Impact on the Fintech Sector

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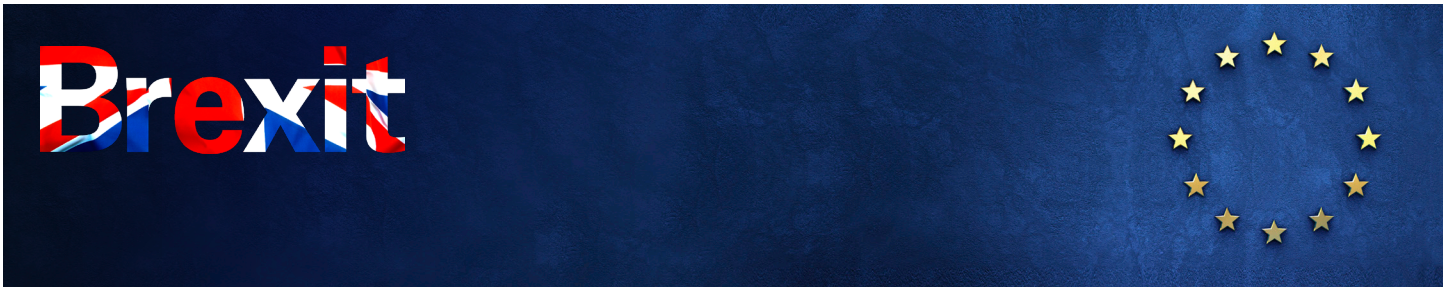

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Simon Toms
Partner / London
44.20.7519.7085
simon.toms@skadden.com

Azad Ali
Of Counsel / London
44.20.7519.7034
azad.ali@skadden.com

One Manhattan West
New York, NY 10001
212.735.3000

40 Bank St., Canary Wharf
London, E14 5DS, UK
44.20.7519.7000

The Trade and Cooperation Agreement (TCA) provides for preferential arrangements in certain areas of trade between the EU and the UK, mainly in goods and continued access to related services such as transport and logistics. There is very little provision for cooperation in relation to trade in services, but the TCA does set out some obligations for parties to establish arrangements governing trade in digital services. As fintech firms generally provide their services through digital channels, this is a helpful provision, albeit with significant limitations.

Takeaways

- The TCA says little about cooperating on trade in services, but it does call for parties to establish arrangements governing trade in digital services.
- Fintech companies now must navigate two regulatory regimes.
- A UK regime to govern cryptoassets similar to the EU proposal should be expected.

Absent from the digital services chapter of the TCA are substantive provisions to offset the fact that the UK no longer benefits from being part of what is effectively the EU single market for financial services. Many fintech firms conduct regulated financial activities when providing their services and so must obtain authorization from the appropriate regulator in their home jurisdiction. The loss of passport rights and other barriers to trade in financial services therefore affects fintech firms in the same way as traditional financial services institutions. (See "Offsetting the Loss of Passporting Rights in Financial Services Regulation.")

With no agreement (as of yet) on equivalence or any other mutual recognition framework for UK and EU financial services firms, fintech companies in these jurisdictions are now required to grapple with two regulatory regimes where they previously relied on the EU-wide passport to provide cross-border services. The need to comply with two regimes, no matter how closely aligned, raises practical questions in relation to the need to establish a presence in another jurisdiction, authorization/licensing perimeters and reporting obligations. These issues are exacerbated by the prospect of future regulatory divergence between the EU and the UK. Potential divergence impacts fintech firms by generating uncertainty in relation to the regulatory regimes which will apply in each jurisdiction and limits the prospect of the EU and the UK negotiating an equivalence or mutual recognition framework in the future. Further, costs of compliance for many fintech firms are likely to increase in proportion to how much the two sets of regulations end up differing.

Data Storage

The digital services chapter of the TCA requires the EU and the UK to ensure the continuation of cross-border data flows between their territories. It outlines specific examples of restricted behaviour, including a prohibition on requiring the use of computing facilities or networks in any particular territory or mandating that any

particular steps in processing take place within the EU or the UK. No customs duties can be imposed on digital services, and electronic contracts must be recognized in both the EU and the UK. Though requiring data to be stored in the UK or the EU is prohibited, nothing in the TCA prevents the EU or the UK from imposing restrictions on the storage or transfer of personal data, provided that such restrictions are imposed in a nondiscriminatory manner. This exemption is critical for fintech firms, which are likely to store and process large amounts of customer data, and will need to navigate and ensure compliance with both the UK and EU personal data protection regimes. The digital services chapter does not ensure mutual recognition of the two regimes. (See "A Temporary Solution for Data Protection and Digital Trade.")

Despite this key limitation relating to personal data, the fact that physical computing infrastructure and processing do not have to be located in any particular territory means fintech firms will not be required to relocate physically (in whole or in part) in order to continue providing services in the EU or UK (although licensing requirements under financial services legislation may compel this outcome).

Memorandum of Understanding

By contrast to digital trade, the TCA makes no meaningful provision for future cooperation or free trade in financial services between the EU and the UK. The Joint Declaration on Financial Services Regulatory Cooperation, which accompanies the TCA, states only that the EU and the UK will work to "establish structured regulatory cooperation on financial services." The process of establishing this cooperation began after the conclusion of the TCA, with the negotiation of a memorandum of understanding (MoU) to establish procedures for information sharing between EU and UK regulators. The negotiation is expected to be concluded in the first quarter of 2021. The MoU is not likely to provide for sweeping mutual recognition of EU and UK financial services firms or offer UK firms any benefits akin to the EU financial services passport. It may instead set out a timeline for the EU to conduct equivalence determinations, which would provide at least some clarity as to the ultimate agreement with respect to financial services.

A Rapidly Changing Fintech Regulatory Landscape

The UK's withdrawal from the EU with no agreement in place for financial services took place against the background of rapidly changing regulations affecting fintech firms. For instance, there is now an EU regulation governing the licensing and operation of crowdfunding businesses, and the UK has introduced restrictions on the marketing of certain cryptoassets and crypto derivatives. The European Commission has also proposed legislation affecting issuers of cryptoassets as well as fintech service providers. Under the legislation as currently drafted, cryptoasset issuers would be subject to transparency requirements similar to those in place for issuers of equities and bonds. Fintech firms would be held to stringent prudential standards, just as EU investment firms are. And issuers of cryptocurrencies may be treated like payment institutions and e-money issuers, depending on the nature of the instrument issued. All of these additional requirements could impose a heavier compliance burden on fintech firms, which currently largely benefit from relatively light-touch regulatory frameworks.

It is unclear whether the UK will impose similar requirements on UK-based fintech firms, although a UK regime to govern cryptoassets or stablecoins similar to the EU proposal should be expected. A review of the UK fintech regulatory environment currently underway is focused on ensuring that the UK is a competitive and stable jurisdiction in which to operate as a fintech business. Therefore, it is likely that any UK legislation which results from this review will diverge to some degree from the EU's proposed legislation. This may be a welcome development for UK-focused fintech firms, but for those that provide cross-border services, the prospect of increasing divergence presents additional compliance challenges.