CLEVELAND & CO

External in-house counsel

PARTNERSHIPS BETWEEN FINANCIAL SERVICES INSTITUTIONS AND FINTECHS

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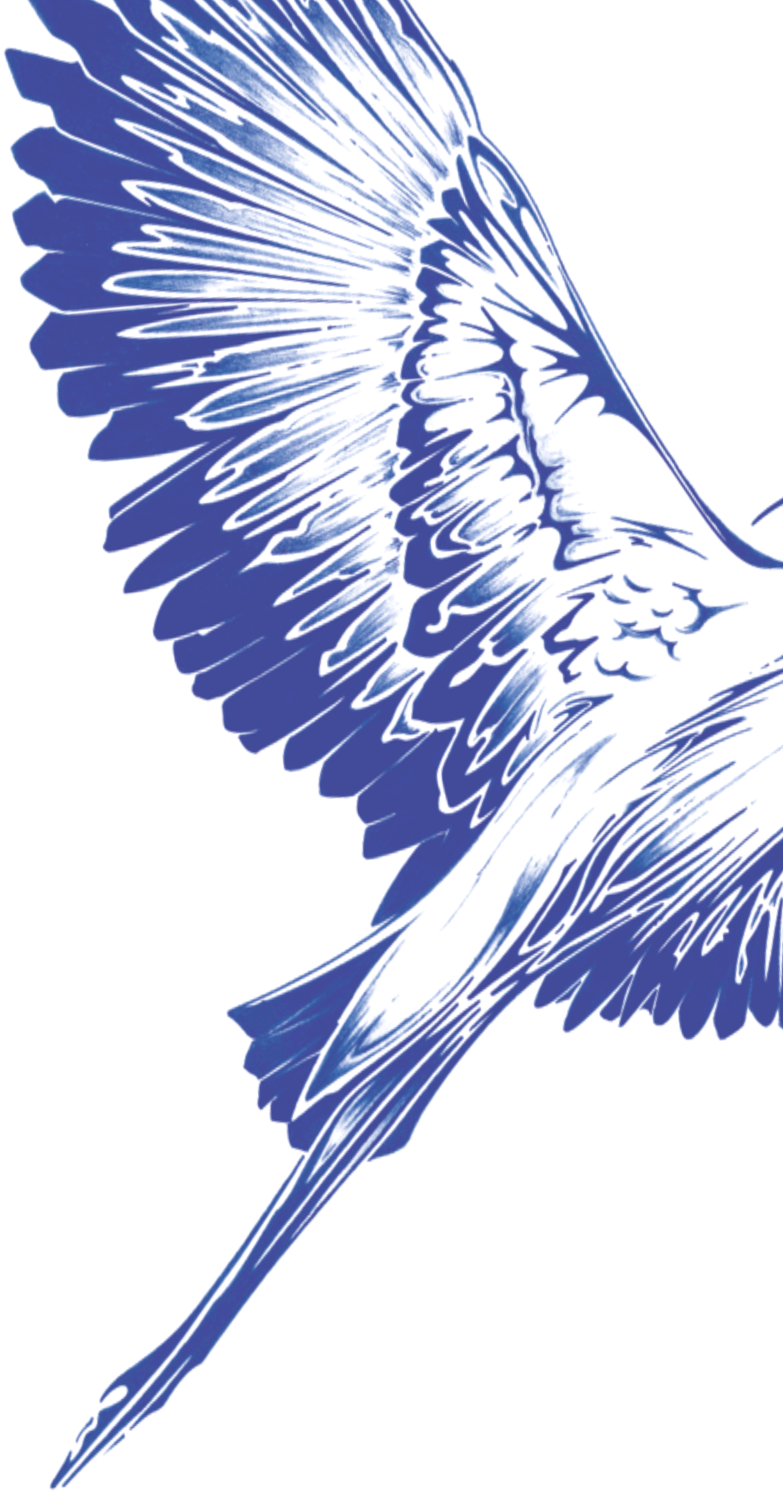

With a current valuation of £6.6 billion, the UK FinTech market is rapidly transforming the way consumers access the financial services sector. To ensure long-term success, the UK aims to position itself at the forefront of the FinTech evolution. In November 2017, TheCityUK published a guide (the "**Guide**") to partnering between FinTechs (primarily start-ups) and Financial Services Institutions ("**FSIs**") that is designed to steer both sides into a collaborative, joined-up approach to reap the benefits of this high-growth area.

The Guide will be taken forward for HM Treasury's Financial Services Trade and Investment Board (the "**FSTIB**") future work programme for their consideration.

KEY AREAS OF CONSIDERATION

The Guide outlines two key areas of consideration that FSIs and FinTechs need to agree upon prior to partnering:

1. legal concerns that could hold up projects; and
2. the nature of the collaboration model itself.

Having these discussions at the start of projects will ensure that both parties' interests are protected while bringing their expertise together.

Model Key legal concerns Case studies

1. COMPARING MODELS OF COLLABORATION

The Guide sets out seven possible models by which FinTechs and Financial Services Institutions can structure a partnership. These are set out below.

Model	Key legal concerns	Case studies
a) Application programming interfaces/sandbox FSIs offer FinTechs limited access to their infrastructure or services through public Application Programming Interfaces (“**APIs**”), sandbox development environments, or anonymised samples of customer data. With this model, FSIs take a hands-off approach while Fintech firms have the ability to build and test new products and services without impacting the FSI. Open APIs are becoming more common, particularly in 2018, with the introduction of the EU’s Revised Payment Service Directive (“**PSD2**”). This will allow banking customers to enlist third parties to manage their finances without leaving their existing bank.	FSIs and FinTechs will need to enter into a legal agreement outlining terms on: – intellectual property rights; – exclusivity; and – development costs for everything produced within the API/sandbox structure. Typically, an API or sandbox model will not include a commercial agreement about how a product will be used, or who owns it.	– Mastercard has seen a 400% increase in API usage. The aim is to have an API for everything so innovators do not have to start from scratch; – Samsung and Google use the MDES API to generate tokens for Samsung Pay and Android Pay; and – Walmart uses the Masterpass merchant API to simplify the online checkout experience.
b) Hackathon/Entrepreneur in residence Hackathons are limited-time development events, where FSIs present a business or technology challenge and invite Fintechs to come up with a solution. These focus on rapid innovation and fast prototyping to test early-stage concepts, rather than producing a polished product.	FinTech teams are often given access to internal expertise and resources by the FSI. This raises questions about intellectual property rights, as solutions are co-created. FSIs will need to establish how their existing intellectual property can be used during the hackathon, and who ultimately owns the rights to products or services that are developed by FinTechs or entrepreneurs in residence. FSIs and FinTechs will need to enter into a legal agreement outlining terms on: – intellectual property; – exclusivity; – data protection; – development costs for the project;	As part of its digital transformation strategy, Lloyds Banking Group has set up: – the LBG Innovation Labs, a dedicated team that runs quarterly hackathons; and – a FinTech mentoring programme.

Model	Key legal concerns	Case studies
	– management of operations; – oversight and access to information; and – regulatory compliance.	
c) Start-up corporate accelerator FinTechs submit applications to FSIs for support with new products or services that are already developing. FSIs are able to identify and capitalise on promising innovations, while the selected FinTechs gain access to expertise, support and a customer base.	Corporate Accelerator programmes may operate on equity agreements, such as share purchase agreements, with the FSI usually taking a stake in the FinTechs it selects. FinTechs will need to ensure they are clear and comfortable with the amount of equity they are offering and the terms it is issued on. Shareholders will expect a higher level of control, so legal agreements will need to be made to prevent the FinTechs and FSI operating under different commercial models. FSIs and FinTechs will need to enter into a legal agreement outlining terms on: – which shares will be issued and for what form of consideration; – intellectual property; – exclusivity; – development costs for the project; – management of operations; and – oversight and access to information. Each party should be made aware of their rights under these arrangements and ensure they are documented upfront if necessary.	Rise is a global community of the world's top innovators, working together with Barclays to create successful engagements. This includes, Wave, in which Barclays, Ornua, and Seychelles Trading Company became one of the first organisations to execute a global trade transaction using blockchain technology.

Model	Key legal concerns	Case studies
d) FinTech product sourcing In this model, the product or service is already complete and market ready. An FSI will select a product developed by a FinTech company to test with limited sections of its customer base. If this process is successful, the FSI then scales the use of the product to its entire business. This allows the FSI to easily trial new products without putting their own capital and development time into building them.	FinTechs will need to understand if entering into an agreement for the use of their product with one FSI, it will prevent them from also selling the product to other companies. This can also affect the FSI as they will need to establish whether it is tied to a single provider, and assess the operational risks associated with relying on one product. FSIs and FinTechs will need to enter into a legal agreement outlining terms on: – intellectual property rights; – exclusivity; – regulatory compliance; – data protection; – development costs for the project; – management of operations; and – oversight and access to information.	RBS launched a joint-venture with an innovative Israeli start-up, Ezbob. Ezbob has developed a lightweight lending platform to service small and medium-sized enterprises, which RBS was able to launch into a stand alone, fully automated lending service. The relationship allowed Ezbob to achieve rapid distribution of their solution, while enabling RBS to better serve customers.
e) FinTech joint venture/venture builder In this model, an FSI sets up its own stand alone start-up to address a specific market niche. This company sits alongside FSI's core business channels, and can have a separate branding. By setting up this partnership with a FinTech or Venture Builder, FSIs are able to bring in specialised skills and investment, bolstered by shared equity.	The main legal concerns for a joint venture are ownership and control of the new company. FSIs and FinTechs will need to enter into a legal agreement outlining terms on: – growth and risk; – exclusivity; – development costs for the project; – management of operations; – oversight and access to information; – exit mechanisms; – intellectual property; and – outsourcing rules.	Shell New Energies focus is the discovery and development of innovative technologies that will shape future energy needs. They have invested in and incubated a new venture, WonderBill, focusing on the management of energy bills.

Model	Key legal concerns	Case studies
f) Corporate venture capital One of the simplest models. An FSI will take a minority stake in one or more up-and-coming FinTechs, in order to secure insider access to new innovations.	The FSIs will need to assess the risk profile of the investment and the stability of the FinTech's value. FSIs and FinTechs will need to enter into a legal agreement outlining terms on: – growth and risk; – exclusivity, in this case, establishing whether the service being developed will be provided solely to the FSI investor; – development costs for the project; – management of operations; – oversight and access to information; – exit mechanisms; and – intellectual property.	Santander Group's $200 million Corporate Venture Capital fund, Santander InnoVentures, has invested in 17 FinTech companies.
g) Mergers and acquisitions Practically and legally, this is one of the most complex models. FSIs buy out specific FinTechs to secure access to new innovations, or speed up strategic transitions. The key issue is valuation as there may be a valuation gap. This can be bridged by an agreement to deferred consideration, which is paid only when certain milestones are reached (known as an 'earn out').	The legal agreement entered into between the FSIs and FinTechs will depend on whether the company is listed or private. The legal agreement should outline terms on: – intellectual property; – risk and revenue; – additional investment needs; – employee agreements; and – regulatory approvals and notifications.	BBVA's stake in Atom, the first mobile-only bank to be granted a licence by the Prudential Regulation Authority in 2015.
h) Hybrids FSIs and FinTechs can agree to a tailored partnership framework. This is likely to be a hybrid of the above models. This can provide a greater degree of flexibility and	Depending on the nature of the hybrid, this will be a variation of the concerns listed in the previous models.	Spain's fifth largest bank and owner of TSB in the UK, Banco Sabadell's InnoCells combines a Start Up Corporate Accelerator and a FinTech Joint Venture/Venture Builder.

Model	Key legal concerns	Case studies
enable the partnership to reap a wider range of benefits. However, this could also result in greater complexity and an increased number of legal issues to consider and address.		
Key legal issues	Concerns	

2. TACKLING LEGAL ISSUES

There are seven legal considerations FSIs and FinTechs will need to consider ahead of a new partnership.

a) Intellectual property rights

The two sides need to be clear about:

- what intellectual property exists;
- who owns the existing intellectual property;
- how existing intellectual property may be used by each party, and on what terms;
- who will own any new intellectual property created as a result of working together; and
- how intellectual property may be combined, where necessary

Key legal issues	Concerns
b) Regulatory compliance	FSIs may require the need for regulatory approvals and/or notifications in a mergers & acquisitions context, or structuring joint venture arrangements in compliance with rules on outsourcing. However, regulators have taken a progressive stance to assist FinTech in bringing new financial products and services to the UK. The Financial Conduct Authority's ("**FCA**") 'Project Innovate' even offers direct financial regulation support and advice to businesses. FinTechs and FSIs should try and take advantage of this FinTech-friendly market.
c) Data protection and privacy	The UK Data Protection Act 1998 ("**DPA**") is a key concern to UK and EEA-based FinTechs, as well as non-EEA FinTechs that use UK-based equipment. This is due to the focus on personal data, which is information relating to living individuals who can be identified from that data and processing. In practice, this includes most methods of handling data, such as collecting, using and organising. The General Data Protection Regulation, which comes into UK law on 25 May 2018, will ensure that the requirements of the EU GDPR will continue to apply in the UK following Brexit. FSIs and FinTechs should ensure there is a clear understanding regarding: – the use, ownership and protection of their proprietary data, and the proprietary and personal data of their respective clients. This includes their ability to share client data. With the exchange of data, cyber security protocols will need to be put in place to ensure that: – the data is protected in transit; and – will be accessed, used, processed and protected throughout its lifecycle. UK and EU data protection laws also include the requirement to provide a data breach notice. FSIs and FinTech will need to consider: – what types of data breach may occur; – how each entity will contribute to the detection and reporting of breaches; and – the liabilities related to any failures in data privacy or security control.

Key legal issues	Concerns
d) Exclusivity	It needs to be established early on in a collaboration whether: – the FinTech will be working on a single project with the FSI, or on multiple projects at once; – the product created can be sold to other institutions; and – the FinTech is able to work with other FSIs, or on other independent projects both during and after the period of collaboration.
e) Growth and risk	FSIs and FinTech will need to agree upfront: – how each party will benefit from any increase in value; and – who is responsible for risk exposure.
f) Costs and control	The FSI and FinTech need to agree on: – who is responsible for funding research and development costs for the duration of the project; – who will manage the day-to-day operations and the general strategic direction of the project; and – whether there is any oversight and access to proprietary information.
g) Exit mechanism	At the end of the project, an exit process should be agreed. Depending on the original agreement, the exit mechanism will include: – who retains the rights to new and existing intellectual property; – who retains the ownership of joint assets; and – which party is responsible for maintaining compliance. As FSIs usually have dedicated legal departments, FinTechs should seek appropriate legal representation during the early stages of discussions.

DISCLAIMER

WHY WE'RE DIFFERENT

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WE OFFER

Cleveland & Co offer you fixed fees and retainer structures that provide you with certainty of cost and we offer industry experience that cuts through common legal complexity.

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