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UK: Law & Practice
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UK

Law and Practice

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1. Fintech Market

1.1 Evolution of the Fintech Market

The UK remains a leading global hub for fintechs. In 2022, UK tech venture capital investment was second in the world (behind the US) according to research from Tech Nation. The fintech ecosystem is supported by a progressive approach to regulation, access to international investment and a skilled workforce.

There are growth opportunities for fintechs, including in playing a role in both addressing underlying environmental, social and governance (ESG) issues, and in deploying AI and other technologies to enable ESG data to be collected and monitored in response to regulation requiring standardised reporting of ESG data. This is an area where the UK fintechs are thriving – with UK funding in climate tech matching France and behind only the US according to research from Tech Nation.

In addition, COVID-19 has accelerated the growth of digital adoption. There is also a shift in consumer behaviour, with increasing payment volumes moving online and an increased use of e-commerce.

The regulatory landscape will continue to evolve to address concepts such as crypto-assets and stablecoins, cloud technology and artificial intelligence (AI).

2. Fintech Business Models and Regulation in General

2.1 Predominant Business Models

There are thousands of fintechs across the UK, including mature brands and start-ups, and covering a wide range of sectors and using a variety of business models. The business models vary for firms across the different sectors.

2.2 Regulatory Regime

There is no single regulatory regime for fintech. Instead, both the nature of the activities a firm performs and its business model determine whether it is regulated.

As discussed in **2.1 Predominant Business Models**, the UK fintech market is notable for the breadth and depth of its sectoral coverage. It encompasses a wide range of services such as crowdfunding, cross-border payments, foreign exchange services, digital wallets and e-money, robo-advice and crypto-asset-related activities. Firms must assess the regulatory regime that applies to their business on a case-by-case basis.

A high-level overview of the general licensing regime and the framework applicable to payment institutions and e-money firms now follows.

General Licensing Regime Under FSMA

All firms should consider the general prohibition in Section 19 of the Financial Services and Markets Act 2000 (FSMA), which prohibits carrying on a regulated activity by way of business in the UK without authorisation or an exemption.

A regulated activity is an activity of a specified kind that is carried on by way of business and relates to an investment of a specified kind. The list of specified activities and investments is set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). Specified activities include accepting deposits, issuing electronic money, advising on or arranging deals in investments, dealing in investments as agent or principal and operating an elec-

tronic system in relation to lending. Specified investments include deposits, electronic money, shares and units in a collective investment scheme.

In January 2023, HM Treasury (HMT) consulted on extending the FSMA licensing regime to certain crytpo-asset activities (see further **12.2 Local Regulators' Approach to Blockchain**).

Payment Institutions and E-Money Firms

Firms should also consider whether they are subject to regulation under the Payment Services Regulations 2017 (PSRs 2017) or Electronic Money Regulations 2011 (EMR 2011).

Payment institutions and electronic money firms must safeguard customer funds to ensure that, in the event of an insolvency of the firm, customers' funds are returned in a timely and orderly manner. This is particularly important as funds held with payment institutions and e-money firms are not protected by the Financial Services Compensation Scheme.

The Financial Conduct Authority (FCA) is focused on ensuring that payments are safe and accessible (see further in **2.6 Jurisdiction of Regulators**). Its main supervisory priority for the payments sector is ensuring that firms have robust safeguarding arrangements, prudential resilience and risk management arrangements, and systems and controls to prevent financial crime.

The FCA intends to extend the Senior Managers and Certification Regime to apply to payment institutions and e-money firms.

New Consumer Duty

In July 2022, the FCA published final rules on the introduction of a new consumer duty that would raise the standard of care that firms need to provide to retail consumers. This includes firms that do not have a direct relationship with retail clients (eg, firms involved in the manufacture or supply of products and services to retail clients). The new rules apply from 31 July 2023 for open products and services and from 31 July 2024 for closed products and services.

Specific Rules for Particular Fintech Business Models

There are specific requirements relevant to certain types of fintech business models. Many of these, including peer-to-peer lending and crypto-asset-related activities, are discussed further below.

Other Upcoming Developments

The Financial Services and Markets Bill (FSMB) introduced into Parliament in July 2022 introduces various fintech-related developments, including provisions enabling development of a comprehensive regulatory regime for stablecoins and other crypto-assets and a regime for the oversight of critical third-party service providers to regulated financial services firms.

UK regulators are also considering how to respond to other market developments. In October 2022, the FCA and PRA published a joint discussion paper (DP22/4) on artificial intelligence and machine learning in financial services and the FCA published a discussion paper (DP22/5) on potential competition impacts of Big Tech firms entering and expanding in retail financial services.

2.3 Compensation Models

The compensation models that fintech firms can utilise vary depending on the nature of a firm's business and the regulatory rules applicable to that firm.

There are restrictions on charging fees for certain types of payment methods. The Consumer Rights (Payment Surcharges) Regulations 2012 (SI 2012/3110) (the "Surcharges Regulations") impose a ban in relation to payment surcharges, and limits on surcharges for certain payments.

2.4 Variations Between the Regulation of Fintech and Legacy Players

The regulation applicable to both legacy players and fintechs depends on the nature of a firm's business model and the activities that it conducts, which must be determined on a case-by-case basis. That being said, there are areas of regulation aimed at fintechs. For example, the PSRs 2017 include specific rules for small payment institutions.

2.5 Regulatory Sandbox

The FCA is a global pioneer in developing initiatives to support firms using innovative technologies. It has offered a regulatory sandbox since 2016 to allow firms to test innovative products in a controlled environment whilst ensuring there are appropriate consumer protection safeguards in place. The FSMB also provides a proposed framework for a financial market infrastructure (FMI) sandbox, which is discussed further at **7.3 Impact of the Emergence of Cryptocurrency Exchanges**.

2.6 Jurisdiction of Regulators

The key regulators for the UK fintech market are the FCA, the Bank of England, the Prudential Regulatory Authority (PRA) and the Payment Systems Regulator (PSR). A brief description of each of their roles and objectives is summarised below:

- FCA – the FCA's strategic objective is to ensure that markets for financial services function well and it is responsible for, amongst other things: regulating standards of conduct in retail and wholesale financial markets; supervising trading and infrastructures that support those markets; and supervising payment institutions and e-money firms;
- Bank of England – the Bank of England's objective is to protect and enhance the stability of the UK's financial system and it is responsible for monetary policy and financial stability;
- PRA – responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms; and
- PSR – the independent regulator for UK payment systems which is responsible for the regulation of payment systems designated by HMT and the participants in such systems.

Co-operation Between Regulators

The Bank of England, FCA, PRA and PSR have entered into a Memorandum of Understanding setting out how they will co-operate with one another in relation to payment systems in the UK. This includes requirements to consult with one another in certain circumstances, or on matters of common regulatory interest.

Other Regulatory and Public Bodies

There are several other regulatory and public bodies that are relevant to the UK fintech market, including the Financial Ombudsman Service, the Competition and Markets Authority (CMA) and the Information Commissioner's Office (ICO).

2.7 Outsourcing of Regulated Functions

Outsourcing Requirements

Regulated firms may outsource certain functions to third-party service providers; however, they retain full responsibility and accountability for their regulatory duties. Firms are not permitted

to delegate any part of this responsibility to a third party.

Different outsourcing requirements apply to different types of firms, and these requirements often depend on the type of function being outsourced (eg, outsourcings deemed material, critical or important are subject to more stringent rules).

A non-exhaustive list of outsourcing requirements includes:

- regulatory notification obligations where the proposed outsourcing is critical or important;
- performing due diligence on the outsourcing service provider (before the outsourcing, and during the term of the outsourcing arrangement);
- identifying and managing operational risks;
- retaining the expertise to supervise the outsourced functions effectively;
- ensuring there is a written policy; and
- regularly evaluating the contingency arrangements to ensure business continuity in the event of a significant loss of services from the outsourcing service provider.

The FCA and PRA expect firms to apply a risk-based and proportionate approach when meeting their outsourcing requirements, considering the nature, scale and complexity of a firm's operations. FMIs will also be subject to similar rules on outsourcing and third-party risk management from February 2024, supervised by the Bank of England.

Under the FSMB, HMT will also be able to designate cloud and other third-party service providers deemed "critical" to financial services firms and FMIs, giving UK regulators direct oversight of those service providers.

Operational and Cyber-resilience

The FCA's new rules on operational resilience came into force in March 2022. These rules include requiring firms to map important business services (including the people, processes, technology, facilities and information that supports these services) and robustly test contingency arrangements. Firms need to consider their dependency on services supplied by third parties and the resilience of these third-party services. The requirements apply to a wide range of firms, including payment institutions, e-money firms, UK banks, building societies and PRA-designated investment firms.

2.8 Gatekeeper Liability

Certain platform providers may be carrying on regulated activities triggering authorisation under FSMA, depending on their activities and business model, as discussed in **7.1 Permissible Trading Platforms**. Where FSMA authorisation is triggered, they will need to comply with conduct of business requirements relating to the operation of the platform.

The government has announced plans to introduce a regulatory regime aimed at the largest digital firms designated with "strategic market status". In addition, there is a draft Online Safety Bill which intends to improve online safety for UK users by requiring in-scope firms to prevent the proliferation of illegal and harmful content. This is discussed below.

Digital Firms With Strategic Market Status

The government intends to bring forward a new Digital Markets, Competition and Consumer Bill during 2023, to introduce a new pro-competition regime for digital markets. In the interim, a Digital Markets Unit (DMU) was established in April 2021 to prepare for the new regime, and it will

eventually oversee digital platforms designated with strategic market status.

The proposed key pillars applicable to firms with strategic market status are:

- a new, legally binding code of conduct;
- pro-competitive interventions (eg, interoperability requirements); and
- enhanced merger rules to enable the CMA to apply closer scrutiny to transactions involving firms with strategic market status.

The proposed regime is an ex ante regime, focused on preventing harm. It is proposed that the DMU be able to impose penalties of up to 10% of worldwide turnover. The FCA will also be given enforcement and implementation powers in regulated sectors.

Online Safety Bill

In May 2021, the government published a draft of the Online Safety Bill, which was revised and introduced to Parliament in March 2022. As of February 2023, it remains subject to much debate, but is expected to establish a new legal duty of care for in-scope companies and aims to improve the safety of their users online. The proposal includes a requirement for in-scope companies to:

- prevent the proliferation of illegal content and activity online;
- ensure that children who use their services are not exposed to harmful content; and
- maintain appropriate systems and processes to improve user safety.

The Online Safety Bill is intended to apply to companies (including companies outside the UK) whose services either host user-generated content which can be accessed by users in the UK and/or facilitate public or private online interaction between service users, one or more of whom are in the UK.

Only companies with direct control over the content of and activity on a service will be subject to the duty of care. Business-to-business services will remain outside the scope, and there are a number of exemptions, including for services which play a functional role in enabling online activity (eg, internet service providers), services used internally by businesses, and certain low-risk businesses with limited functionality.

Ofcom will be the regulator and its enforcement powers include the ability to impose fines of up to GBP18 million or 10% of a company's annual turnover (whichever is higher) and blocking non-compliant services from being accessed in the UK.

2.9 Significant Enforcement Actions

The PSR and FCA has taken enforcement action against a number of payments firms. Most notably, in January 2022, the PSR fined five companies more than GBP33 million for breaching antitrust rules in the prepaid cards market. In February 2021 the FCA publicly censured a regulated payment institution for failing to safeguard its customers' money and for misuse of its payment accounts under the PSRs 2017. Currently, the PSR has a number of open investigations regarding potential breaches of payments regulations. In addition, the Office of Financial Sanctions Implementation (OFSI) recently imposed financial penalties on two fintechs for breaches of financial sanctions regulations.

UK regulators have not otherwise concluded any significant enforcement actions against fintechs. However, given the sector is under increasing scrutiny, it is expected that regulators will take

enforcement action against fintechs if they identify regulatory breaches.

2.10 Implications of Additional, Non-financial Services Regulations

Firms should assess the impact of non-financial services regulation, including data privacy rules and guidance in relation to big data and AI.

Data Privacy

The UK data protection regime is set out in the Data Protection Act 2018 along with the General Data Protection Regulation ((EU) 2016/679), as it forms part of the domestic law of the UK by virtue of the European Union (Withdrawal) Act 2018 (EUWA). Firms will need to assess the requirements on the processing and storage of personal data on a case-by-case basis. For example, business models using blockchain or distributed ledger technology will need to ensure compliance with the data privacy requirements, which can raise practical issues given the decentralised and immutable nature of blockchain technology.

Technology Development – Big Data and AI

Firms developing innovative technology and software need to assess the legal and regulatory framework in relation to big data and AI. One of the ICO's top three strategic priorities includes addressing data protection risks arising from technology and, specifically, the implications of AI and machine learning. The ICO has published guidance on AI and data protection, which includes advice on how to interpret data protection law as it applies to AI. Additionally, the ICO has published guidance on how organisations can best explain their use of AI to individuals. This addresses transparency and "explainability" in relation to AI, meaning the ability to give full and clear explanations of the decisions made by or with the assistance of AI.

In September 2021, the UK government published its National AI Strategy, in which it committed to develop a pro-innovation national position on governing and regulating AI. Following this, in July 2022, the UK government published a white paper on the UK's position on the governance and regulation of AI, seeking to harness economic and societal benefits while also addressing the complex challenges it presents.

In October 2022, the UK regulators published a joint discussion paper (DP22/4) on the use of AI in financial services and how policy and regulation can support safe and responsible adoption of AI in financial services.

2.11 Review of Industry Participants by Parties Other than Regulators

Industry groups and trade associations (such as UK Finance) play a key role in representing stakeholders, engaging in dialogue with regulators and publishing guidance. Firms may also need to comply with the rules and standards imposed by operators of payment systems. In particular, Pay.UK operates the UK's retail payment systems and is responsible for delivering a New Payments Architecture (NPA) (see **5.1 Payment Processors' Use of Payment Rails**). Firms may need to engage with other external parties such as auditors (to conduct an audit of the accounts or carry out the requisite safeguarding audit) or external consultants.

2.12 Conjunction of Unregulated and Regulated Products and Services

In broad terms, it is permissible for a regulated entity to provide unregulated products and services. However, some high-level FCA rules such as Principles for Business and the individual conduct rules under the Senior Managers and Certification Regime may apply to that unregulated activity. The FCA also reminded authorised

firms in a Dear CEO letter dated January 2019 that they must not indicate or imply that they are regulated or otherwise supervised by the FCA in respect of unregulated activities that they carry on. Any financial promotions that also refer to unregulated products or services should make clear those aspects which are not regulated. Experience shows that some firms establish a separate entity to provide unregulated products and services.

See **12.2 Local Regulators' Approach to Blockchain** in relation to future changes in the regulatory perimeter with respect to crypto-assets.

2.13 Impact of AML Rules

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLR) impact both regulated firms (eg, payment institutions and e-money firms) and unregulated firms. For example, certain crypto firms that are not currently regulated by the FCA must register with the FCA and comply with the requirements of the MLR, including customer due diligence requirements (see **7.3 Impact of the Emergence of Cryptocurrency Exchanges**). Based on public records, the FCA applied a high bar when assessing AML controls of crypto-asset firms meaning that many crypto-asset firms that applied for registration under the MLR were ultimately unsuccessful.

3. Robo-advisers

3.1 Requirement for Different Business Models

Robo-advice is an umbrella term that refers to a broad spectrum of automated digital or online advice tools. Many firms use hybrid business models which combine automated advice with some potential for interaction with a human adviser. The FCA "think it is likely that hybrid models will continue to dominate the sector" (in a report dated December 2020).

There is no single, specific regime for robo-advisers. The regulatory requirements applicable to each firm depend on the nature of the activities it performs. The provision of investment advice is a regulated activity in the UK. There are also a number of other regulated activities which may be performed in connection with robo-advisory services such as arranging transactions in investments and making arrangements with a view to transactions in investments.

The FCA confirmed that it expects automated investment services to meet the same regulatory standards as traditional discretionary or advisory services, particularly in relation to suitability requirements. The FCA established its Advice Unit in 2016, which provides regulatory feedback to firms developing automated advice models.

3.2 Legacy Players' Implementation of Solutions Introduced by Robo-advisers

According to the FCA, all major retail banks are expected to have an automated advice proposition in the next few years. Such legacy players will be able to leverage their existing client base.

3.3 Issues Relating to Best Execution of Customer Trades

The best execution rules are capable of applying to robo-advisers, depending on the nature of the activities conducted by the firm. Best execution means firms must obtain the best possible result for their clients when executing client orders or passing them to other firms for execution. The requirements vary depending on the nature of the activities conducted by the firm. Firms that execute orders on behalf of clients are subject

to more onerous requirements than firms that transmit or place orders with other entities for execution. The best execution requirements are primarily set out in the FCA's Conduct of Business Sourcebook (COBS).

The UK best execution rules are derived from the EU regime (in particular, under MiFID2 and MiFIR). Firms are expected to adhere to guidance issued by EU supervisors prior to Brexit, interpreting it in light of the UK's withdrawal from the EU and associated UK legislative changes.

4. Online Lenders

4.1 Differences in the Business or Regulation of Loans Provided to Different Entities

There are significant differences in the regulation of lending to consumers and commercial lending. Commercial lending activities do not typically trigger a regulatory authorisation requirement. In contrast, there are a number of regulated consumer credit activities in the UK, including the activity of entering into a regulated credit agreement.

For details on peer-to-peer lending, see **7.1 Permissible Trading Platforms**.

4.2 Underwriting Processes

The requirements for underwriting processes depend on the type of credit activity being carried out. For consumer credit, the FCA's Consumer Credit Sourcebook (CONC) requires firms to undertake a creditworthiness assessment of a customer. The FCA has also communicated its expectations in relation to vulnerable consumers. Firms will also need to comply with the applicable rules relating to anti-money laundering and KYC requirements.

4.3 Sources of Funds for Loans

The source of funds permissible for each business depends primarily on the nature of the lender. For example, banks are permitted to use deposits to fund loans subject to certain conditions, whereas some entities may obtain funds through peer-to-peer lending.

4.4 Syndication of Loans

Consumer credit loans are not typically syndicated.

5. Payment Processors

5.1 Payment Processors' Use of Payment Rails

HMT has the power to designate a payment system as a regulated payment system, which brings the system's participants (operators, infrastructure providers, and payment service providers that provide payment services using the system) within the scope of the Payment Service Regulator's powers. There are currently nine payment systems which have been designated by HMT, as follows:

- BACS;
- CHAPS;
- Faster Payments Scheme (FPS);
- Sterling Fnality Payment System (Fnality);
- LINK;
- Cheque and Credit;
- Northern Ireland cheque clearing;
- Visa Europe; and
- Mastercard.

Fnality is the first distributed ledger technology (DLT) based payment system to be designated in the UK. See **12. Blockchain** for further detail on regulation of blockchain, DLT and crypto-assets.

Payment processors are permitted to create their own payment rails outside these designated systems. Such other payment systems could, however, be designated by HMT in future if they become important enough.

New Payments Architecture
Retail payments in the UK have historically been processed using separate infrastructures, resulting in a mix of rules and standards around processing, settlement cut-off times and messaging formats. There is a proposal to bring certain payment systems together to simplify the requirements for payment service providers.

Pay.UK (the operator of BACS and FPS) is responsible for facilitating the delivery of the NPA, which is a new way of organising interbank payments. The NPA is intended to replace the existing central infrastructure for FPS (and BACS at a later stage) and will provide more technically advanced central infrastructure which includes API connectivity. Testing of the NPA is expected to start during 2023 with go-live planned for 2024.

Payments Landscape Review
HMT consulted in July 2022 on various proposed reforms to the payments regulatory landscape, following its 2021 Payments Landscape Review. This included proposals to bring systemically important firms in payments chains into Bank of England regulation and supervision. HMT has also consulted in January 2023 on its review of the PSRs 2017.

5.2 Regulation of Cross-Border Payments and Remittances
Brexit has resulted in changes to the regulation of cross-border payments in the UK, including in respect of the UK Cross-Border Payments Regulation, UK Funds Transfer Regulation and Single Euro Payments Area (SEPA) transactions.

Cross-Border Payments Regulation
The UK has onshored some aspects of the EU Cross-Border Payments Regulation relating to transparency requirements on currency conversion charges. However, post-Brexit, the principle of equality of charges for cross-border and corresponding national payments is not part of the UK regime.

UK Funds Transfer Regulation
Post-Brexit, it is now necessary to provide the name of the payer and payee, and the address of the payer, when making payments between the UK and the EU. The UK regime is set out under the MLRs and in Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers, as it forms part of domestic law of the UK by virtue of the EUWA (the “UK Funds Transfer Regulation”).

Amendments to the MLRs extend similar requirements to crypto-asset transfers under the so-called “travel rule” effective from 1 September 2023.

SEPA
The UK has maintained participation in SEPA as a third country. SEPA enables quick and efficient cross-border payments across the EU and a number of third countries.

6. Fund Administrators

6.1 Regulation of Fund Administrators
Whilst there is no regulated activity which specifically covers fund administration services, a fund administrator could potentially fall within the

scope of the UK regulatory regime, depending on the nature of the activities that it conducts. In particular, a fund administrator should assess whether it is conducting the regulated activity of advising on investments, arranging deals in investments, and establishing, and operating or winding up either a collective investment scheme or an unregulated collective investment scheme. It may also need to consider whether it is acting as a manager of a UK undertaking for collective investment schemes (UCITS) or UK alternative investment funds (AIFs) or a depositary, as there are detailed rules that apply to these entities.

6.2 Contractual Terms

The contractual terms that a fund administrator enters into may need to reflect regulatory requirements in relation to outsourcing, the processing of personal data, and potentially other regulatory requirements which will depend on the specifics of the business model and nature of activities being performed.

7. Marketplaces, Exchanges and Trading Platforms

7.1 Permissible Trading Platforms

Exchanges and Trading Platforms

Stock exchanges (including UK-recognised investment exchanges), securities markets, and operators of such markets are heavily regulated. There are three main types of trading venues (regulated markets, multilateral trading facilities (MTFs) and organised trading facilities (OTFs)) and different rules apply to companies with shares trading on each of these markets.

To the extent that an exchange or trading platform engages with crypto-assets or tokens that come into the scope of the UK's regulatory perimeter (see **7.2 Regulation of Different Asset Classes**), the entity may be carrying out a regulated activity. For example, this may include operating an MTF or OTF, dealing in investments as principal or as agent, arranging deals in investments, sending dematerialised instructions, making arrangements with a view to investments, and safeguarding and administering investments.

For a discussion on the regulatory regime applicable to crypto-exchanges and the UK FMI sandbox, please see **7.3 Impact of the Emergence of Cryptocurrency Exchanges**.

Peer-to-Peer and Crowdfunding

The activity of operating a crowdfunding platform may be regulated, depending on the nature of the activity conducted. The FCA regulates the following crowdfunding activities:

- loan-based crowdfunding (known as peer-to-peer lending): where consumers lend money in return for interest payments and a repayment of capital over time; and
- investment-based crowdfunding: where consumers invest directly or indirectly in businesses by buying investments such as shares or debentures.

Payment services provided in connection with the following activities are also regulated:

- donation-based crowdfunding: where consumers give money to enterprises or organisations they want to support; and
- prepayment or rewards-based crowdfunding: where consumers give money in return for a reward, service or product (such as concert tickets, an innovative product, or a computer game).

EU rules on crowdfunding were not "onshored" into UK law at the end of the Brexit transition period (which expired on 31 December 2020) and the UK government has not indicated it intends to implement similar rules. However, HMT has proposed introducing a licensing regime for firms operating a crypto-asset lending system. See **12.2 Local Regulators' Approach to Blockchain**.

7.2 Regulation of Different Asset Classes

See **2.2 Regulatory Regime** for a discussion on the licensing regime. In broad terms, an activity is a regulated activity if it is an activity of a specified kind that is carried on by way of business in the UK and relates to a specified investment under the RAO. In general, the MiFID2 financial instrument categories map into RAO-specified investment categories.

7.3 Impact of the Emergence of Cryptocurrency Exchanges

Firms which carry on certain crypto-asset-related activities in the UK, referred to as crypto-asset exchange providers and custodian wallet providers, are subject to the MLR. Crypto-asset exchange providers and custodian wallet providers are required to register with the FCA. They are subject to ongoing obligations, such as requirements to take steps to identify and manage the risks of money laundering and terrorist financing. These include establishing appropriate policies, controls and procedures, and carrying out the requisite customer due diligence.

Crypto-asset exchanges may be subject to other regulatory requirements depending on the regulatory characterisation of the types of crypto-assets that are traded on the exchange, and the activities that the firm conducts. For example, if the crypto-asset qualifies as a transferable security or other financial instrument, the operator of the exchange may need to be authorised as the operator of an MTF or OTF. A crypto-exchange business should also consider whether it is issuing electronic money or providing a payment service.

UK FMI Sandbox

The FSMB includes proposals to grant HMT the power to create sandboxes which would allow FMIs and other designated persons to test and adopt new technologies and practices (such as distributed ledger technology) by temporarily disapplying, modifying or even applying certain legislation for specific purposes. This is an important step towards ensuring that UK FMIs can fully embrace technological innovation as part of a wider effort to ensure that the UK continues to be attractive as a fintech hub.

7.4 Listing Standards

There are no specific listing standards for unregulated platforms (or for listing unregulated crypto-assets, though HMT consulted in January 2023 on introducing the expansion of the regulatory perimeter to include these activities). However, crypto-assets that have substantive characteristics that are akin to traditional securities (eg, shares or bonds) will be regulated as securities. For example, if a crypto-asset or token is a transferable security and the tokens are either offered to the public in the UK or admitted to trading on a regulated market, the issuer will need to publish a prospectus unless an exemption applies.

There are detailed rules governing the eligibility requirements and ongoing obligations for a premium and standard listing of shares on a UK-regulated market, including prospectus requirements. A fintech firm interested in listing would need to consider these requirements. FCA rules

also set out requirements for operators of MTFs and OTFs.

7.5 Order-Handling Rules

The FCA's Handbook contains rules in relation to client order handling requirements and client limit orders.

7.6 Rise of Peer-to-Peer Trading Platforms

See **7.1 Permissible Trading Platforms** for further details on the regulatory framework for peer-to-peer platforms.

7.7 Issues Relating to Best Execution of Customer Trades

See **3.3 Issues Relating to Best Execution of Customer Trades** for further details on the best execution requirements.

7.8 Rules of Payment for Order Flow

An FCA report dated April 2019 discusses the expectations in relation to payment for order flows. This occurs when an investment firm (eg, a broker) that executes orders for its clients receives a fee or commission from both the client that originates the order and the counterparty the trade is then executed with (typically a market-maker or other liquidity provider). These payments can create a conflict of interest between the firm and its clients. Regulated firms that engage in payment for order flows must consider the FCA's rules in respect of the inducements regime, managing conflicts of interest and meeting the best execution requirements.

7.9 Market Integrity Principles

The UK market abuse regime is primarily set out in Regulation (EU) 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse as it forms part of domestic law of the UK by virtue of the EUWA (UK MAR). This contains prohibitions on insider dealing, unlawful disclosure of inside information and market manipulation.

Broadly speaking, the scope of the market abuse regime under UK MAR covers financial instruments (including security tokens) that are traded or admitted to trading on a trading venue or for which an application for admission has been made, as well as financial instruments whose price or value depends on or has an effect on the types of financial instruments referred to above. Certain provisions of UK MAR also apply to spot commodity contracts, financial instruments that affect the value of spot commodity contracts and behaviour in relation to benchmarks.

FX transactions and unregulated crypto-assets (such as cryptocurrencies) are not generally captured by the regime, though HMT's January 2023 consultation on a new regulatory regime for crypto-assets does propose introducing a market abuse regime for crytpo-assets. See **12.2 Local Regulators' Approach to Blockchain**.

8. High-Frequency and Algorithmic Trading

8.1 Creation and Usage Regulations

Algorithmic trading, including high-frequency algorithmic trading, is regulated in the UK. Algorithmic trading requirements encompass trading systems, algorithmic trading strategies and trading algorithms.

The definition of algorithmic trading is limited to trading in "financial instruments" – defined by reference to specified investments in the RAO, which broadly maps the MiFID2 financial instruments categories. Therefore, algorithmic trading in asset classes which do not constitute "finan-

cial instruments" will not constitute "algorithmic trading" for regulatory purposes.

8.2 Requirement to Register as Market Makers When Functioning in a Principal Capacity

There are specific requirements for firms who engage in algorithmic trading to pursue a market-making strategy. In particular, such firms must:

- carry out market-making continuously during a specified proportion of the trading venue's trading hours so that it provides liquidity on a regular and predictable basis to that trading venue, except in exceptional circumstances;
- enter into a binding written agreement with the trading venue; and
- have in place effective systems and controls to ensure that it meets the obligations under the agreement.

However, the FSMB is expected to give the FCA powers to remove the requirement for algorithmic liquidity providers and trading venues to enter into binding market-making agreements, following the outcome of the UK's Wholesale Markets Review.

8.3 Regulatory Distinction Between Funds and Dealers

There are no specific rules which distinguish between funds and dealers engaging in algorithmic trading.

8.4 Regulation of Programmers and Programming

Whilst providers of algorithmic trading systems are not typically subject to the same regulations as the firms employing their software, there are regulatory requirements that apply when developing and creating algorithmic trading programmes. Firms that engage in algorithmic trading must have effective systems and controls to ensure their trading systems meet these requirements. They must:

- be resilient and have sufficient capacity;
- be subject to appropriate trading thresholds and limits;
- prevent the sending of erroneous orders, or the systems otherwise functioning in a way that may create or contribute to a disorderly market; and
- not be used for any purpose that is contrary to UK MAR or the rules of a trading venue to which they are connected.

Market conduct considerations need to be a vital part of the algorithm development process. The FCA has noted that it is good practice for firms to consider, as part of their approval process, the potential impact of algorithmic trading strategies. The considerations would not be limited to whether a strategy strictly meets the definition of market abuse; rather, they would consider whether the strategy would have a negative impact on the integrity of the market and/or if it would likely further contribute to scenarios where there is wider market disruption.

9. Financial Research Platforms

9.1 Registration

The extent to which a financial research platform would be regulated in the UK depends on the exact nature of its activities and the content of the research it provides.

Licensing Requirements

Producing research material of a general and purely factual nature is unlikely to trigger any licensing requirements in the UK. However,

research materials that provide recommendations in relation to individual securities, for example, may constitute regulated investment advice. This would mean that the platform provider would need to be authorised by the FCA to provide investment advice.

Financial Promotion Restrictions

If the financial research platform produces content that would induce clients to enter into investment activity, this would constitute a financial promotion. There is a restriction prohibiting any person from issuing financial promotions unless that person is authorised, the content of the promotion is approved by an authorised person or, if the issuer of the financial promotion is not authorised, that person must rely on certain exemptions.

9.2 Regulation of Unverified Information

As discussed in **7.9 Market Integrity Principles**, UK MAR prohibits insider dealing, unlawful disclosure of inside information and market manipulation. The dissemination of rumours and other unverified information – including through online channels – may, in some cases, constitute market manipulation.

Additionally, to the extent that a platform is providing investment advice, it must ensure that investment recommendations and supporting information are objectively presented, and disclose any conflicts of interest. If the financial research platform is engaged in financial promotions, the content of any financial promotions must be clear, fair and not misleading.

9.3 Conversation Curation

UK MAR prohibits insider dealing, unlawful disclosure of inside information and market manipulation; see **7.9 Market Integrity Principles**.

The FCA's Handbook provides descriptions of behaviour that amounts to market abuse. This includes voicing an opinion via traditional or electronic media about an in-scope investment while having previously taken positions on that investment, and profiting from the impact of the opinions voiced on the price of that instrument without having disclosed that conflict of interest to the public. It also includes "pump and dump" and "trash and can" schemes (which entail taking a position on an in-scope investment and disseminating misleading information about that investment with a view to changing its price).

10. Insurtech

10.1 Underwriting Processes

Insurtechs have transformed the underwriting processes used in the insurance industry. These firms typically use big data and AI technology to inform underwriting decisions, including pricing strategies and risk assessments. Insurtechs must consider their regulatory obligations in relation to data privacy, the use of big data and AI ethics (see **2.10 Implications of Additional, Non-financial Services Regulations**).

10.2 Treatment of Different Types of Insurance

In principle, all types of insurers are regulated in the same way. Subject to a few exceptions, they are all subject to the UK regime, which implemented the Solvency II Directive, and to prudential regulation by the PRA. In November 2022, the UK government announced its policy proposals to amend and tailor the prudential regime to support the unique features of the insurance sector and regulatory approach in the UK, in a post-Brexit context.

11. Regtech

11.1 Regulation of Regtech Providers

There is no specific regulatory regime for regtech providers. Regtech providers typically provide technical services and so may be less likely to trigger a regulatory licensing requirement. However, such firms should assess whether they are conducting a regulated activity in light of their specific business model and the activities that they perform.

11.2 Contractual Terms to Assure Performance and Accuracy

A regtech provider may need to reflect in its contractual terms any requirements relating to outsourcing, the processing of personal data, and potentially other regulatory requirements which will depend on the specifics of the business model and nature of activities being performed.

12. Blockchain

12.1 Use of Blockchain in the Financial Services Industry

The financial services industry has been exploring the use of blockchain or DLT in various ways, including cross-border payments and remittance, trade finance, and identity verification. Financial institutions have traditionally taken a cautious approach to adopting blockchain technologies. This is likely due to reputational, data privacy and security considerations. However, there are increasing signs of growth assisted by regulators providing legal clarity in relation to blockchain-related activities. It is expected that legacy players will increase their use of private, permissioned blockchain networks, particularly where pilot projects have demonstrated the feasibility and benefits of use.

12.2 Local Regulators' Approach to Blockchain

A non-exhaustive list of the key developments in the regulatory framework applicable to blockchain technology follows.

- The UK has brought custodian wallet providers and crypto-asset exchange providers into the scope of AML regulation. See **7.3 Impact of the Emergence of Cryptocurrency Exchanges**.
- In July 2019, the FCA published its Final Guidance on when crypto-related activities will fall within the scope of its regulatory perimeter, including a taxonomy for crypto-assets (see **12.3 Classification of Blockchain Assets**).
- On 18 November 2019, the UK Jurisdiction Taskforce published a Legal Statement on Crypto-assets and Smart Contracts to address legal questions as regards the status of crypto-assets and smart contracts. In December 2019, these statements were referenced in a High Court judgment.
- In March 2021, the UK tax authority (HMRC) published a manual on the tax treatment of crypto-assets (following previous guidance published in December 2019).
- On 6 January 2021, a ban on the sale, marketing and distribution to all retail consumers of derivatives and exchange-traded notes that reference unregulated transferable crypto-assets by firms acting in, or from, the UK came into effect.
- In July 2022, the Law Commission published a consultation on the status of crypto-assets as property. The consultation closed in November 2022 and the Law Commission intends to publish a final report with its law reform recommendations in 2023.
- In January 2023, HMT published the outcome of its consultation on the extension of the

financial promotions regime to crypto-assets and a consultation on regulation of crytpo-assets.

Additionally, some of the key proposals on changes to the UK regulatory regime in respect of crypto-assets are summarised below.

Proposed Extension of Financial Promotions Regime to Crypto-assets

In January 2023, HMT published the outcome of its consultation on the extension of the financial promotions regime to crypto-assets, confirming the UK's intention to bring additional types of crypto-assets into the scope of financial promotion regulations. Due to industry feedback, and as there is not yet a UK authorisation regime for crypto-asset activities, HMT proposes to introduce a temporary exemption to the financial promotions restriction at Section 21 FSMA, which will enable crypto-asset businesses that are registered with the FCA under the MLRs (but which are not authorised under FSMA) to communicate their own financial promotions in relation to qualifying crypto-assets.

In February 2023, the FCA issued a statement on the future crypto-asset financial promotions regime, indicating that the FCA will take robust action against firms that breach the restrictions (including firms outside the UK). The FCA also confirmed that it would publish final rules on crypto-asset promotions once the statutory regime has been made. This follows an FCA consultation from January 2022 on strengthening its financial promotion rules for high-risk investments (for which the FCA published a policy statement in August 2022) and for crypto-assets.

Regulation of Crypto-assets

The FSMB proposes to introduce a regime for regulation of fiat-backed stablecoins that are used for payments (termed "digital settlement assets"). See **12.7 Virtual Currencies**.

In January 2023, HMT published a consultation proposing an extension of the FSMA licensing regime to firms engaging in certain crypto-asset activities. HMT intends to create various new regulated activities or designated activities (under the new designated activities regime introduced under the FSMB) relating to crypto-assets.

Many of these proposed activities mirror, or closely resemble, regulated activities under the existing FSMA regime, though some novel crypto-asset activities are proposed. The proposals include a regime for the issuance, offering and admission to trading of in-scope crypto-assets and a crypto-asset market abuse regime based on elements of UK MAR for financial instruments. The proposals also cover the operation of a platform to facilitate crypto-asset lending.

Work on a UK Central Bank Digital Currency

In April 2021, the Bank of England and HMT launched a joint Central Bank Digital Currency (CBDC) Taskforce to co-ordinate the exploration of a potential UK CBDC. In February 2023, HMT and the Bank of England published a consultation on the design of a potential UK CBDC. Work is now moving onto a "design phase", which will look at the technology and policy requirements for a digital pound.

12.3 Classification of Blockchain Assets

Whilst there is no specific legislation for blockchain assets, certain uses of blockchain technology and related crypto-asset types could fall within the UK's regulatory perimeter. Currently,

some (but not all) crypto-assets are regulated in the UK. The FCA has indicated that a case-by-case analysis is needed to determine the correct regulatory treatment of a particular crypto-asset or token, depending on "the token's intrinsic structure, the rights attached to the tokens and how they are used in practice". Therefore, the structure and substantive characteristics of the blockchain asset determine whether it is regulated in the UK.

The FCA has identified three broad categories of crypto-assets comprising:

- security tokens (crypto-assets with characteristics akin to traditional securities);
- e-money tokens (crypto-assets that meet the definition of electronic money under the EMR 2011: broadly, digital payment instruments that store value, can be redeemed at par value at any time, and offer holders a direct claim on the issuer); and
- unregulated tokens (including cryptocurrencies such as Bitcoin).

Both security tokens and e-money tokens fall within the scope of the UK's regulatory perimeter as specified investments under the RAO, whereas crypto-asset firms providing exchange or wallet services for unregulated tokens in the UK are only subject to registration under the MLRs.

A new definition and classifications of crypto-assets are proposed under the FSMB and HMT's 2023 consultation on a regulatory regime for crypto-assets.

12.4 Regulation of "Issuers" of Blockchain Assets

There is no single regulatory regime for issuers of blockchain assets. An issuer may come within the scope of the UK's regulatory perimeter, depending on the nature of its activities. In particular, issuers of blockchain assets should consider whether they are crypto-asset exchange providers as discussed in **7.3 Impact of the Emergence of Cryptocurrency Exchanges**.

Issuers should be aware of potential future changes to the regulatory regime, including the HMT's January 2023 consultation on expanding the UK regulatory regime to encompass certain crypto-asset activities, including issuance activities.

12.5 Regulation of Blockchain Asset Trading Platforms

The FCA has confirmed that crypto-asset exchanges allowing trading in security tokens must ensure they have appropriate authorisation and permissions for their activities as discussed in **7.1 Permissible Trading Platforms**. Additionally, crypto-asset trading platforms should consider whether they fall within the categories of crypto-asset exchange providers or custodian wallet providers subject to registration under the MLRs, or whether they could benefit from the FMI sandbox as described in **7.3 Impact of the Emergence of Cryptocurrency Exchanges**.

12.6 Regulation of Funds

Funds that invest in blockchain assets are subject to the usual regulatory rules applicable to investment funds and collective investment schemes. The FCA has confirmed that firms can gain exposure to unregulated tokens (such as exchange tokens) through financial instruments such as fund units and derivatives referencing those tokens. These financial instruments are likely to fall within the UK regulatory perimeter (even though they reference unregulated crypto-assets) as specified investments (eg, options,

futures or contracts for difference under the RAO).

There is a ban on the sale to retail consumers of derivatives and exchange-traded notes that reference unregulated transferable crypto-assets, as discussed in **12.2 Local Regulators' Approach to Blockchain**.

12.7 Virtual Currencies

The UK regulatory regime is technology agnostic. The regulatory treatment of virtual currencies does not depend on whether they rely on blockchain technology. See **12.3 Classification of Blockchain Assets** for further details on the regulatory classification of crypto-assets.

However, the UK government does plan to introduce a new regulatory regime for fiat-backed stablecoins, or digital settlement assets (DSAs), under the FSMB. In particular, HMT will be empowered to:

- establish an authorisation and supervision regime for issuers of DSAs and payment service providers using DSAs;
- recognise operators of systemic payment systems using DSAs and service providers to those payment systems, bringing them within the scope of Bank of England supervision; and
- extend the FMI special administration regime to systemic DSA firms, with appropriate modifications.

Exploration of a UK CBDC is also underway as discussed at **12.2 Local Regulators' Approach to Blockchain**.

12.8 Impact of Regulation on "DeFi" Platforms

Decentralised finance (DeFi) is an umbrella term covering the use of blockchain technology which commonly takes the form of decentralised apps that use smart contracts to automate transactions to provide traditional financial services (such as loans and insurance) without human involvement.

An HMT consultation published in January 2021 confirmed that, at present, certain DeFi activities could fall within the UK's regulatory perimeter, and the "government does not currently propose to bring specific DeFi activities into the scope of regulation", but this will be kept under review.

12.9 Non-fungible Tokens (NFTs)

NFTs are a type of crypto-asset that can be used to create tokenised ownership of a unique digital version of underlying physical or digital assets (eg, artworks, sports memorabilia, and other collectibles). Each NFT is unique, meaning that NFTs are distinguishable from and not interchangeable with other NFTs.

There is currently no NFT-specific regulation in the UK. However, depending on the NFT's features and activities being carried on, certain activities with respect to some types of NFTs could fall within the UK's existing regulatory perimeter. See **12.3 Classification of Blockchain Assets** for details on the regulatory classification of crypto-assets.

13. Open Banking

13.1 Regulation of Open Banking

The PSRs 2017 facilitated the roll-out of open banking by introducing regulation for third-party payment service providers (TPPs) and requiring

account servicing payment service providers to open up access to accounts and data to TPPs within the regulatory framework.

At present, the UK's largest banks and building societies are required to make customer data available through use of standardised open banking application programming interfaces (APIs), but some other smaller banks and building societies have also chosen to adopt open banking APIs, including as a means of compliance with their broader obligations to facilitate TPP access to accounts under the PSRs 2017. There may be an expansion of open banking to a wider range of accounts and financial products (such as savings, mortgages, consumer credit, investments and insurance) as part of the FCA's proposed open finance initiative.

The UK has also been considering similar broader initiatives as part of its Smart Data review; the government proposed next steps for Smart Data in September 2020 and indicated in a July 2022 impact assessment that its preferred policy option would be to introduce primary legislation to facilitate a Smart Data framework. In the area of pensions, the Pension Schemes Act 2021 introduces a legislative framework for pensions dashboards that will enable consumers to access data about all their pensions in one place, with the first pension schemes required to connect to dashboards from August 2023.

13.2 Concerns Raised by Open Banking

The PSRs 2017 include rules on the access and use of data by TPPs as well as strong customer authentication (SCA) and secure communication standards, which address some of the concerns in relation to data sharing in the context of open banking. Although regulatory rules introducing SCA requirements generally began to apply from 14 September 2019, the FCA granted certain sectors of the industry additional time to prepare and implement these requirements to minimise potential disruption to merchants and customers.

In the context of proposals for open finance, the FCA has noted that greater access to data gives rise to the potential for personalised pricing to almost an individual basis, which could lead to forms of discrimination. The FCA has emphasised the importance of ensuring that data is held securely and used in an ethical manner in its open finance feedback statement published in March 2021. An anticipated Smart Data legislative framework may seek to address some of these issues.

Clifford Chance has a market-leading, multi-disciplinary fintech practice with significant depth across five continents, providing an unparalleled international reach. Clients approach the firm for advice on their most transformational fintech projects across key areas such as blockchain, smart contracts, digital assets, payments, AI, data, cyber and insurtech. The firm's fintech clients range from tech-focused corporates branching out into financial services, banks and other financial institutions, regulators and governments, insurance companies, sovereign wealth funds, asset managers and private equity houses, right through to fintech and insurtech disruptors, start-ups and industry consortiums. The firm is deeply embedded within the UK and global fintech ecosystem and collaborates with leading industry-wide working groups, consortia and academic institutions, including R3, GBBC Digital Finance, CryptoUK, the Digital Pound Foundation and the Crypto Council for Innovation.

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