia, a stable and supportive government, a well educated labour pool, access to capital and a regulator prepared to help start-ups collaborate with banks. The introduction of a regulatory sandbox has been particularly popular, allowing start-ups to develop and test new concepts.”

And for those looking for something between east and west, Europe could provide the answer: “Both Berlin and Frankfurt have seen the sector grow at rapid speed. The German Federal Financial Supervisory Authority is exploring how it can provide these young companies with a fair and level regulatory environment,” says Alexander Behrens, Finance partner in Mayer Brown’s Frankfurt office.
The Brexit vote is already affecting sentiment in fintech and financial services. The majority of respondents on both sides of the story believe that uncertainty around the Brexit process will slow the development of the fintech market.

For fintech executives, that pessimistic view is rooted in one key area: the potential lack of access to EU talent if free movement is cut off.

“The uncertainty about business immigration regulation is already affecting plans by major multinational companies that have London as their European headquarters,” says Liz Stern, a partner in Mayer Brown’s Washington DC office, leading the firm’s Global Mobility & Migration practice. “In the face of border restrictions for Britain, basing senior executives in other EU states to allow their free movement in the rest of the region is an option they are considering. Similarly challenging is deciding now, without the benefit of understanding what agreements Britain will reach with other EU states, how to address talent recruitment and planning for the next two to five years.”

While leaders from both camps say the referendum result on its own already makes attracting and retaining EU talent more difficult, fintech executives are much more likely to characterise the problem as “significant” (40%, versus 26% in financial services). In addition, 82% of respondents say they are concerned that access to European markets from the UK will be restricted, as they expect passporting rules will no longer apply after the completion of the disengagement process.

“These are all clearly significant challenges,” says Mayer Brown’s Dickinson. “Right now, there’s default compliance across the EU28. After March 2019 – that’s the current assumption – it’s going to be more problematic for UK firms. And there is a fintech land-grab underway already. Berlin is aggressively wooing London’s fintech firms, for example. For many, the pragmatic solution will be a branch in the UK and one in the EU.”

But it would be wrong to characterise sentiment as exclusively negative. The majority of respondents remain overwhelmingly confident (79% versus 21%) that a post-Brexit UK will be able to conclude free trade agreements.
with countries outside the EU, and 64% expect a lower tax and lower regulation regime to follow.

Almost half of respondents believe that the UK will continue to be an attractive location in which to operate. Additionally, a clear majority of financial services respondents (61% versus 39%) feel that the vote won’t slow M&A or joint venture activity.
“We have invested a large amount in the UK market,” says one optimistic fintech executive. “Brexit will bring problems with freedom of movement and access to the EU. But we think the UK will continue to build on its policies and we expect them to increase the amount of free trade agreements to help companies in the UK get access to the EU market.”

Others are not quite so sanguine – as one financial services executive points out: “Investing in the UK is quite risky now and we are not very optimistic about when the UK will work out trade agreements with the EU and other countries. Movement of people across borders will become stricter, affecting businesses in the UK and this will cause a slowdown.”

But even this difference of opinion could produce positive results, says Mayer Brown’s Wilkes. “Brexit does present opportunities, but it will be some time before it’s clear exactly what they are. For example, one solution to the passporting problem would be to make an EU27 acquisition rather than open up a new office. That could drive M&A deal-flow over the next couple of years.”

Mayer Brown’s Dickinson agrees: “Uncertainty is currently the biggest issue for firms and it is affecting deal activity,” he says. “And it’s not just UK and EU firms that are pausing. Prior to Brexit, US firms saw the UK as a perfect springboard into Europe. The language and culture was an easy fit, they could test the waters in Europe safely and there were already plenty of familiar names in London. Now, they have been given reason to pause. We need real clarity on whether the single market is still on the table or if it’s going to be hard Brexit, if only to make their decision-making clearer.”

The Brexit negotiations are going to be tough and nuanced – even “hard Brexit” proponents concede it’s not a binary option. But when offered a clear choice between membership of the EEA along with EU regulation of financial services versus a typical “hard Brexit” - option, over two-thirds of respondents expressed a preference for continued regulation from Brussels.

For pragmatic fintech executives, this decision is as much about the simplest way of doing business rather than sovereignty or even free access to a diverse talent pool. As one points out, “The final shape of Brexit does not impact us much either way as we have businesses abroad and will expand our business there. A divergence in regulatory approaches will not be good for us as we will have to face different regulations in both regions, along with changes in the tax structures, which can lead to double taxation.”
And when it comes to deal-flow, expect similarly pragmatic approaches.
“For many large financial services firms, investing in a smaller fintech business is a relatively small financial commitment,” says Dickinson. The benefits of exposure to technologies that will drive down costs, boost customer engagement and open up new markets far outweigh potential downsides from various Brexit outcomes.

“Even with the uncertainty, we expect to see plenty of investment and even acquisitions,” Dickinson concludes. “Higher value deals might take longer. But collaborations and deal-making between financial services and fintech are too compelling to be derailed by any outcome from the Brexit negotiations – and will continue however either type of business structures itself in the aftermath.”
Conclusion:

Unstoppable forces, immovable objects

The financial services sector is in the midst of a fintech revolution. Huge opportunities may be on the horizon for both parties as technologies mature but only if lingering uncertainties – both regulatory and geopolitical – can be resolved.

Financial services and fintech firms are engaged in a complicated balancing act at the moment. The complexity and age of the IT systems being used by many financial institutions have left them vulnerable to disruption, whether it be from cloud computing or a tech-native consumer base. They are also far more expensive to run than those built on flexible new platforms. And any brands dented by the financial crisis still running those systems risk being left behind as competitors offer a fresh fintech image.

Fintech companies, meanwhile, have prioritised customer experience at a time when many financial services giants are struggling to align their legacy channels with new expectations. Our survey shows fintech firms are hungry, agile, willing to move jurisdictions for a relatively minor edge on their rivals – and impatient when their counterparties become slow or bureaucratic.

The fintech executives we surveyed were equally clear about the advantages held by their longer-standing rivals (and partners). Experience of regulatory systems, in particular, gives traditional financial services players a highly defensible position in many markets. And most fintech executives understand that they cannot, by themselves, gain exposure to many different geographies. If fintech firms want to expand quickly, the financial services players – with their established operations and a critical mass of customers – are likely to be their quickest route to market.

Despite these tensions, almost every financial services firm has worked with a fintech provider and close to nine out of ten have been happy with the result. Given this track record, both financial services executives and fintech leaders are positive about the prospects for partnerships, joint ventures, investment deals and acquisitions between the two sectors.

Buy or borrow?

Entering formal partnerships with, or acquiring, fintech businesses is far from being risk-free for financial services firms. Three key areas stand out in our survey.
First, targeting young, agile, growth-oriented companies presents difficulties for heavily regulated acquirers. The due diligence process will often uncover processes and relationships that are outside the comfort zone of conservative buyers. Retrofitting a fintech business with controls intended for a regulated entity such as a bank can be challenging.

Second, financial services firms with layers of legacy systems often encounter problems integrating the more modern IT infrastructure of a fintech acquisition. Even in partnership arrangements, fintech executives told us they had struggled to create the seamless systems integration that their models often rely upon.

Third, there is always a risk of culture clash. While more financial services acquirers say taking control of IP was their priority, rather than bringing talent on board, entrepreneurial managers and developers are often key to the success of any fintech innovation. Even with earn-outs or other incentives to stay, financial services cultures that cannot adapt to a lighter, more agile approach may struggle to make a success of their acquisition.

Buy or build around Brexit

Finally, Brexit is clearly a major and still evolving risk for financial services and fintech. Both financial services and fintech firms fear that the loss of access to the single market will necessitate restructuring in order to gain a foothold in the EU27 or maintain trading rights.

Financial services leaders also tend to appreciate the effect that stringent regulations have on restraining competition from less mature fintech-based businesses. Fintech executives would welcome a lower regulatory burden to allow them to carry through innovations to market more quickly. Neither are pleased at the prospect of two years of uncertainty in either the UK or the EU27.

Fear of losing the free movement of workers is forcing many fintech firms, in particular, to consider relocating to Europe – Berlin, Stockholm and Amsterdam being favoured locations. Financial services firms more generally see opening European branches or subsidiaries as a strong option.

Both should consider buying businesses in the EU27 as a fast route into the European market with fewer risks around starting afresh.

“...both financial services executives and fintech leaders are positive about the prospects for partnerships, joint ventures, investment deals and acquisitions between the two sectors.”
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