RAIN OR SHINE FOR LONDON? REEXAMINING THE FINTECH CAPITAL OF EUROPE AFTER BREXIT

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ABSTRACT

The literature on the state of European cross-border financial services post-Brexit has focused on negative downwind economic effects. As such, commentators have not offered a model by which we can predict the future UK-EU relationship from a regulatory perspective to guide firms who may be engaging in contingency planning. This note looks at UK-based fintech firms that provide services in the EU, suggesting that the UK, as the regional market leader, has an advantage in the fintech space over the rest of the EU. It discusses how UK institutions such as the Bank of England, FCA, and HM Treasury have worked to mitigate negative impacts to the UK fintech market. However, fintechs operating on the continent on both sides of the English Channel are dependent on continued easy access to cross-border trade. While recognizing that post-Brexit negotiations may be contentious in social policy arenas, the note concludes that the UK and EU are best served in this space by negotiating an agreement for cooperation in the trade of cross-border financial services.

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INTRODUCTION

Brexit is a product not of concrete policy choices, but rather of social tensions around the British identity and values.[1] Unfortunately, this identity crisis does not translate well to the economic sphere.[2] This is true for the cross-border trade in financial services, where the success of both the United Kingdom ("UK") and European Union ("EU") is largely co-dependent.[3] Much has been written on the downwind economic effects of Brexit for both the UK and EU, including for financial services markets.[4] Commentators initially predicted that the UK, as the smaller player geographically and as measured by GDP, would experience a sharp decrease in jobs, capital, and workforce.[5]

The move from a single market to tariffs, licensure, and ancillary operational costs is expected to negatively affect major sectors of the UK economy, financial services chief among them.[6] The financial services sector accounts for roughly 15% of London's economic output, and 23% of all UK service exports.[7] The UK has maintained a trade surplus in financial services in each of the last 20 years,

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[1] *See* Joseph Sternberg, *The U.K.'s Brexit Journey of Self-Discovery – Crises of identity are common in the West, but Britain's came with an impossible deadline,* WALL ST. J. (Mar. 28, 2019), https://www.wsj.com/articles/the-u-k-s-brexit-journey-of-self-discovery-11553815362?ns=prod/accounts-wsj.

[2] *See id*.

[3] *See* Lionel Laurent, *Let Singapore-on-Thames Fight It Out with Europe*, BLOOMBERG (May 24, 2019), https://www.bloomberg.com/opinion/articles/2019-05-24/brexit-let-the-city-of-london-fight-it-out-with-the-eu.

[4] *See generally* Nauro F. Campos, *B is for Brexit: A Survey of the Economics Academic Literature* (IZA Institute of Labor Economics Discussion Paper Series, IZA DP No. 12134), http://ftp.iza.org/dp12134.pdf for a survey of the economics literature on both short-run and expected long-term consequences of the Brexit vote; *see also* Thomas Sampson, *Brexit: The Economics of International Disintegration,* J. ECON. PERSP., vol. 31 (4), 163-84 (Sept. 2017), http://eprints.lse.ac.uk/84192/1/BrexitDisintegration_Final.pdf for a review of the literature on the likely economic consequences of Brexit and lessons for European and global political integration.

[5] *See* IMF, *Macroeconomic implications of the United Kingdom leaving the European Union*, IMF Country Report 16/169 3-4 (June 2016), https://www.imf.org/external/pubs/ft/scr/2016/cr16169.pdf [hereinafter IMF Country Report].

[6] *See* Philip Salter, *Why EU Passporting is Vital For Britain's Fintech Firms*, FORBES (Apr. 18, 2017), https://www.forbes.com/sites/philipsalter/2017/04/18/why-eu-passporting-is-vital-for-britains-fintech-firms/#71496c90149d.

[7] The financial sector contributed a much higher proportion to London's regional economy (14%) when compared against the UK as a whole (7%). In addition, London represents 50% of all UK financial services. *See* CHRIS RHODES, HOUSE OF COMMONS LIBRARY, BRIEFING PAPER 6193: FINANCIAL SERVICES: CONTRIBUTION TO THE UK ECONOMY, 10 (Apr. 25, 2018), https://researchbriefings.files.parliament.uk/documents/SN06193/SN06193.pdf.

and exports of UK financial services were worth £60 billion in 2017 (the year after the referendum).[8] On the EU side, estimates indicate that 90% of the European wholesale financial services market is located in the UK[9], with 75% of all euro-denominated derivative contracts cleared in London alone, representing approximately €850 billion per day.[10] This note focuses on a small but highly visible subset of the cross-border trade in financial services – financial technologies, or "fintech" firms. In particular, it considers the impact of Brexit on the European cross-border fintech market from the perspective of the UK, which is currently leading a regional sector worth approximately £6 billion.[11] From platforms for peer-to-peer lending, to remittances, digital currencies, online finance and investment, and big data analytics, fintech stands for the universe of alternative solutions to the barriers and inefficiencies surrounding the investment and movement of capital through the traditional banking system.[12]

As of 29 March 2019, the original 'exit day,' the British government was still heading toward an arrangement that would have resulted in a loss of access for UK fintechs to the EU single market following the third defeat of then-Prime Minister Theresa May's deal in parliament.[13] That position did not shift with the election of Boris Johnson as the new Prime Minister on 23 July 2019, who was apparently determined to lead Britain to an exit with or without further

[8] *See id*. at 11.

[9] The authors predict that the UK's share of the European wholesale market will drop to 60% on account of Brexit, with the 30% loss projected to be picked up by Frankfurt, Paris, Dublin, and Amsterdam as the primary hosts of the new EU27 wholesale market. *See* Andre Sapir, Dirk Schoenmaker, Nicolas Véron, *Making the Best of Brexit for the EU27 Financial System* 5 (2017), http://bruegel.org/wp-content/uploads/2017/02/Bruegel_Policy_Brief-2017_01-090217.pdf.

[10] *See* Georges Ugeux, *How to Achieve Equivalence of Financial Regulation in the EU and UK Post-Brexit*, COLUMBIA LAW SCHOOL BLOG ON CORPORATIONS AND CAPITAL MARKETS (Sept. 20, 2018), http://clsbluesky.law.columbia.edu/2018/09/20/how-to-achieve-equivalence-of-financial-regulation-in-the-eu-and-uk-post-brexit/.

[11] *See* Salter, *supra* note 6.

[12] *See* Annette Mackenzie, *The Fintech Revolution*, 3 LONDON BUS. SCHOOL REV. 50, 50-53 (2015), https://onlinelibrary.wiley.com/doi/abs/10.1111/2057-1615.12059.

[13] *See* Daniel Boffey, *Brexit: as May's deal is defeated for third time, the next steps explained,* GUARDIAN (Mar. 29, 2019), https://www.theguardian.com/world/2019/mar/29/brexit-as-parliament-votes-again-what-happens-next; *see also* Press Release, European Council, *European Council (Art. 50) Conclusions* 228/19, (Mar. 21, 2019), https://www.consilium.europa.eu/en/press/press-releases/2019/03/21/european-council-art-50-conclusions-21-march-2019/ [https://perma.cc/SND2-JEWH], where on 21 March, 2019, the European Council agreed to an extension of Brexit until 22 May 2019 provided that the Withdrawal Agreement is approved by the House of Commons by 29 March; otherwise the extension is only valid until 12 April 2019, provided the UK indicates a transition plan before that date.

negotiation.[14] After several extensions, the UK ultimately left the EU on 31 January 2020, and has entered an implementation period until 31 December 2020.[15] During this period, EU law will continue to apply in the UK, and UK fintechs will continue to have access to the EU market, though it remains to be seen on what terms they may access the EU market thereafter.[16]

The note proceeds as follows. Part I provides a brief overview of UK-EU political integration. Part II explains the history of the robust financial culture in London that fostered the growth of London's fintech market. Part III looks at the key players in the UK financial regulatory space: the Bank of England, the Financial Conduct Authority, and the HM Treasury to understand how institutional actors in the UK were able to position its fintech market to withstand political upheaval and economic stress following the Referendum and beyond Brexit. Part IV discusses options for the future of UK fintechs. Finally, Part V discusses takeaways for fintechs operating on the European continent, suggesting that despite pervasive fears of the UK losing its market position in the fintech space, continuing business operations in the UK is advisable over exiting the UK fintech market altogether while the UK and EU inevitably work towards a cooperative arrangement.

I. A BRIEF OVERVIEW OF UK-EU POLITICAL INTEGRATION

The EU began with the European Coal and Steel Community, which was set up after the Second World War in 1950 with six original member states: Belgium, France, Germany, Italy, Luxembourg, and the Netherlands.[17] The goal of the Community was to end the devastating wars between neighboring countries on the European continent.[18] The UK, a victor in the Second World War, was not a founding member.[19] In 1957, the Treaty of Rome created the European Economic Community, and with it, the first "Common Market."[20] The modern-day "Single Market" was established by the Maastricht Treaty on the European Union following the collapse of communism in Europe in 1993.[21] The EU today is built around the four fundamental freedoms – the free movement of

[14] *See* Stephen Castle, *As New Prime Minister, Boris Johnson Faces the Brexit He Championed,* N.Y. TIMES (July 23, 2019), https://www.nytimes.com/2019/07/23/world/europe/boris-johnson-uk-prime-minister.html.

[15] *See* Sharon Kimathi, *What Brexit Day means for the future of fintech,* FINTECH FUTURES (Feb, 1, 2020), https://www.fintechfutures.com/2020/02/what-brexit-day-means-for-the-future-of-fintech/.

[16] *See id.*

[17] *See The History of the European Union*, EUROPA, https://europa.eu/european-union/about-eu/history_en (last visited Feb. 13, 2020).

[18] *See id*.

[19] *See id*ˆ

[20] *See id*.

[21] *See id.*

goods, services, capital and persons.[22] The catch is that this system relies on the cooperation of 28 separate nations with diverse populations, culture, religion, history, government, and traditions. Some have noted that the "values gap" among member states raises questions about the ongoing sustainability of the EU, even beyond Brexit.[23]

The relationship between the UK and its European neighbors over the past several centuries has been ambivalent. From the UK's perspective, Britain was once a formidable empire that stretched across the world, defeated Napoleon, and played a key role in shaping European borders, ideology, and political organization.[24] By the 20th century it remained a powerhouse in Europe – a position it solidified by its victory in both 20th century-wars while other European states were occupied.[25] However, England and mainland Europe are inextricably intertwined. For its part, European pressures such as Viking raids, and the reign of Louis XIV of France, were largely responsible for the formation of the nation state of England and the UK, respectively.[26] European political events and movements such as German Nazism and Soviet communism also always had a way of bleeding into Britain.[27] To this day a large number of the royal families of Europe are related to each other, due to a culture of intermarriage stretching back countless generations.[28] Much like family, Britain alternatively fought with its European brothers, including multiple wars with France, Spain, Russia, and Germany, and also forged various allegiances.[29] Yet an uncertainty endured among the British people, who are still split between those who believe Britain's future is with Europe and those who want an arms-length relationship.[30]

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[22] *See* Nick Chism & Rohitesh Dhawan, *Brexit Basics, The Four Freedoms*, KMPG (Jan. 2017), https://assets.kpmg/content/dam/kpmg/xx/pdf/2017/02/brexit-basics-the-four-freedoms.pdf.

[23] *See* Yaroslav Trofimov, *The Culture War Dividing Europe – Poland and Ireland offer divergent visions of the continent's future,* WALL ST. J. (Mar. 29, 2019), https://www.wsj.com/articles/the-culture-war-dividing-europe-11553872752?mod=cx_immersive&cx_navSource=cx_immersive&cx_tag= contextual&cx_artPos=5#cxrecs_s.

[24] *See* Sternberg, *supra* note 1.

[25] *See* Brendan Simms, *Britain and Europe: a long history of conflict and cooperation*, THE CONVERSATION (June 21, 2016), http://theconversation.com/britain-and-europe-a-long-history-of-conflict-and-cooperation-61313.

[26] *See id.*

[27] *See id.*

[28] *See* Sinead Baker and Samantha Lee, *Almost all the royal families of Europe are related to each other. This family tree shows how they share a single ancestor,* THE BUSINESS INSIDER (Oct. 22, 2018), https://www.businessinsider.com.au/how-europe-royal-families-related-2018-10.

[29] *See id*.

[30] *See* Sam Wilson, *Britain and the EU: A long and rocky relationship*, BBC NEWS (Apr. 1, 2014), https://www.bbc.com/news/uk-politics-26515129.

The UK joined the predecessor to the EU, the European Economic Community (EEC), in 1973 after two failed attempts to do so in 1963 and 1967, both on account of vetoes levied by Charles de Gaulle, then-president of France.[31] European integration was a problem for the UK from the start, and consequently the first referendum on British membership took place in June 1975.[32] Despite no further votes on the subject of leaving between 1975 and 2016, the internal divide in the UK persisted.[33] And so, while the literature diverges as to the results, the event of the referendum on June 23, 2016 may even have been expected.[34] On that day, by a slim margin of approximately 52% to 48%, the UK voted to discontinue its participation as a member state.[35] Thereafter, the Prime Minister formally triggered Article 50 of the Treaty on the European Union on 29 March 2017 and began the two-year period to the UK formally leaving the EU.[36] Predictably, this move has left many questions unanswered, not least of which is the future position of UK fintech firms who regularly provide services in the EU.

II. LONDON AS A CENTER OF EUROPEAN FINTECH

Fintech tend to present either as "sustaining fintech," which refers to solutions developed by established financial institutions that work to integrate new technologies, or "disrupting fintech," which refers to solutions leveraged by new companies challenging established providers with competing products and services.[37] Sustaining fintech may include internal digitization of processes to increase efficiency, such as electronic claims management.[38] Disrupting fintech tends to be more customer-oriented, including tools such as electronic wallets that facilitate payment but also store personal data and loyalty points.[39] Both variants of fintech have popped up in the last ten years in London, where what used to be distinct financial and technology service providers are now

[31] *See* Stefan Haagedoorn, *The historical evolution of EU-UK relations,* COUNCIL OF THE EUROPEAN UNION (June 2, 2017), https://www.consilium.europa.eu/en/documents-publications/library/library-blog/posts/the-historical-evolution-of-eu-uk-relations/.

[32] The 1975 vote ended in a strong victory for remaining in the EEC. *See id*.

[33] *See id*.

[34] *See id*.

[35] *See* Alex Hunt & Brian Wheeler, *Brexit: All you need to know about the UK leaving the EU*, BBC NEWS (Jan. 31, 2019), https://www.bbc.com/news/uk-politics-32810887.

[36] *See* Nigel Walker, HOUSE OF COMMONS LIBRARY, BRIEFING PAPER 7960: BREXIT TIMELINE: EVENTS LEADING TO THE UK'S EXIT FROM THE EUROPEAN UNION, 3 (Jan 24, 2020), http://researchbriefings.files.parliament.uk/documents/CBP-7960/CBP-7960.pdf.

[37] *See* Peter Gomber, Jascha-Alexander Koch, Michael Siering. *Digital Finance and FinTech: Current Research and Future Research Directions*, 87 J. BUS. ECON. 537, 540 (2017).

[38] *See* Thomas Puschmann, *Fintech*, 51 INTL. J. WIRTSCHAFTSINFORMATIK 69, 70 (2017).

[39] *See id*. at 71.

increasingly characterized by partnerships between the two sectors to solve ever more complex problems.[40]

Much of the growth of fintech in London can be attributed to the right people in the right place at the right time. Over 350 banks are based in London, as well as the largest stock exchange in the EU, the head EU offices of all three ratings agencies, and numerous large auditing, law and consulting firms.[41] Though the majority of global fintech investment still flows into the United States, there are more people working in the fintech sector in London than in either Silicon Valley in California or Wall Street in New York City.[42] The proximity of London's fintech industry to key financial, academic, and business resources has allowed fintechs to draw on local talent with high levels of financial literacy, and tap into the regulatory infrastructure underlying financial services.[43] Besides the availability of financial institutions and other infrastructure, London is also well-positioned globally and sits in a time zone right in between North America and Asia, offering an attractive destination for new businesses.[44]

The UK government views investment in fintech as strategically important to maintaining the dominant position of its financial sector.[45] Therefore, the UK has engaged in various programs and appropriated funds to support the expansion of fintech, particularly in London.[46] Tech City UK, founded in 2010, is a private organization dedicated to accelerating digital technology businesses, with £2 million in support per year furnished by the UK government's Department for Digital Culture, Media & Sport.[47] Tech City UK's business

[40] Kat Hanna, *How London's Fintech Sector is Evolving*. THE ESTATES GAZETTE, 39 (Apr. 28, 2018), http://www.cushmanwakefield.com/~/media/global-reports/CW_London_s_Fintech_Ecosyst em_Report.pdf.

[41] *See* Karel Lannoo, *EU Financial Market Access After Brexit*, 51 INTERECONOMICS 255, 256 (2016), https://doi.org/10.1007/s10272-016-0614-y.

[42] *See* Anna Irrera & Sarah Krouse, *Race to be the Big Wheel in Fintech*, FIN. NEWS (Nov. 11, 2014), https://xignite-cdn.s3.amazonaws.com/static/News/Race%20to%20be%20the%20big%20wheel%20in%20fintech_Financial%20News.pdf [https://perma.cc/VJD5-L2M6].

[43] GOVERNMENT OFFICE OF SCIENCE, *Fintech futures: The UK as a world leader in financial technologies* 11-12 (Mar. 2015), *available at* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/413095/gs-15-3-fintech-futures.pdf [https://perma.cc/FGL8-56JR].

[44] *See id*.

[45] *See* GOVERNMENT OFFICE OF SCIENCE, *supra* note 43, at 45.

[46] *See* Michael Mandel & Jonathan Liebenau, *London: Digital City on the Rise*, LONDON SCH. ECON., 7 (Jun. 2014), https://southmountaineconomics.files.wordpress.com/2014/06/london-digital-city-on-the-rise.pdf [https://perma.cc/TRJ9-KWUX].

[47] SQW, *Final Report to the Department for Digital, Culture, Media & Sport - Tech City UK Impact Evaluation* (Oct. 2017), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/663190/TCUK_Evaluation_Impact_Evaluation_.pdf. [https://perma.cc/L7GH-Y7DS].

lifecycle programs that focus on networking and increasing awareness for firms were estimated to have added £11 million of gross value to the UK economy between 2014 and 2017.[48] In addition, the Tech Nation Visa Scheme was launched in 2015 to allow Tech City UK to endorse up to 200 visa applications for internationally recognized professionals in the field of digital technology per year for up to five years in length, with eligibility for permanent settlement under the Tier 1 Exceptional Talent visa framework.[49] Other programs supported by the UK government include computer science offerings in London schools, financial support for businesses willing to train workers in technological skills, and an accelerator for fintech start-ups in London's Canada Square at Canary Wharf.[50] The city has also invested in long-term infrastructure, including upgrading transportation systems to support expanding tech in urban areas in close proximity to existing financial and trading centers.[51]

Various technology firms in London have partnered with financial and business leaders to change the way that people use banks, and to make financial services more accessible, affordable, and transparent. One example can be seen in London-based Zopa, the world's oldest peer-to-peer ("P2P") lending platform, and the first to be awarded a full UK banking license by the Financial Conduct Authority.[52] Zopa was built on the idea of making small-scale credit more affordable by matching consumers directly with lenders.[53] The P2P lending business model creates opportunities for small investors who may have shied away from traditional lending.[54] Where lending generally requires a large amount of capital for diversification purposes, P2P platforms enable even small amounts of money to be spread across a range of business models.[55] In 2015, Zopa announced it was working with Metro Bank, which marked the first such partnership between a retail bank and a P2P platform that simultaneously gave Zopa access to institutional funds and also enabled Metro Bank to tap new returns by facilitating small consumer loans to its customers on Zopa's

Tech City today is known as Tech Nation in an effort to expand beyond London, and has an arm dedicated specifically to helping UK fintech companies at series A funding stage scale. *See* https://technation.io/programmes/fintech/.

48 *See id*. at iii.

49 *See id.* at 3, 28-9.

50 *See* Mandel, *supra* note 47, at 3, 9.

51 *See id* .at 3.

52 *See* Martin Coulter, *P2P Lender Zopa Granted Full UK Banking License,* FIN. TIMES (Dec. 3, 2018), https://www.ft.com/content/a2e0b6fa-f720-11e8-8b7c-6fa24bd5409c; *see also* ZOPA, *Our story,* https://www.zopa.com/about/our-story.

53 *See* Zopa*, supra* note 49.

54 *See* David C. Stevenson, *How to profit from peer-to-peer lending,* MONEY WEEK (Oct. 10, 2013), https://moneyweek.com/288994/profit-from-peer-to-peer-p2p-lending/.

55 *See id*.

platform.[56] London's early start with fintechs like Zopa and its efforts to build a fintech-friendly environment has spurred it to become the regional market leader in fintech on the European continent. [57]

III. KEY PLAYERS IN UK FINTECH REGULATION

A. *Regulatory Hurdles posed by Fintech*

As with any innovation, fintech has strained existing financial regulatory mechanisms.[58] In order to allow for the industry to develop alongside effective regulation that does not hinder growth, it is helpful for regulators to understand the characteristics of fintech that are reshaping how markets are structured, and how investors, customers, and companies access information, financial services, and capital.[59] The challenges for regulators posed by fintech include innovation, disintermediation, industry convergence, low costs, a lack of borders, and democratization.

First, due to fintech's ability to leverage data science and computing power in place of personal networks, the nature and pace of innovation in fintech means that software and other tools can be deployed, accessed, and remodeled at far faster rates than those in the traditional financial system.[60] Second, fintech platforms tend to remove intermediaries (e.g. such as banks in the case of P2P lending) that traditionally served as gatekeepers for regulators.[61] Third, the introduction of fintech into financial services generally has blurred old distinctions between certain industry sectors such that regulators must now look more holistically at each new product or service and cannot rely on former assumptions about the underlying business.[62] Fourth, fintech prides itself on a lack of operational barriers to enter the space; regulators, however, still struggle to calibrate an appropriate level of compliance requirements for companies that cannot afford a full-blown compliance division.[63] Fifth, where financial services were previously subject to national or regional regulatory schemes, fintech regulators now must work together to coordinate an approach to a global marketplace so that fintechs are not subject to duplicative or conflicting

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[56] *See* Tom Groenfeldt, *Zopa, UK P2P Lender, Partners With Metro Bank*, FORBES (March 8, 2016), https://www.forbes.com/sites/tomgroenfeldt/2016/03/08/zopa-uk-p2p-lender-partners-with-metro-bank/#651d8e974d22.

[57] *See* Mandel, *supra* note 47, at 1.

[58] *See* Chris Brummer & Daniel Gorfine, *FinTech: Building a 21st-Century Regulator's Toolkit*, 3 (Oct. 21, 2014), http://www.milkeninstitute.org/publications/view/665.

[59] *See id*.

[60] *See id*. at 4.

[61] *See id*. at 5.

[62] For example, consumer technologies company Apple become subject to financial services regulation with the advent of its Apple Pay product. *See id*.

[63] *See id*. at 6.

regulation.[64] Sixth, in promoting greater access and inclusion, fintech also creates greater risks for uninformed consumers, tasking regulators with a responsibility to educate the public and carefully watch market developments in an environment that generally moves faster than traditional financial services.[65]

B. *The UK's Response*

Due to their exposure to this changing environment, and close relationships with financial institutions that are either innovating in this area or else partnering with fintech terms, UK financial regulatory authorities are well positioned to respond to the challenges posed by fintech.[66] UK authorities have worked to provide regulatory guidance around areas such as crowdfunding and investment-based platforms for marketplace lending, as well as to establish meaningful independent relationships with fintech firms early in their lifecycle.[67] This way, rather than operating via responsive regulation, regulatory bodies are able to get ahead of risks and influence how new products are designed, marketed, and sold to consumers.[68] Perhaps in recognition of the attention the UK has received as the fastest growing fintech hub, the Chancellor of the Exchequer of the UK declared his intention to make the UK a world leader in developing a robust environment for fintech.[69]

C. *The Bank of England*

The Bank of England (the "Bank") is one of the authorities responsible for the safe and fluid integration of fintech into the larger financial services market in the UK.[70] The Bank has been increasingly involved in the development of fintech regulation, including by engaging in projects such as the Future of Finance, which is designed to evaluate the evolution of financial services with an eye toward digitization, increasing use of data, environmental impacts, declining use of cash, and new channels of investment.[71] In a speech given in March 2018, the Bank's Deputy Governor for Markets and Banking suggested that while access to payments and infrastructure has shifted with fintech, the role

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[64] *See id*.

[65] *See id*.

[66] *See id*. at 11.

[67] *See* Jonathan Lawrence, Sonia Gioseffi, Ronnie Yearwood, Shehram Khattak, *FinTech in the UK: Regulating Disruption*, K&L GATES (Jan. 21, 2016), http://www.klgates.com/fintech-in-the-uk-regulating-disruption-01-20-2016/.

[68] *See id*.

[69] *See id*.

[70] *See* Andrew Fawthrop, *Bank of England's fintech hub a priority for 2019, says senior banker*, NS BANKING (Apr. 30, 2019), https://www.nsbanking.com/news/bank-england-fintech-hub/.

[71] *See* BANK OF ENGLAND, *The Future of Finance – our response* (June 2019), https://www.bankofengland.co.uk/research/future-finance.

of banks as intermediaries remains.[72] As a result, the Bank of England feels a responsibility to address the needs of a changing financial sector, which includes considering the role of distributed ledger technology (the tech behind cryptocurrency), RegTech, machine learning and cyber security in the banking system.[73] In addition to assisting in regulatory efforts, ,the Bank is also involved in a number of specific initiatives aimed at supporting the growth of fintech in the UK.[74] It is renewing and upgrading its Real-Time Gross Settlement (RTGS) system through which financial institutions can make real-time payments.[75] It launched a permanent FinTech Hub to build on the success of its two-year FinTech Accelerator program, to allow for testing various "proofs of concepts," like the use of artificial intelligence, directly with fintech firms.[76] It is collaborating with the Bank of Canada and the Monetary Authority of Singapore to solve issues in the cross-border payments system.[77] Above all, the Bank of England recognizes the potential for fintech to stimulate business growth and competition and the Bank's role in this development.[78]

C. *The Financial Conduct Authority*

The Financial Conduct Authority (FCA), established in 2013, is an independent regulator responsible for overseeing the operations of 59,000 financial services firms in the UK in order to protect consumer and markets and promote competition.[79] The FCA has proven willing to tackle some of the substantive challenges that the growth of fintech has posed for financial services. It has been active in establishing relationships with fintechs in an effort to collaborate on the most effective approach to regulation without overburdening

[72] *See* BANK OF ENGLAND, *The Bank of England – Open to Fintech* (Mar. 22, 2018), https://www.bis.org/review/r180327a.pdf.

[73] *See id.*

[74] *See* SIMMONS & SIMMONS, *Bank of England embraces the promise of Fintech* (Mar. 27, 2019), https://www.simmons-simmons.com/publications/ck0bar0a0eo7w0b59g679cjx2/270319-bank-of-england-embraces-the-promise-of-fintech.

[75] *See id.*

[76] *See* Fawthrop, *supra* note 67.

[77] *See* SIMMONS & SIMMONS, *supra* note 75.

[78] *See id*.

[79] The FCA is primarily what is called a conduct regulator, meaning it is concerned with the activities of firms and assessing impacts on consumers. However, it is also the prudential regulator for some 18,000 firms, meaning that for those it will also look to ensure adequate financial resources, appropriate systems and controls, risks to continuity, and other metrics. *See* FIN. CONDUCT AUTH., *About the FCA* (Apr. 21, 2016), https://www.fca.org.uk/about/the-fca; *see also* BAKER MCKENZIE, *United Kingdom: Prudential Regulation – How the UK FCA Assesses Adequate Financial Resources* (Sept. 13, 2019), https://www.bakermckenzie.com/en/insight/publications/2019/09/prudential-fca-regulation.

companies who have yet to fully implement their business models.[80] In doing so, the FCA has worked to find a balance between adequate regulation and encouraging innovation, to ensure that consumers are clearly informed about firms and the products being offered.[81] The FCA has experimented with new regulatory models, including agile regulation, where fintechs brainstorm how they hope to achieve certain regulatory goals; automated regulation, where "fintech regulates fintech" such that regulators can leverage certain fintech innovations, especially in the data sciences; and open-source regulatory platforms that can simultaneously provide data to regulators and would also be available to multiple parties.[82]

In an effort to remove regulatory barriers to innovation, the FCA launched Project Innovate to identify these barriers, especially those that may distort competition or discourage market entry, and work to resolve these to support the development of new products.[83] Other initiatives include an innovation hub – an incubator that helps fintech companies gain access to a fast-track authorization process while fostering an open dialogue to provide feedback on the regulatory implications of various concepts, regulatory "sandboxes" where new products can be tested with customers, and participation in a payments strategy forum in collaboration with the UK Payment Systems Regulator (further discussed in Section 3.5 herein).[84] Not only has this increased the accessibility of the financial services sector for early stage companies, but it also lends credibility to those firms accepted to participate[85]

In order to be eligible for the innovation hub, a firm must first prove that the specific product or service includes innovative characteristics significantly different from existing ones and that the innovation offers considerable benefit to consumers.[86] Thereafter, regulators will work with the business to understand the process of acquiring authorization, which in turn significantly reduces regulatory risks and costs related to navigating complex financial regulatory systems without the benefit of in-house compliance function.[87] The FCA processes applications for authorization to conduct business on behalf of entities

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[80] *See* ERNST & YOUNG, FINANCIAL REGULATION OF FINTECH, 8 (Shahin Shojai) (2015), https://www.ey.com/Publication/vwLUAssets/ey-financial-regulation-of-fintech/$FILE/ey-financial-regulation-of-fintech.pdf.

[81] *See id*. at 12.

[82] *See id*. at 11.

[83] *See id*. at 12.

[84] *See id*. at 12-13.

[85] *See* DELOITTE CENTRE FOR REGULATORY STRATEGY EMEA, *A Journey through the FCA regulatory sandbox* (2018), https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-fca-regulatory-sandbox-project-innovate-finance-journey.pdf.

[86] *See* Hyoeun Yang, *The UK's Fintech Industry Support Policies and its Implications,* 4 (KIEP Research paper, World Economy Brief 17-05) (Feb. 17, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2919191.

[87] *See id*.

participating in the innovation hub separately from generic applications, and also provides additional supervision and support for up to a year after authorization.[88]

The term regulatory sandbox was actually coined by the FCA in 2015, and the concept has since spread to more than 20 countries looking to change the nature of the relationship between regulators and financial services providers and engage in a collaborative dialogue.[89] The FCA's first cohort in 2016 included 18 firms out of 69 submitted applications – of which 15 were startups, including firms working on e-money platforms, cross-border money transfer powered by blockchain technology, micro savings applications, and online platforms for everything from managing personal financial products to charity donations.[90] In 2017, the FCA worked with 24 fintech start-ups from many more applications, suggesting this program continues to show growth despite uncertainties around Brexit.[91]

E. *Section 3.5: The HM Treasury*

The HM Treasury is the UK's economic and finance ministry, overseeing public spending and financial policy.[92] The HM Treasury has also been substantially involved in supporting the UK fintech space. It specifically acknowledged that "making the UK the best place to start and grow a Fintech business" is part of its industrial strategy, seeing as fintech delivers tangible benefits for consumers, including lower prices, more choice, and better service.[93] In line with these goals, the HM Treasury has created a joint government-industry board to identify barriers to fintech growth and operationalized a new Payment Systems Regulator (PSR) in April 2015 to ensure banks and fintech firms can gain access to payment systems on fair terms and that payment systems embrace innovation in the interests of consumers.[94] It also promoted UK fintech internationally via 'Fintech Bridges' with Hong Kong, South Korea, Singapore, and China, contributed £395m to fintech firms and challenger banks through the British Business Bank program, and commissioned a fintech census at the inaugural International Fintech Conference in March 2017.[95] Perhaps most

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[88] *See id*.

[89] *See* Ivo Jenik & Kate Lauer, Regulatory Sandboxes and Financial Inclusion, 1 (Oct. 2017) (on file with the Consultative Group to Assist the Poor), https://www.cgap.org/sites/default/files/Working-Paper-Regulatory-Sandboxes-Oct-2017.pdf.

[90] *See id*. at 13-14.

[91] *See id*. at 15.

[92] *See* HM TREASURY, ABOUT US, https://www.gov.uk/government/organisations/hm-treasury/about (last visited Feb. 13, 2020).

[93] *See* HM TREASURY, FINTECH SECTOR STRATEGY: SECURING THE FUTURE OF UK FINTECH,2-3 (Mar. 22, 2018), https://www.gov.uk/government/publications/fintech-sector-strategy.

[94] *See id.* at 5.

[95] *See id*. at 5-6.

importantly, the HM Treasury ordered the 9 largest UK banks to deliver "Open Banking" – meaning that third party providers, including fintech firms, would be allowed to offer products to existing consumer accounts.[96]

F. *Guidance*

Notwithstanding this robust regulatory environment, that even if Brexit could have been foreseen, the European Union was not designed to accommodate an easy separation by its member states. Most of the modern institutional and regulatory framework underpinning UK financial services was created under EU law.[97] The EU has recognized a single market for financial services since the Second Banking Directive in 1992, pursuant to which member countries agreed to abide by basic rules for banking, investment products and services, and insurance.[98] Of the approximately 5,500 UK-based fintechs, those that currently rely on the ability to provide services in the all EU member states on the basis of their authorization in the UK (a single member state) via a regime known as passporting under the Second Banking Directive stand to lose those rights should a "hard Brexit" conclude without a trade agreement for services in place with the EU.[99] In addition, a hard Brexit would deprive UK fintech firms of access to the free trade agreements set in place between the EU and sixty economies besides those of its member states, and potentially access to the more than sixty agreements under negotiation, with markets including Brazil, Canada, India, Japan, and the United States.[100] Finally, a hard Brexit means losing the benefit of top-down regulation by the EU.[101] This regional approach to regulation is especially useful for hot button issues such as data privacy, in that it facilitates clear expectations around how, for example, to transfer data without duplicative

[96] *See id*. at 6.

[97] The technical issues of separation will need to be resolved separately from political negotiations and any Withdrawal Agreement that may be ratified. *See generally* European Central Bank, Press Release, Statement: ECB and BoE Convene Joint Technical Working Group on Brexit-related Risks, (Apr. 27, 2018), https://www.ecb.europa.eu/press/pr/date/2018/html/ecb.pr180427_5.en.html [hereinafter ECB Press Release].

[98] The Investment Services Directive was later finalized in 1994. *See* Lannoo, *supra* note 41, at 256.

[99] A "hard Brexit" refers to a complete separation with the EU, and in this case, a loss of access to the tariff-free single market and the ability of UK firms to offer services in the EU directly from the UK without separate subsidiaries and licensure. *See* IMF Country Report, *supra* note 5, at 5; *see also* Salter, *supra* note 6.

[100] *See id*.

[101] *See* FINANCIAL CONDUCT AUTHORITY, EU WITHDRAWAL IMPACT ASSESSMENT, 8 (Nov. 2018) (UK), https://fca.org.uk/publication/impact-assessments/eu-withdrawal-impact-assessment.pdf [hereinafter EU WITHDRAWAL].

or conflicting laws, thereby increasing the compliance of firms operating in the space.[102]

All three regulatory arms discussed in Part III have been active in issuing continually updated guidance for people and business in the months of uncertainty leading up to Brexit. The Bank of England has partnered with other UK authorities and private firms to engage in extensive contingency planning since 2016.[103] The Bank's Financial Policy Committee, through simulations known as stress tests, identified risks of disruption to the financial system in the wake of a hard Brexit, including significant re-pricing in financial markets, barriers to cross-border services, a depreciating exchange rate, and high interest rates.[104]

On the regulatory side, to mitigate the risk of barriers to cross-border service provision, the Bank worked with the UK Parliament to pass legislation allowing for a Temporary Permissions and Recognition Regime that enables continued access to financial services offered by companies in other EU member states for UK residents and entities.[105] The Bank continues to track 60-some odd pieces of domestic legislation currently in Parliament to ensure the regulatory framework remains workable when the UK is no longer a member of the EU.[106] The Bank's Financial Policy Committee publishes a quarterly checklist of progress towards mitigation of Brexit-related risks.[107] The Bank additionally collaborates with the European Central Bank through a special working group on cross-border financial issues.[108]

On the monetary policy side, with respect to re-pricing and the exchange rate, through the same stress tests, the Bank has identified appropriate levels of capital and liquidity to withstand the level of economic shock expected from a hard Brexit with no implementation period.[109] In fact, the capital ratio (percentage of

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[102] The EU Commission allows for the transfer of personal data inside the EEA as well as to certain recognized countries including the USA, it regulates the transfer of personal data to third country recipients outside of these, for which the GDPR requires certain safeguards, whether by contract or otherwise. *See* SEAN O'DONNELL, GDPR IMPLICATIONS OF A "NO DEAL" BREXIT ON PERSONAL DATA TRANSFER IN THE UK (Byrne Wallace, 2019), https://www.lexology.com/library/detail.aspx?g=df5f0a10-a267-4ed0-b5a4-46023a1b752e.

[103] *See generally* BANK OF ENG., FINANCIAL STABILITY REPORT i. (Nov. 2018), https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2018/november-2018 [hereinafter BANK, FIN. STABILITY REP.].

[104] *See id*. at 18-21.

[105] *See id*. at 27. However, access to EU financial services is determined by the EU and member states, so legislation needs to appear on both sides to be effective.

[106] *See id*. at 29.

[107] *See* Mark Carney, Governor of the Bank of England, Speech to the Society of Professional Scientists: Guidance, Contingencies and Brexit (May 24, 2018), https://www.bankofengland.co.uk/-/media/boe/files/speech/2018/guidance-contingencies-and-brexit-speech-by-mark-carney.pdf.

[108] *See* ECB Press Release, *supra* note 98.

[109] *See* BANK, FIN. STABILITY REP., *supra* note 104, at 17.

capital relative to risk-weighted assets) of major UK banks in 2018 was nearly three and a half times higher than before the 2007-2009 financial crisis – as such, any losses can be absorbed by available capital.[110] With respect to high interest rates, the Bank has chosen to levy support for jobs and activity at a time when the economy is slowing by spreading out the timeline for returning the interest rate to 2% past the 18-24 month standard as the UK moves to new trading arrangements.[111] Further, on 20 March 2019, the Bank of England's Prudential Regulatory Authority (PRA), together with the FCA and European Banking Authority (EBA) announced a Memorandum of Understanding setting out expectations for continued supervisory cooperation up to and beyond the original exit date of 30 March 2019, to provide for the smoothest possible transition for UK and EEA citizens and firms alike.[112]

The FCA too has been very responsive to concerns as to the post-Brexit environment raised by various firms currently relying on passporting permissions to conduct business in the EU with a UK license.[113] The FCA is simultaneously preparing for a transition period through December 2020 as well as the possibility of a "hard Brexit."[114] The FCA is working closely on gap-filling any regulatory concerns with the HM Treasury, and on developing a legislative framework that would allow for a smooth transition from EU rules to UK rules in collaboration with the Bank of England's PRA.[115]

In addition, the FCA has urged firms to stay up to date with published guidance on servicing its UK and EEA customers in the event of a no-deal Brexit, including information on what should be communicated to consumers.[116] Specific information is available on the FCA's website for firms operating in the UK's five key financial services sectors: (1) banking and payments, (2) life insurance, pensions and retirement income, (3) general insurance, (4) retail investment, and (5) wholesale banks, markets and asset managers.[117] This includes information such as the notification that on 7 March 2019, the UK received approval to continue participation in the Single Euro Payments Area (SEPA) scheme, as well as the notification that confirmed the ability of UK

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[110] *See id*. at 1, 3; *see also* Press Release from the Bank of England, Fin. Policy Comm. Statement from its Policy Meeting 2 (Oct. 3, 2018), https://www.bankofengland.co.uk/-/media/boe/files/statement/fpc/2018/financial-policy-committee-statement-october-2018.

[111] *See* Carney, *supra* note 108 at 10-11.

[112] *See* Press Release, Fin. Conduct Auth., PRA and FCA agree Memorandum of Understanding (MoU) with EBA (Mar. 20, 2019), https://www.fca.org.uk/news/press-releases/pra-and-fca-agree-memorandum-understanding-mou-eba.

[113] *See* EU WITHDRAWAL, *supra* note 102, at 2-3.

[114] *See id*. at 2.

[115] *See id*. at 10.

[116] *See* Press Release, Fin. Conduct Auth., FCA released updated guidance on EU departure preparations (Feb. 27, 2019), https://www.fca.org.uk/news/press-releases/fca-releases-updated-guidance-eu-departure-preparations.

[117] *See id*.

businesses to continue to use clearing services provided by EU-based clearing houses under a temporary recognition regime.[118]

Meanwhile, the HM Treasury continues to insist that the majority of residents and organizations located in the UK will see little or no impact on their daily lives, and will be able to use and rely on their bank accounts, insurance, personal pensions or annuities and other financial services whether provided by a firm based in the UK, the EU, or elsewhere in the world.[119] The Treasury has worked with Parliament and other regulators to ensure that financial services providers based in the EU, Norway, Liechtenstein, and Iceland may continue to provide services in the UK for a minimum of three years after Brexit, and that UK citizens and firms can continue to make and receive payments denominated in Euro, to pay and be paid by merchants in the EEA, and send and receive payments to accounts with EU-based providers, although admittedly these transactions may become more expensive.[120] At a time when the political landscape is constantly changing and no one has concrete answers about how Brexit will play out, UK supervisory authorities have proven to be responsive and prepared for a variety of scenarios.

IV. OPTIONS FOR UK FINTECH IN LIGHT OF BREXIT

A. *"Hard Brexit"*

At the outset of the 2016 referendum, Britons generally favored one of two options: either a "soft" Brexit in which the UK economy maintained its economic, but not political ties to the EU, or else a "hard" Brexit, or total economic and political separation of the UK and EU.[121] Though alternative structures have since come to light, a total separation is still possible and perhaps most likely.[122] After much back and forth, a revised Withdrawal Agreement and Political Declaration was considered and agreed by the European Council and the United Kingdom on 19 October 2019, setting forth the UK's exit from the EU to take effect on 31 January 2020, and a framework for negotiating the future

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[118] *See id*. SEPA is an integrated market for euro payments in the Eurozone, resulting in faster and cheaper transactions across member states as compared to traditional bank transfers. *See generally List of Abbreviations Used in Bank Funds Transfers*, IBAN, *available at* https://www.iban.com/glossary.

[119] *See* HM TREASURY, GUIDANCE – FINANCIAL SERVICES FOR UK RESIDENTS, BUSINESSES AND ORGANISATIONS IF THERE'S NO BREXIT DEAL (Mar. 12, 2019) (UK), https://www.gov.uk/government/publications/banking-insurance-and-other-financial-services-if-theres-no-brexit-deal/1banking-insurance-and-other-financial-services-if-theres-no-brexit-deal-information-for-uk-residents-and-businesses.

[120] *See id*.

[121] *See* Hellen Lewis, *How Britain Came to Accept a 'No-Del Brexit'*, THE ATLANTIC (Aug. 22, 2019), https://www.theatlantic.com/international/archive/2019/08/how-no-deal-brexit-became-new-normal/596524/.

[122] *See id*.

relationship between the EU and UK, including an implementation period to last until 31 December 2020.[123] The European Union (Withdrawal Agreement) Act 2020 was then passed by the UK Parliament on 23 January 2020 to give effect to the Withdrawal Agreement in UK law.[124] However, if the EU and UK do not agree on the details of their future economic relationship by 31 December 2020, or otherwise agree to a further extension of the implementation period by 30 June 2020, then the UK shall thereafter hold the same position in relation to the EU as any other third country, meaning that its access to the EU market shall be determined by default World Trade Organization (WTO) rules in conjunction with national member state rules and EU-level rules.[125] The WTO has a list of tariffs and quotas organized by trade sector that are applicable to its 164 members (including the UK) that do not have free trade agreements with each other.[126] While this will allow the UK to establish an independent trade policy in its own right, the UK represents a much smaller market on its own than it did as part of the EU, which may result in less attractive trade deals.[127] Specifically for financial services, the EU is the UK's largest export market, and so the greatest effect will be felt with respect to UK-EU cross-border service provision.[128]

In a "hard Brexit" scenario, EU legislation that is not automatically applicable to the UK would have to be converted into domestic UK legislation via the EU (Withdrawal) Act 2018 and thereafter implemented by the UK Government.[129]

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[123] *See* HM GOVERNMENT, STATEMENT THAT POLITICAL AGREEMENT HAS BEEN REACHED AND THAT THE UNITED KINGDOM HAS CONCLUDED AN AGREEMENT WITH THE EUROPEAN UNION UNDER ARTICLE 50(2) OF THE TREATY ON EUROPEAN UNION, 1 (Oct. 19, 2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840658/Statement_that_political_agreement_has_been_reached_and_that_the_United_Kingdom_has_concluded_an_agreement_with_the_European_Union_under_Article_50_2__of_the_Treaty_on_European_Union.pdf.

[124] *See* BANK OF ENGLAND, *EU (Withdrawal Agreement) Act 2020*, https://www.bankofengland.co.uk/eu-withdrawal/eu-withdrawal-agreement-act (last visited Mar. 4, 2020).

[125] In practice, this means that the UK would have to negotiate a trade agreement that will be less favorable than a tariff-free trade environment. *See* Chris Morris, *Brexit: What is the 'no deal' WTO option*, BBC NEWS (July 29, 2019), https://www.bbc.com/news/uk-45112872; *see also* PRICEWATERHOUSE COOPERS, *Brexit and beyond timeline* (Jan. 28, 2020), https://www.pwc.co.uk/eu-referendum/images/brexit-timeline-master.pdf.

[126] *See id*.

[127] *See id*.

[128] *See* Lannoo, *supra* note 41, at 256.

[129] The EU (Withdrawal) Act 2018 repeals the European Communities Act 1972, which in effect would render EU legislation void in the UK apart from preserving existing UK law implementing EU obligations. In addition, when converting directly applicable EU legislation to domestic UK legislation, the Act preserves the ability to amend the original EU legislation to fit UK conditions. To this end, the HM Treasury and the Bank of England are in the process

UK fintech firms that currently rely on passporting into the EEA would need to meet local authorization requirements, perhaps through temporary permissions in the short-term but ultimately through licensing operations in a member state.[130] This scenario, though favored by conservative Brexiteers, would hurt both the UK and EU. On the other hand, despite every indication of an economic downturn, the fintech industry in the UK has expanded rapidly in the last ten or so years.[131] But even though it may be unlikely that the UK's position with respect to fintech will be dismantled, it can certainly be weakened by individual competing European cities drawing some firms to relocate or obtain licenses.[132]

B. *Delay Transition*

Although as of 31 January 2020, the UK already exited the EU, the UK and EU may extend the current implementation period to 31 December 2022 (though this is not favored by the UK government)[133] This would allow the UK to retain passporting rights through a temporary permissions regime (TPR) as well as access to networks and information systems established under EU law.[134] During the implementation period, though the UK is no longer be able to participate in EU decision making, EU law, including any new laws ratified during the period, continue to apply in the UK.[135] Such an implementation period may be preferable to the hard Brexit scenario in terms of the reduced risk of disruption to UK financial services.[136] However, the UK's ability to mitigate risks by legislation to allow for some cross-border continuity would depend heavily on the willingness of EU partners, especially the European Securities and Markets Authority (ESMA) and the European Central Bank to cooperate and legislate in

of drafting around 60 Statutory Instruments (SIs) to tailor converted EU legislation. *See* EU WITHDRAWAL, *supra* note 102, at 10.

[130] Licensing in each member state is dependent upon national rules. In addition, there is no consensus on temporary permissions, with each state that decided to allow for this focusing on the subset of the financial services sector most important to them. For example, Germany implemented a transitional period for banking and financial services, while other states have only enacted such regimes for investment or legal services. *See* Gustav Korobov, *No-deal Brexit negative effect for Payment Service and E-money Institutions authorized in the UK*, FINEXTRA (Mar. 12, 2019), https://www.finextra.com/blogposting/16796/no-deal-brexit-negative-effect-for-payment-service-and-e-money-institutions-authorised-in-the-uk.

[131] *See* Mandel, *supra* note 47, at 10.

[132] Joe Wallen, *Will Europe's Emerging Fintech Cities Rival London in 2019?,* FORBES (Dec. 5, 2018), https://www.forbes.com/sites/joewalleneurope/2018/12/05/will-europes-emerging-fintech-cities-rival-london-in-2019/#603c74df32d2.

[133] *See* PRICEWATERHOUSE COOPERS, *supra* note 127.

[134] *See id*. at 13, 15, 17.

[135] The Financial Conduct Authority would lose the right to participate in European Supervisory Authorities, meaning that the UK would be potentially subject to EU rules where UK authorities have not played a role in decision making. *See id*. at 4, 21, 23.

[136] *See id*. at 3.

a similar fashion.[137] For example, the UK and EU may undertake 'equivalence assessments' to facilitate market access in place of passporting.[138] This means the two governments may decide that their respective supervisory frameworks are equivalent while still retaining autonomy over how to meet their own standards.[139] However, such equivalence determinations are by no means mandatory and may also be limited under European legislation to particular subsets of the financial sector.[140]

Barring an extension, by 31 December 2020, the UK and EU would expect to agree on a future trading relationship and a structured plan to cooperate on regulatory matters.[141] Notably, unlike the Withdrawal Agreement negotiated by Theresa May's government in November 2018, which proposed a 'Backstop' clause that if a future trade deal was not agreed by 31 December 2020, the UK would remain within a single customs territory for imports and exports, the revised Withdrawal Agreement negotiated by Boris Johnson's government contains no such arrangement save for with Northern Ireland (which will otherwise apply EU customs rules)..[142] While a further extension of the implementation period may simply delay the inevitable, it has the advantage of providing more time for both sides to mitigate the impact of a hard Brexit and also to continue to work towards a mutually beneficial arrangement.

C. *Other Alternatives*

Other less probable possibilities for the UK post-Brexit include (or else included prior to the UK's exit on 31 January 2020[143]) EEA membership or the

[137] Another consideration is that the EU will have parliamentary elections and appoint a new European Commission in 2019, making it more important for the UK to carry on involvement in policy decisions in order to be able to avoid disruption to financial services. *See id*. at 4-5.

[138] *See id*. at 15.

[139] *See id*. at 15, 27.

[140] *See id*. at 15.

[141] *See id*. at 5, 21.

[142] Theresa May's Withdrawal Agreement provided for a single customs territory only for imports and exports and not financial services, where market access would have been decided by each member state. The UK would also have been able to legislate on matters concerning EU access to its financial services notwithstanding the customs territory. *See id*. at 22; *see also* HOUSE OF COMMONS LIBRARY, BRIEFING PAPER 8713, 5-6, (Oct. 17, 2019), https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8713#fullreport for a more nuanced discussion of the changes to the protocol on Ireland/Northern Ireland and the previous 'backstop' that would have kept the UK in the EU customs union.

[143] The UK ceased to participate in the EEA after its withdrawal from the EU on 31 January 2020, and the future trade relationship between the EEA states and the UK after the implementation period laid out in the revised Withdrawal Agreement will have to be agreed in the post-Brexit negotiations. *See* Simon Lovegrove, *Financial Services: Regulation Tomorrow, Is the UK still a member of the EEA?,* NORTON ROSE FULBRIGHT (Feb. 4. 2020), https://www.regulationtomorrow.com/eu/is-the-uk-still-a-member-of-the-eea/.

successful negotiation of a bilateral agreement.[144] First, in the "soft" Brexit or the "Norway option," the UK could leave the EU but remain in the European Economic Area (EEA), after which it could continue to participate in the single market.[145] This means it would largely be subject to the EU regulatory scheme, including the ability to benefit from the four fundamental freedoms, in exchange for a contribution to the EU budget, though it would effectively be outside the Customs Union and so would retain sovereignty in its trade agreements.[146]

Second, the UK could negotiate some form of free trade agreement (FTA) with the EU, which could range from a basic FTA covering trade in goods, to a bilateral agreement for specific sectors, such as the tariff and quota-free agreement with Switzerland on insurance (but not financial services), to a bilateral agreement covering all financial services to the exclusion of other trade sectors.[147] A bilateral agreement covering financial services using regulatory equivalence rules may, however, place the UK under the jurisdiction of some EU financial services regulation,

making this option seem in actuality not all that far off from EEA membership.[148] However, at this point in the UK-EU Brexit negotiations, it is far more likely that the process will conclude either with a hard Brexit following the expiration of the implementation period on 31 December 2020, or else a narrow trade agreement for specific sectors.

D. *The Post-Brexit Regime*

Once the relevant implementation period for Brexit concludes, assuming any restricted trade arrangement will be costlier than trading in a single market, one interesting question is what, if any, actions firms can take to mitigate losses on both sides. In other words, how should fintech firms respond to restricted market access? Another open question is around data sharing and enforcement of regulations. Responses by UK supervisory authorities as to trade access post Brexit were discussed in Part III. However, the single market also provided the benefit of shared data systems and cooperative market oversight.[149] With respect to data sharing, a lack of cooperation in this area could hurt each side's ability to adequately engage in transaction reporting and thereby track market abuse

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144 *See* IMF Country Report *supra* note 5, at 7-8.

145 *See id*. at 7.

146 *See id*. at 8.

147 *See id*. at 7-8.

148 If viewed on a spectrum, an FTA should give the UK more independence than EEA membership. However, there are trade-offs that come with the access attached to an FTA, and it is difficult to predict the level of compliance with EU regulations that will be required as this depends on the particular arrangement. For example, Switzerland is not an EEA state and therefore has no passporting rights; instead it maintains an FTA with the EU covering certain sectors. This comes with the consequence of foregoing independence with respect to setting an immigration policy. *See id*. at 8, 46

149 *See* EU Withdrawal, *supra* note 103 at 16.

and understand new market developments.[150] Similarly, with respect to enforcement sharing, disallowing free flows of information may have serious implications for law enforcement activities that rely on shared information systems such as Europol.[151]

Interestingly on the issue of data sharing, the UK has said it intends to continue to allow the free flow of data after Brexit, while the EU's position would require companies transferring personal data from the EU to the UK to find alternative GDPR-compliant mechanisms.[152] On this front, the UK, as a single state, seemingly has more to lose by being cut off from open data and enforcement mechanisms pertaining to the entire EU. On the other hand, independent of its EU membership, as a leader in financial services, the UK is fully engaged with global standard setting bodies that shape financial services legislation, potentially even more so than the European Commission.[153] This data sharing analysis suggests that when looking at nearly any facet of post-Brexit life for fintechs on the continent, one comes back to the concept of UK-EU co-dependence.

V. LESSONS FOR FINTECH FIRMS

Despite the difficult economic environment that resulted from the June 2016 Referendum, the UK, and particularly London, retains the necessary infrastructure and favorable regulatory climate to sustain its position in the European fintech space. 70% of fintech investment in the first quarter of 2017 after the Referendum was consolidated in traditionally strong financial centers, with London fintech firms receiving three times as much investment as the second-place city, Berlin.[154] Other cities actually lost out on investment in the aggregate, suggesting that London firms are managing to whether the storm.[155] And yet, this must be balanced against operating in an inevitable economic downturn. It is still predicted that the UK's decision to leave the EU will have a significant negative macroeconomic impact, including £22.5 billion in increased tariffs and up to 12,000 lost jobs that will trickle down into the UK's financial services sector.[156] After the referendum, the Sterling depreciated significantly and still remains some 15% below its late-2015 peak, while interest rates rose well above the target 2% to a peak of 3.1%.[157]

[150] *See id*. at 16-17.

[151] *See id*. at 18.

[152] *See id*. at 16.

[153] *See id*. at 25.

[154] *See Six European Cities Attract 70% of All Investments in European Private Fintech Companies*, GLOBAL BANKING & FINANCE REVIEW (June 16, 2017), https://www.globalbankingandfinance.com/six-european-cities-attract-70-of-all-investments-in-european-private-fintech-companies/.

[155] *See id*.

[156] *See* Wallen, *supra* note 132.

[157] *See* Carney, *supra* note 108.

Perhaps in response, as many as one hundred fintech firms are purportedly considering relocation, including TransferWise, the $1.6bn money remittance service well-known in the UK.[158] Others, including digital banking giant Revolut and Google's parent company Alphabet obtained licenses in EU states such as Lithuania, which offers the benefit of a three month processing time for electronic money institution license applications, in comparison to a year-long licensing process in Luxembourg, Ireland, or Belgium.[159] Lithuania also runs a sandbox much like that in the UK to allow fintechs to test products, and has increasingly been cited as an attractive location for its favorable regulatory environment and tech-savvy workforce.[160]

On balance, it is still likely that London will continue to be a fintech center regardless of whether a "hard Brexit" concludes on 31 December 2020 in the event that the UK is left without a trade deal at the end of the current implementation period. o.[161] Conscious efforts on the part of the UK, and the city of London in particular, to create a tech community, in combination with an educated workforce, a strong financial culture, an infrastructure of support services, and government support and investment into technology, have all contributed to the continued growth and resilience of UK fintech.[162] As a short-term solution, UK fintechs may need to consider forming a subsidiary or otherwise acquiring regulatory authorization in another member state in order to ensure that they can continue to provide financial services in the EU after the implementation period ends. They may likewise transfer contracts to a separate legal entity with appropriate regulatory permissions, or else rely on properly licensed third parties/partners for cross-border activities.[163] It is also advisable to continue operating in the UK in parallel, since, in addition to cross-border trade, the UK is a leader in digital transformation, with the highest percentage

[158] *See* Wallen, *supra* note 132.

[159] In fact, as of February 2019, Lithuania has issued 83 licenses, making it second only to Britain out of EU countries. *See* Andrius Sytas, *Lithuania Sees Flood of Fintech Firms Apply For Licenses Ahead of Brexit*, REUTERS (Feb. 8, 2019), https://www.reuters.com/article/uk-lithuania-fintech/lithuania-sees-flood-of-fintech-firms-apply-for-licences-ahead-of-brexit-idUSKCN1PX15X; *see also* Mekebeb Tesfaye, *Google just nabbed an e-money license – and it highlights the serious threat tech companies pose to incumbent banks*, BUSINESS INSIDER (Dec. 27, 2018), https://www.businessinsider.com/google-secures-lithuania-emoney-license-2018-12, explaining that Facebook licensed in Ireland in 2016, while Amazon Payments licensed in Luxembourg.

[160] *See* Vicky Baker, *From Brexit with love: Lithuania sees its chance*, BBC NEWS (Feb. 6, 2019), https://www.bbc.com/news/world-europe-46670752.

[161] *See* Wolf-Georg Ringe, *The Irrelevance of Brexit for the European Financial Market,* 3-4 (University of Oxford Legal Research Paper Series, Paper No. 10/2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2902715.

[162] *See* Mandel, *supra* note 47, at 1.

[163] Relying on partners, however, is notoriously more expensive than direct service provision. *See* EU Withdrawal, *supra* note 103, at 14.

of GDP of all EU states based in its digital economy.[164] Given the co-dependence of the European fintech market, the UK and EU may come to a mutually beneficial arrangement that make parallel operations less costly and cumbersome than they now appear prior to the current 31 December 2020 deadline.

CONCLUSION

Despite a growing literature around the implications of Brexit as measured by various performance metrics underlying the UK and EU financial markets, the future for fintech serving the European market, and in particular for firms now relying on passporting rights, is unclear. What is clear is that in the short term, Brexit, and particularly a hard Brexit, has already and will continue to hurt both the UK and EU economies. This impact will likely be felt by UK fintechs in that they, along with all UK businesses in the coming years, may be faced with weak economic growth prospects and decreased consumer and business investment due to uncertain market conditions.[165] In this vein, London lost its place as the world's top financial center in 2018 to New York City, after a five-year reign in the top spot[166] due to what commentators are calling "the biggest challenge to the City of London's finance industry since the 2007-2009 global crisis."[167]

Passporting has been undeniably crucial to the growth and success of the sector on both sides. Specifically from a UK perspective, approximately 43% of the UK's financial services exports land in the EU, and 34% of imports are from the EU.[168] Immediately following the referendum in late June and into early July of 2016, the Bank of England estimated that the average equity price of UK-focused companies fell by 10%, and the Sterling exchange rate index fell by 9%, pushing up the price of imported goods and services and squeezing consumer spending.[169] In addition, through stress tests the Bank estimated that GDP would fall overall by 8%, and that unemployment would peak at 7.5%.[170] And not least of all, firms engaging in a variety of contingency planning could cause market fragmentation and increase cross-border risk, as well as increase costs for consumers by reducing competition in any single market.[171]

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[164] *See* SQW, *supra* note 48.

[165] *See* BANK, FIN. STABILITY REP *supra* note 105, at 22.

[166] *See* Cat Rutter Pooley, *London slips further behind New York in financial centre rankings*, FINANCIAL TIMES (Sept. 19, 2019), https://www.ft.com/content/b8ab7f22-daac-11e9-8f9b-77216ebe1f17.

[167] *See* Andrew MacAskill, *London loses top spot to New York in financial survey due to Brexit*, REUTERS (Sept. 12, 2018), https://www.reuters.com/article/us-britain-eu-financialcentres/london-loses-top-spot-to-new-york-in-financial-survey-due-to-brexit-idUSKCN1LS16I.

[168] *See* Rhodes, *supra* note 7, at 3.

[169] See BANK, FIN. STABILITY REP., *supra* note 100, at 22, 26.

[170] See BANK, FIN. STABILITY REP., *supra* note 100, at 22.

[171] *See* EU WITHDRAWAL, *supra* note 102, at 3.

However, by assuming that economic consequences stemming from price movements and other market conditions is the focal point of the inquiry, the literature on implications for financial services has failed to connect the problem to the larger UK-EU relationship. And so, despite offering highly technical solutions such as "quasi-passports" in the short-term,[172] commentators have not suggested a model by which we can predict the future of the market. By contrast, this note has looked at what the UK and the EU each stand to gain and to lose in the operation of the fintech market post-Brexit. Only by first understanding the stakes in each position can we try to predict the regulatory position to be agreed between the UK and EU.

For the EU, London's historical stronghold over financial services in Europe means that the benefits of continued participation in the UK fintech market are likely to outweigh any uncertainties associated with Brexit. In turn, for the UK, its position as a market leader is dependent on the EU as a trading partner. What this means is that firms on both sides are best served by continuing to find ways to engage in the cross-border fintech trade as it stands today – with low infrastructure and regulatory costs. Therefore, decision makers in the UK and the EU are similarly best served by formulating a cooperative agreement around the trade in financial services, despite the ongoing debates in other areas, such as immigration policy, that may be affected by Brexit.

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[172] *See* Mark Compton, Alexandria Carr, Guy Wilkes, Alexander Behrens, *Brexit: What Are The Options For The Financial Services Industry*?, 17 J. INV. COMPLIANCE 4, 45 (2016).