CLIFFORD CHANCE

>THOUGHT LEADERSHIP>

FINTECH: DISRUPTORS DISRUPTED?

FINTECH: DISRUPTORS DISRUPTED?

Financial technology – fintech – is shaking up traditional financial services. From payments to wealth management, from peer-to-peer lending to crowd funding, a new generation of startups is competing head to head with banks for a share of their business. These disruptors aim to be faster, cheaper and more efficient than the market leaders. But financial institutions are fighting back and investing heavily in their own technology to take on the fintech companies at their own game.

To explore the challenges and opportunities for both fintech companies and established financial services players, Clifford Chance hosted a lively panel discussion with Martin Cook, General Counsel of Funding Circle, a peer-to-peer lending company for small businesses; George Osborne, Innovation Director at Barclays; Erez Mathan, Chief Operating Officer at GoCardless which focuses on simplifying direct debits; Martin Prescott, Executive Director of Capita; Izabella Kaminska, fintech reporter at FT Alphaville and Clifford Chance Partner André Duminy. Bas Boris Visser, Clifford Chance's Global Head of Innovation, moderated the session and in this extract the panel discusses whether financial institutions should compete, concede or collaborate with fintech companies and the role of the regulatory environment.

Size versus agility

Erez Mathan explained that GoCardless offers direct debit facilities to small businesses or organisations such as local gyms and scout groups enabling them to collect recurring payments without going through a bank. He said that his business isn't challenging traditional financial services but is filling a gap in the market. "I don't think we are disrupting the financial industry, we're expanding Direct Debit to serve clients on a smaller scale than the banks. The products we've created actually help businesses to recoup their cash flows and to grow," he said. "If bigger organisations could learn how to do that too, it would be amazing."

Banks have always been heavy users of technology but as Clifford Chance partner André Duminy, said: "A typical financial institution is basically a huge technology stack with products on top. The bigger you get, the bigger the challenges to refresh that technology and be agile enough to get products to market very quickly."

And as fintech startups grow, they will face their own challenges. More than 20 fintech companies around the globe are "unicorns" valued at over US$1 billion, a number have already gone public and others have grown from a couple of people working out of a spare bedroom to employing hundreds of people. "These nimble companies will see their own technology stack grow and so they will they be disrupted by the next generation. It's going to be an interesting cycle," Duminy said.

The established financial services industry and fintech startups also face competition from other sectors, said Martin Prescott, Executive Director of Capita, an international business process outsourcing company. "Major retailers are entering the banking market and mobile operators are enabling payments through capitalising on their brands." He said that banks need to find new ways of working and encourage a sense of curiosity so that innovative ideas are not shot down. "At Capita we look to cross-fertilise ideas between clients in how to engage with consumers and the use of insights and analytics."

The role of collaboration

Collaboration is common in the fintech industry said Erez Mathan: "We're currently operating in a very collaborative environment but obviously the more players that enter the market, the more competition develops." GoCardless already works together with the peer- to-peer lender Funding Circle because they both focus on small businesses. As Mathan explained: "Banks historically have built layer on layer so you get this huge beast that wasn't designed to bring all its services together. Fintech companies have the luxury of focusing on one specific problem and solving it. We focus on Direct Debit, Funding Circle focuses on loans for small businesses and so we recommend each other's services to our clients – we are not competing."

André Duminy said that collaboration is also a route for the established financial services sector. "They often inhabit different spaces and have different strengths which can work well together. We did think initially that if banks struggled to innovate on their own it might be easier just to acquire fintech companies but there seems to be an aspiration to work together."

However, collaboration is not without its challenges. Who owns the clients? Who owns the IP? How is it exploited? How do you take the collaboration forward? How do you exit the collaboration? "Those challenges are not insurmountable and it is an attractive option for people to investigate," said Duminy.

Creating value with technology

While there is a great deal of focus on the cutting edge technology that is powering the fintech sector, it is not just about technology for technology's sake but is about creating solutions to real problems, said Funding Circle's Martin Cook. "Technology is hugely important to our business but the big idea is about providing access to finance for small businesses. For every loan we make, small businesses on average have employed three extra employees within 12 months. Technology is an enabler, it's not the outcome."

Barclays is amongst the most tech-driven banks in the world as George Osborne, its Innovation Director explained: "Everything we do is enabled by great tech and delivering the right things for our clients. For example, technology means that a data search process that took six weeks last year now takes about 12 seconds." Barclays is now working with a number of fintech companies and has its "Barclays Accelerator" programme which supports startups and helps them to grow. Osborne said that this support to the fintech ecosystem in London does not directly threaten its own business given the banks' scale and customer reach. Fundamentally we should be confident in our products ability to compete with disruptors; challenges will keep us updating our own products and systems. It's about creating value. Mentoring and supporting firms help us to change our own culture and improve our systems, whilst Barclays helps the firms with a wide range of banking products, with our rigour helping them with regulatory and control areas."

As fintech companies grow they face new challenges, as Izabella Kaminska of FT Alphaville said: "When they try to scale they become more and more like banks and with that comes all the headaches of regulation, compliance, risk and cross-subsidisation and legal structures." There is also a danger that fintech companies can get stuck in the middle ground – challenged by newer up and coming disruptors who see them as dinosaurs, but not big enough to take on the major financial institutions. Martin Cook of Funding Circle said: "We continue to innovate. I think complacency is a danger but we employ bright people, with interesting ideas. Maybe someone will come along and do it better but I think we focus on what we do and we're not pretending to be something we're not. We're not looking to become a bank. I think the idea of focus is a strong point in our favour."

The regulatory environment

As fintech booms, regulation is becoming a major issue. In April major financial institutions and regulators from the US and Europe called for a standardised approach to fintech regulation and the Financial Stability Board has flagged fintech as a sector that needs "close attention." Regulators are currently trying to achieve a balance between opening up the market to new entrants and preventing systemic risk.

The Financial Conduct Authority (FCA) has introduced a "regulatory sandbox" which enables fintech companies to test ideas and products in a safe space. Izabella Kaminska said the lack of regulation is problematic: "I see companies that are getting away with not being called banks but operating very much like banks. The regulators don't want to stifle innovation but at the same time we have just come from an environment where a lot of these same processes led to a very bad situation."

Martin Cook of Funding Circle said that his company welcomes regulation: "Proportionate regulation is a good thing. It provides for minimum acceptable standards and it helps build trust with the customer base. It's not in our interest to operate in a 'wild west' environment. We want credibility for our business and we work with Government, with the Treasury and with the FCA on many aspects of specific peer-to-peer regulation and more generally. We also have to follow the FCA Handbook which is a substantial undertaking for a small business."

CLIFFORD CHANCE

CLIFFORD CHANCE CONTACTS

André Duminy
Partner, London
T: +44 20 7006 8121
E: andre.duminy@cliffordchance.com

Bas Boris Visser
Partner, Amsterdam
T: +31 20711 9624
E: basboris.visser@cliffordchance.com

Simon Gleeson
Partner, London
T: +44 20 7006 4979
E: simon.gleeson@cliffordchance.com

Jonathan Kewley
Senior Associate, London
T: +44 20 7006 3629
E: jonathan.kewley@cliffordchance.com

Peter Chapman
Senior Associate, London
T: +44 20 7006 1896
E: peter.chapman@cliffordchance.com

Alvin Khodabaks
Partner, Amsterdam
T: +31 20711 9374
E: alvin.khodabaks@cliffordchance.com

Robert Villani
Partner, New York
T: +1 212878 8214
E: robert.villani@cliffordchance.com

Alistair Dunlop
Associate, New York
T: +1 212878 3259
E: alistair.dunlop@cliffordchance.com

Marian Scheele
Senior Counsel, Amsterdam
T: +31 20711 9524
E: marian.scheele@cliffordchance.com

Lena Ng
Counsel, Singapore
T: +65 6410 2215
E: lena.ng@cliffordchance.com

TieCheng Yang
Partner, Beijing
T: +86 106535 2265
E: tiecheng.yang@cliffordchance.com

Marc Benzler
Partner, Frankfurt
T: +49 697199 3304
E: marc.benzler@cliffordchance.com

J20161205162009