

The Impact of FinTech on Financial Services Businesses

Jacob Ghanty, Partner, London

Todd Gibson, Partner, Pittsburgh

Rodney Smyth, Consultant, London

Tom Wallace, Partner, London

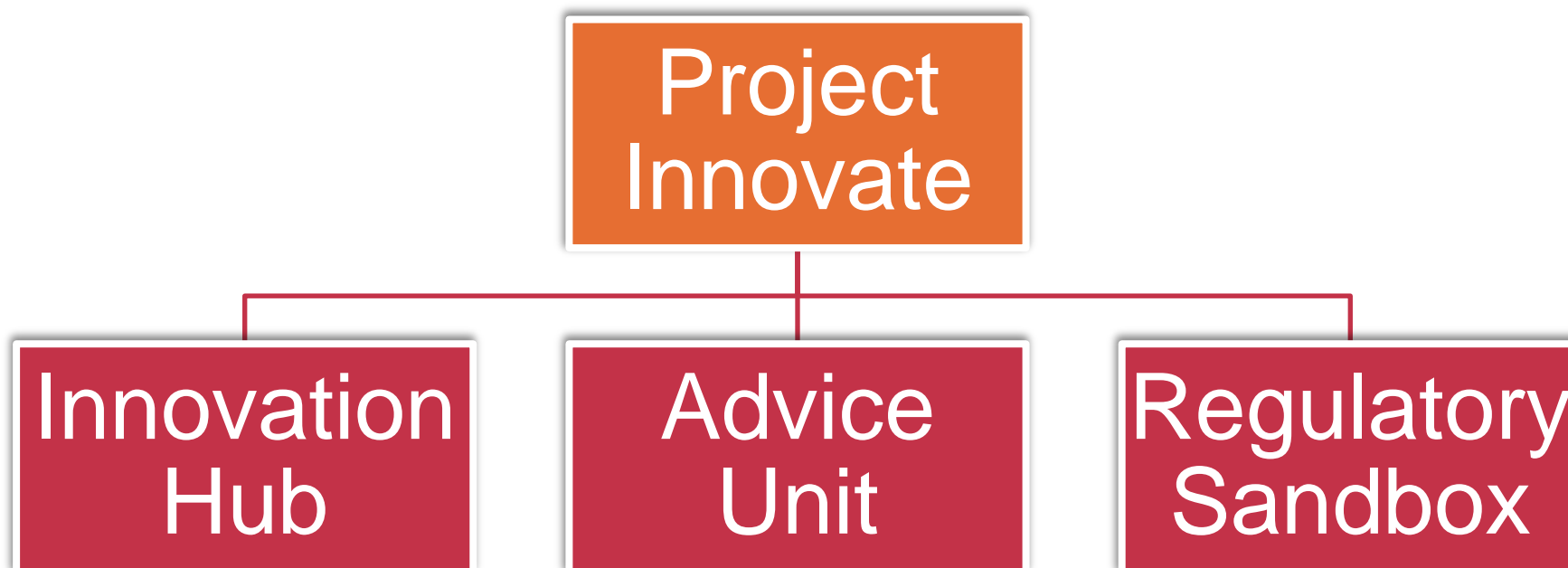
OVERVIEW

- Crowdfunding, Blockchain and Robo Advice – *Todd Gibson*
- FinTech and Corporate Activity – *Tom Wallace*
- Platforms – *Jacob Ghanty*
- Social Trading – *Rodney Smyth*
- Panel discussion

WHAT IS FINTECH?

- In the investment management context FinTech includes:
 - Platforms
 - Use of blockchain
 - Robo Advice
 - Technology to support regulatory reporting (so-called “RegTech”)
 - Trading via tablets and smartphones

FCA'S APPROACH TO FINTECH AND INNOVATIVE BUSINESSES



THE FCA REGULATORY SANDBOX

Criteria are introduced as a prerequisite for sandbox to ensure consistent treatment of firms and advancement of FCA objectives.

Criteria for using Sandbox
Firm in scope / Genuine innovation / Consumer benefit
Need for Sandbox / Background research

1

Firm proposal to use sandbox

A firm submits a testing proposal to the FCA setting out the new solution and how it meets the criteria.

2

FCA assessment



FCA reviews the proposal. The proposal is accepted if eligibility criteria are met. A case officer is allocated as a contact person for the firm.

3

Firm and FCA collaborate and agree a testing approach

If the proposal is accepted, the FCA works with the firm to establish the best sandbox option, testing parameters, measures for outcomes, reporting requirements and safeguards.

7

Firm decides whether it will offer solution

After the FCA receives and reviews the final report, the firm decides whether it will offer the new solution outside the sandbox.

6

Firm submits final report ↓ FCA reviews final report

The firm submits a final report about the outcomes of testing and the FCA reviews the report.

5

Testing and monitoring

The firm starts testing and engages with the FCA according to what was agreed in step 3.

4

Delivery of sandbox option

FCA allows the firm to start testing.

* The FCA Regulatory Sandbox, November 2015, page 11



Hot Issues in U.S. FinTech

REGULATION CROWDFUNDING

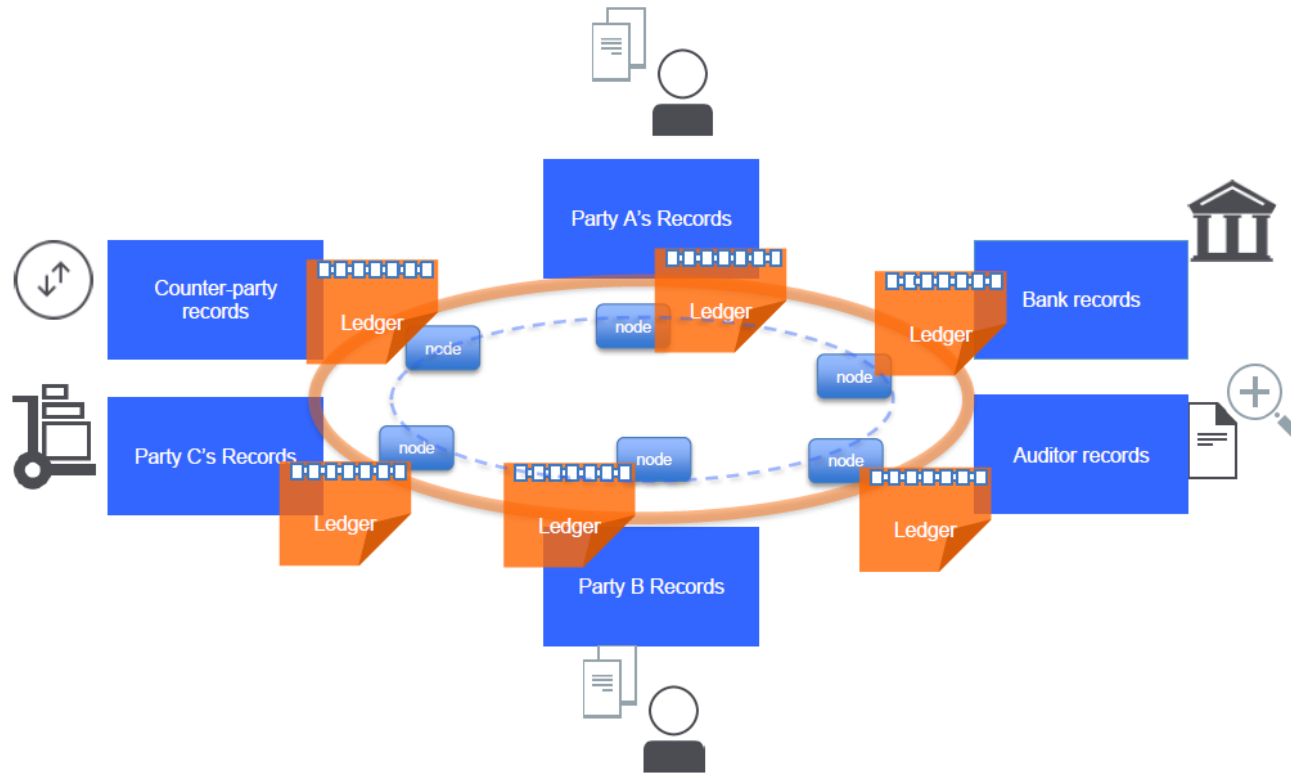
- Effective in May 2016 (Title III of JOBS Act)
- Allows small issuers to raise capital publicly from small investors through broker-dealers or a new type of entity, “funding portals”
- Funding portals exempt from registration as broker-dealers
- Offerings exempt from registration under the Securities Act of 1933 (Section 4(a)(6))

WHAT IS “BLOCKCHAIN”?

- Detailed set of rules for tracking and transferring data utilizing the internet
- Public or private network of participants running same blockchain software
- Peer-to-Peer (P2P) network
- “Distributed ledger” technology allowing for distributed consensus

A BLOCKCHAIN ILLUSTRATION

Blockchain – a shared, replicated, permissioned ledger



WHY USE BLOCKCHAIN?

- Incorporates ledger of data transfers
- Verifies ownership ex-ante
- Verifies transfer of ownership ex-post
- All participants have copy of ledger
- Ledger is encrypted & tamper-proof
- Removes need for intermediaries
- Reduces costs and increases efficiencies

BLOCKCHAIN IN THE ASSET MANAGEMENT INDUSTRY

- Clearing and settlement of trades (e.g., DTCC)
 - Repo & Sec Lending
 - Swaps
- Trading and distribution of fund shares
- Working group of UK asset managers evaluating potential blockchain uses
- IPOs and other securities transactions

BLOCKCHAIN IN THE REAL WORLD

NASDAQ Linq – first use of blockchain ledger technology to complete and record a private securities transaction for **Chain.com**.



Overstock.com issues public shares of its stock on its **t0** blockchain platform - traded, settled and recorded “entirely on a decentralized ledger.”



Banks and FinTech - Integration



DRIVERS OF FINTEGRATION

- **FinTech:** Odds, Time, Scale, Grow up
- **Banks:** Death by a thousand cuts, low fees/margins, category killers, slow development

IS THERE A DEAL TO BE DONE?

- **FinTech Want:** Customers, Trust, Finance, Compliance/Risk Management
- **Banks Want:** Technology, Innovation, Efficiency

STRENGTHS

Innovative culture

Appeal to millennials

Agile and mobile technology

Single product excellence

OPPORTUNITIES

Integration

Reduce costs

Brand building

WEAKNESSES

Regulatory compliance

Data security

Financial controls

THREATS

Culture clash & loss of key staff

Brand contamination

MANAGING RISKS IN PARTNERSHIP/M&A

- IP/IT DD and Integration Planning
- Preserve innovative culture
- ...while making compliance and regulatory integration and early priority...
- Data security
- Data integration
- Merger of systems



Platforms



PLATFORMS

- What is a platform?
- Regulation of crowdfunding platforms
- Developments in marketplace or peer-to-peer lending





Social Trading





Authorisation



1. PLATFORM ESTABLISHED IN THE UK (FSMA INVESTMENTS)

- Discretionary investment management (with the social trader as the client): RAO, 37 – if the platform automatically executes (for the trader) the trade signals of a third party trader preselected by the trader. The automatic execution constitutes discretionary investment management. The mandate is the instruction to the platform to execute automatically.
- Dealing as agent (for the social trader): RAO, 21 – by executing the trader's trades (whether or not the platform is also discretionarily managing)
- Investment advice (given to the social trader): RAO, 53 – unlikely, but possible

2. SOCIAL TRADER ON A PLATFORM ESTABLISHED IN THE UK (FSMA INVESTMENTS)

- Authorisation unlikely to be required
- No holding out – securities: RAO, 15 – and/or:
- Dealing through an authorised person (= the platform) – derivatives: RAO, 16

3. PLATFORM ESTABLISHED IN THE EEA EX-UK (MiFID INVESTMENTS)

- UK-authorized by FSMA, 31(1)(b), if “passporting” into the UK under MiFID

4. SOCIAL TRADER IN THE UK ON A PLATFORM ESTABLISHED IN THE EEA EX-UK (MiFID INVESTMENTS)

- Apply the law of the ex-UK EEA state in which the platform is established



Financial Promotion Regulation



1. PLATFORM ESTABLISHED IN THE UK (FSMA INVESTMENTS)

- Financial promotion by the platform is permitted: FSMA, 21(2)(a) (authorised person)
- FCA COBS 4 – “retail clients” “MiFID business” rules regulate the content of the promotion – e.g., it must be “fair, clear and not misleading,” and past performance (= track record) information heavily restricted
- Does the platform “cause” promotions by social traders ? – e.g., in the form of comments posted by them on the platform’s website: FSMA, 21(3)
- Even if it does, the promotions are regulated only if made by a trader “in the course of business”: FSMA , 21(1). Arguably, though, this may catch comments by “lead traders” who are paid by “followers”.

2. PLATFORM ESTABLISHED IN AN EEA STATE EX-UK, “PASSPORTING” INTO THE UK UNDER MiFID (MiFID INVESTMENTS)

- Financial promotion by the platform is permitted: FSMA, 21(2)(a)
- Rules of the ex-UK EEA state in which the platform is established regulate the content of the promotion, either because the platform is carrying on “electronic commerce activity” (ECA); or, to the extent it is not (e.g., where there is telephone dealing), because it is carrying on “MiFID business”: COBS 1, annex 1. In either case, the effect is that MiFID applies, as transposed into the law of the state, because the state is in the EEA
- Note that UK general and civil law still apply (e.g., conspiracy to defraud and misrepresentation) : Electronic Commerce Regulations, 4(4) and sch., 3, and 5(1)



Practice



CUSTOMER AGREEMENT WITH PLATFORM

- Special social trading terms
 - Trading always for non-commercial purposes
 - Follow lead traders at own risk
 - Followers agree that lead traders are not making recommendations to them (so that no investment advice)
 - Lead traders not to comment on specific securities
 - Lead traders not liable to followers
 - Consent to other traders on the platform viewing your trades
 - Consent by lead traders to being followed
 - Each lead trader must act independently
 - Platform not liable to followers for lead traders' acts or omissions
 - Platform not liable to pay lead traders (you are)
 - Suggestions welcome !

WHAT SOCIAL TRADERS LOOK FOR

- Minimum investment (e.g., US\$10 or US\$10,000)
- Average EUR/US\$ spread
- Broker choice
- Instruments traded
- Account currencies
- Cost per trade
- How many lead traders can you copy?
- Automated lead trade copying?

WHAT SOCIAL TRADERS LOOK FOR *(continued)*

- Demo. lead trader accounts allowed? – or only real money accounts?
- Lead trader compensation – amount; results–linked?
- How far back does available lead trader history go?
- Can you publicly rate traders?
- Lead trader qualifications (e.g., none or minimum number of trades + minimum return over given period)
- Trader account protection - what if your lead trader suddenly loses his touch?

SOCIAL TRADING STATISTICS

- One platform claimed:
 - >4,500,000 traders “already” registered
 - 187,946,727 trades “opened” (= c.40/registered trader) –

as of when accessed on 16 June 2016



Panel Discussion



K&L GATES