

FinTech Sector Report

1. This is a report for the House of Commons Committee on Exiting the European Union following the motion passed at the Opposition Day debate on 1 November, which called on the Government to provide the Committee with impact assessments arising from the sectoral analysis it has conducted with regards to the list of 58 sectors referred to in the answer of 26 June 2017 to Question 239.
2. As the Government has already made clear, it is not the case that 58 sectoral impact assessments exist. The Government's sectoral analysis is a wide mix of qualitative and quantitative analysis contained in a range of documents developed at different times since the referendum. This report brings together information about the sector in a way that is accessible and informative. Some reports aggregate some sectors in order to either avoid repetition of information or because of the strong interlinkages between some of these sectors.
3. This report covers: a description of the sector, the current EU regulatory regime, existing frameworks for how trade is facilitated between countries in this sector, and sector views. It does not contain commercially-, market- or negotiation-sensitive information.

Description of the sector

4. Financial Technology, or "FinTech" is not a sub-sector of financial services in the traditional sense of describing a particular activity or business model within the wider financial services market. Rather, it is a label applied to firms operating across a wide range of financial services sectors, which use new technology to provide services in new ways. Whilst technological innovation has always been a key driver of progress in financial services, Fintech is marked out by the way a range of emerging, general-purpose technologies are being harnessed to change how financial services are delivered across a range of different product-types and customer segments.
5. One way of characterising the sector would be to divide it into four main areas of FinTech activity.

Investment, advice and neo-banks

6. These are firms which provide individuals and businesses with access to traditional retail financial services in new ways, usually through the use of internet-based platforms.
7. In the investment space, customers can use a web-based platform to gain access to a managed investment portfolio, without needing to go to a traditional stockbroker or wealth manager.
8. On advice, FinTech firms are looking to help close the "advice gap" in financial services by providing so-called "robo-advice" to help customers work out the best product to invest in. Neo-banks are the new wave of challenger banks looking to serve customers solely via in-app banking, rather than through a traditional bank

network. A number of these banks have been authorised by regulators in the past couple of years, and they are now starting to come to market.

Back-end systems and compliance

9. Regulatory compliance is a significant cost for FS firms, and a range of FinTech firms have grown up looking to help them do this in a cheaper and more efficient way – so-called “RegTech” firms.
10. RegTech firms can, for instance, provide banking institutions with a user-friendly data visualisation platform to see where they stand against the existing regulatory framework, and explore ‘what-if’ questions to see how possible actions would play out against regulatory requirement, or provide digital ID verification services that help FS institutions meet Know-Your-Customer and Anti-Money Laundering requirements.
11. A common factor within RegTech propositions is that they are looking to take non-core, cost-centre activities off the hands of the individual FS providers, leaving them to concentrate on their core mission.

Payments and technologies underpinning digital currencies (eg. Bitcoin)

12. Payment services is one of the more mature areas of FinTech development. One group of firms concentrates on using the existing domestic payments infrastructure but overlaying a user-friendly internet or app based interface, which may also offer additional services.
13. A second group of firms concentrates on the international remittance market, aiming to use technological innovation to make sending money abroad cheaper and easier.
14. A third group of firms cluster around digital currencies. Some firms operate firmly within the established Bitcoin market, allowing individuals to buy and trade Bitcoin. Other firms look to use the underlying blockchain technology to facilitate cheaper and easier transfers of funds.

Alternative finance

15. Alternative finance firms use technology to match lenders and borrowers, cutting out the need for a centralised lender. They include peer-to-peer lenders and crowdfunding platforms. These firms can vary in the level of services they offer to their lenders and borrowers.
16. As a result of the fact that it is difficult to establish a firm definition of FinTech, sizing the UK market is not straightforward. One study by EY¹ found that true or “emergent” FinTech (as opposed to incremental investment in technology by incumbent financial services firms), generated £6.6 billion in revenue in the UK in 2015. Most analysts expect this figure to rise rapidly in the coming years, but there is no clear consensus around which elements of FinTech will deliver the most growth in future.

¹ <http://www.ey.com/Publication/vwLUAssets/EY-UK-FinTech-On-the-cutting-edge/%24FILE/EY-UK-FinTech-On-the-cutting-edge.pdf>

17. According to EY, the UK FinTech sector employs around 61,000 people in the UK, mostly concentrated in London, but with a presence across the UK, particularly in Belfast, Cardiff and Edinburgh.² Individual FinTech firms, however, often employ small numbers of staff relative to their size. Many FinTech firms employ people with specialist skills (e.g. in computer programming and coding) and so look to recruit from beyond the UK. Innovate Finance, the FinTech trade body, estimates that around one-third of the founders of UK-based FinTech are non-UK EU nationals.
18. As a part of financial services, FinTech regulation is a reserved issue.

The current EU regulatory regime

19. There is no regulatory regime for FinTech. FinTech firms are regulated according to the activity they carry out. The main activities³ that are affected by EU regulation are:
- Neo-banks, which are regulated in the same way as other deposit-takers;
 - Payment firms (section three, above), which are covered by the current Payment Services Directive, the Payment Services Directive II from 13 January 2018 and the second E-Money Directive where relevant; and
 - Alternative finance firms engaged in the trade of transferable securities, which are subject to the Markets in Financial Instruments Directive (MiFID).
20. Other areas such as alternative finance and digital currencies are generally not regulated at the EU level, though the European Commission has stated that it is exploring whether European-level policy action in this field is needed. Likewise, there are tech firms that do not provide regulated financial services: examples might include businesses providing expert systems that identify compliance issues for banks, or robo-advice services that firms then badge and use with their clients.
21. Beyond financial services regulation, there is a clear read-across for FinTech firms from EU regulation around the handling, storage and protection of data, since this is a key requirement for many of the business models set out above.

UK regulatory environment

22. In 2014, the Financial Conduct Authority (FCA) launched Project Innovate, aiming to encourage innovation in financial services in the interests of consumers. The FCA's approach to innovation has been imitated abroad and is widely credited as a significant factor supporting the strength of the UK FinTech sector. The Bank of England has launched a FinTech 'accelerator' in 2016, in order to gain insight into FinTech products, concepts and firms and to give FinTech firms insight into the work of the Bank.

² <http://www.ey.com/Publication/vwLUAssets/EY-UK-FinTech-On-the-cutting-edge/%24FILE/EY-UK-FinTech-On-the-cutting-edge.pdf>

³ These activities interact with other areas of financial services regulation, for which HMG's analyses relating to retail and corporate banking; payments systems and services; and asset management and wholesale capital markets are also relevant.

Existing frameworks for how trade is facilitated between countries in this sector

23. The arrangements described in this section are examples of existing arrangements between countries. They should not be taken to represent the options being considered by the Government for the future economic relationship between the UK and the EU. The Government has been clear that it is seeking pragmatic and innovative solutions to issues related to the future deep and special partnership that we want with the EU.
24. With respect to international trade, the World Trade Organization's General Agreement on Trade in Services (WTO-GATS) establishes a baseline for trade in services including in relation to all financial services, including FinTech. This has been developed through EU FTAs with, in particular, South Korea and Canada.
25. More widely in financial services, there are well-developed principles at the international level which seek to support cross-border activity and avoid duplicative regulation and fragmentation. These are set out in more detail in the wholesale capital markets report.

Sector views

[This information was provided by the Government to the Committee, but the Committee has decided not to publish this section]

HOUSE OF COMMONS EXITING THE EUROPEAN UNION COMMITTEE