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Helping fintechs move up to the next level

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Lawyers in Spain and Portugal will have their hands full advising a plethora of financial and banking start-ups as new regulations help to create the perfect environment for innovators and investors

The future of finance is digital, and digital transformation will be key for relaunching and modernising the Spanish and Portuguese economies. Iberia is fast becoming an attractive market for local and international fintech initiatives due to the fast adoption of mobile-based and other non-banking payments and financial solutions, both by users and enterprises.

In addition, some Iberian cities such as Barcelona are cited as among the best locations in Europe for launching fintech projects (Savills European Fintech Occupier Index ranked Barcelona at no.4 and Madrid at no.6 out of 23 European cities). The pull for fintech businesses lies in high-quality financial services infrastructure combined with strong tech employment growth prospects, a large working-age population, the moderate costs of employing tech-savvy professionals and cost-effective office rents (at €342 per sq m, less than a third of cities such as London).

According to co-head of Garrigues' digital and fintech hub, José Ramón Morales, these factors generate a great opportunity in a number of fintech fields, "particularly in paytech, but also in many other verticals such as wealthtech, insurtech, automated trading, alternative financing, crowdfunding and crowdlending, among others."

Over the past few years, a growing number of fintech projects have launched or announced the opening of their operations in Iberia, including: established challenger banks Revolut and N26; e-wallet payment solutions (Samsung Pay, Apple Pay and Google Pay); local consolidated emerging companies such as Fintonic (personal finance), Kantox (currency risk management solutions) and Bip&Drive (mobility payments); and traditional banks, either by creating their own fintech brands (CaixaBank's ImaginBank) or in joint projects in collaboration with other banks (e.g. P2P mobile payments solution Bizum).

Large international fintechs have also acquired Spain-based entities (in 2020, US company Square acquired Verse, Swedish company Tink acquired Eurobits, and Australian company Afterpay acquired Pagantis).

The Lawyer spoke t finance specialists from firms in Spain and Portugal to find out the legal uncertainties and challenges, as well as what lies ahead.

Q *What legislative changes have taken place in Europe in recent months that have supported the rise of fintech?*

José Ramón Morales, Garrigues: EU regulation of electronic payment services (PSD2) implementation in Spain and Portugal represented an excellent tool to leverage opportunities to open up the markets to new entrants: a large number of start-ups and emerging companies using banks' application programming interfaces (APIs) launched new services available to users and enterprises (or improved existing services due to a better integration with the client's information controlled by banks).

In addition, the efforts made by banks to adapt to PSD2 open API requirements have been harnessed by banks to create a new strategy of partnerships with more dynamic players and to launch open banking initiatives (beyond the payments field) that are transforming the banking business and increasingly impacting the market. Strong customer authentication requirements arising from PSD2 are boosting the process of digital transformation of banks, as well as merchants, most of whom are SMEs. Adoption of EU eIDAS Regulation 23 July 2014 has also ▶

On the panel

Isabel Aguilar, banking and finance partner and head of fintech, Uría Menéndez

Tiago Correia Moreira, banking and finance partner, Vieira de Almeida (VdA)

Miguel Lamo de Espinosa, head of banking and finance, Gómez-Acebo & Pombo

António Payan Martins, Portugal partner and head of banking and finance, CMS

José Ramón Morales, co-head of digital and fintech hub, Garrigues

Miguel Sánchez Monjo, finance partner and Elisenda Baldrís, senior associate, Cuatrecasas helped to clarify the role of entities providing electronic identification and trust services for electronic transactions on a cross-border basis. This regulation, together with recently published Spanish Law 6/2020, provides a predictable regulatory environment to enable secure and seamless electronic interactions with special incidence in the fintech industry: remote on-boarding processes (for AML and other regulatory requirements), online transactions which require a high degree of trust and the ability to generate strong electronic evidences (for the purposes of MiFID and MiFID II among others).

And recently approved EU Regulation 2020/1503 on European crowdfunding service providers for business will represent a landmark for cross-border crowdfunding projects gaining legal clarity and a more homogenous regime across the EU.

Finally, the proposed EU digital finance package, which includes legislative proposals for a regulation on Markets in crypto-assets as well as a regulation for a pilot regime for DLT-based market infrastructures may represent an excellent opportunity to enable the financial sector's adoption of distributed ledger technologies while mitigating the potential risks.

Q *Can you discuss the relationship between fintech firms and the Spanish banking sector?*

Miguel Lamo de Espinosa, Gómez-Acebo & Pombo: Consumers expect more from their financial services providers and the Spanish banking sector is embracing financial innovation to evolve and grow, implementing new digital solutions fast and highly efficiently at scale. For example, we advised a large EU financial institution in the development of its robo-advisor platform in Spain after MiFID II.

Isabel Aguilar, Uría Menéndez: We have recently seen the rise of the so-called 'enhanced user experience' concept throughout different industries, particularly through the development of new, more creative multi-platform apps for streaming, finding property or even retail services that aim to quickly bring users the right content. Clients increasingly demand a more evolved user experience also in their consumption of financial services and interaction with financial services providers. This shift in demand, paired with the banks' need to become more efficient and for swifter institutions, has resulted in their slow but steady internal transformation where the use of technology is essential.

The aim of this transformation is for banks to meet new customer demands more quickly but also to streamline their own internal processes to reduce costs and increase efficiency.

To that end, cooperation between banks and non-traditional fintechs has been key and the former is investing progressively more in the latter. In fact, data from September 2020 shows that around 75 per cent of Spanish fintech companies actively collaborate with entities in the Spanish banking and financial sectors.

Ramón Morales: In the past few years, the Iberian market has seen a number of projects, transactions and partnerships, with fierce competition between pre-existing players and new entrants (bigtechs, emerging fintech entities). Examples include:

- Open banking initiatives launched by banks, initially reluctant to share their clients' data but increasingly seeing open banking as an excellent opportunity to create a new strategy of partnerships with more dynamic players to accelerate transformation of the traditional banking business models. This includes API marketplaces for start-up acceleration programmes, either internally in certain banks or in collaboration with innovation platforms (Caixabank's recent collaboration with Plug and Play).
- Joint development of fintech innovative initiatives by banks (Bizum, which started with P2P mobile payments between consumers, and now also offers payments to merchants, and has more than 14 million active users) owned by 24 banks operating in the Spanish market.
- Creation by banks of specialist subsidiaries or brands adopting fintech business models or business approach (CaixaBank's Imaginbank).
- Investments made in the past few years by large pre-existing banks in already existing fintech businesses (BBVA acquiring 39 per cent of the digital-only UK-based Atom Bank, Santander investing in the US-based Upgrade and in UK fintech Uncapped).
- Partnerships between Iberian banks with foreign fintechs from the US, United Arab Emirates or Asia, in many different areas (e-wallets, interoperability of payment solutions, among others).

Q *What significant legal ramifications and challenges does the growth of fintech have?*

Tiago Correia Moreira, VdA: The most relevant legislative changes are those related to the EU digital finance package, including proposals on the regulation of crypto-assets and the pilot regime for issuance of securities under blockchain-related technology. In Portugal, a draft decree-law has also been prepared to deal with free law technology areas which will certainly benefit fintechs when it comes into force.

Ramón Morales: The main challenges in connection with the growth of fintech can be illustrated as follows:

- How the existing regulation (on financial conduct, but also on prudential supervision) matches with new business models enabled by technology in a context of

> The economic downturn caused by the pandemic has increased the attractiveness of alternative ways of investing"
> *Miguel Sánchez Monjo, Cuatrecasas*

accelerated innovation in the fintech arena. The new flexible regulatory approaches such as the sandbox are a great opportunity to facilitate a reasonable degree of keeping control of new business projects without over-regulating them.

- How to adapt traditional legal requirements related to the relationship with customers (for AML, transparency and customer protection, among others) initially designed for present-based interactions to a relationship and interactions with customers increasingly based on distant and electronic means (e.g. online onboarding process, investment and trading transactions, among others).
- How to manage the adoption by financial services of innovative technologies to replace legacy information systems and to boost efficiency and user experience, without generating an increased level of risk (operational compliance, reputational). Special attention is being focused on the creation of internal policies and negotiation with service and solution vendors in order for the financial services to comply with outsourcing and cloud services EBA guidelines, GDPR requirements, network infrastructure legal requirements, and other pieces of regulation designed to mitigate risks in sensitive financial activities.

Isabel Aguilar, Uría Menéndez

Q *Why was the regulatory sandbox introduced and what effect is it having?*

Aguilar: Due to the highly regulated nature of the financial sector, it is often difficult (and costly) to launch new ideas, especially for smaller businesses and start-ups. The sandbox should be a catalyst for innovation, removing obstacles and facilitating the launch of innovative projects within the financial sector. This is without compromising customer protection or the stability of the financial system.

Miguel Sánchez Monjo, Cuatrecasas: The regulatory sandbox has implemented a controlled testing area aimed at technology-based financial innovations and has been devised as a regulatory and supervisory instrument. Public authorities expect that the regulatory sandbox will provide valuable insight into the developments and potential effects of digital transformation on the provision of financial services. In parallel, fintech innovators expect to be closer to the competent authorities and can address certain regulatory rigidities.

Every six months, the secretariat general of the Treasury and International Finance will publish the deadline for admission of applications on its website. The first call for applications started on 13 January and ended on 23 February. Since the submission of projects is confidential and only the selected projects will be publicly announced at a later stage, we will have to wait some weeks to assess the initial impact and acceptance of the regulatory sandbox in the market.

António Payan Martins, CMS: The Portuguese government has already published the framework for a regulatory sandbox which will test emerging technologies and involve national and international projects, including fintech. A resolution has been published to establish the general principles "for the creation and regulation of Technological Free Zones" (Zonas Livres Tecnológicas (ZLTs)) which will facilitate the experimentation of new technologies in a real environment. The ZLTs are aimed at boosting social and economic progress and helping the country transition to a sustainable economy.

More developments are anticipated, as the prime minister has recently stressed that the government will work on the legal framework for ZLTs, adding that "the pandemic crisis has only reinforced the need to continue on this path of developing our entrepreneurial ecosystem".

Q *Which growth trends are you anticipating during 2021?*

Lamo de Espinosa: We believe that central bank-issued digital currency (CBDC) projects such as the digital euro, Decentralised Finance (DeFI) and sustainable fintech will be hot topics. We are currently analysing several matters related to open banking, tokenisation of assets and other prominent use-cases of distributed ledger technologies (DLTs).

Correia Moreira: The pandemic will certainly increase the need for mobility solutions and distance banking relationships with consumers; at the same time, fintech security and protection of personal data will be more important than ever. We further expect the fintech-related sector to take advantage of the implementation of the EU Digital Finance Package and adapt faster than incumbents to the demands the package is requiring as well as adapting their models to such regulations. Fintechs are also likely to continue to ask for more regulatory support and guidance.

Sánchez Monjo: In 2021, we expect the growth of companies providing fintech services focused on investments: trading platforms and cryptocurrencies. The economic downturn caused by the pandemic has increased the attractiveness of these alternative ways of investing. They are a crucial challenge for the Spanish regulator and investor protection.

Both ways of investing generate different challenges: the excess of regulation with regards to trading platforms seems not to be sufficient to discourage the investment in them by retail investors, while the lack of such regulation might be also part of the interest in and attractiveness of cryptocurrencies.

Aguilar: The main disruption in the global financial sector is still expected to result from ledger technologies such as blockchain. Although this type of technology is not yet widespread, it is expected to develop in many areas such as cryptocurrencies, crypto-assets and CBDC. In particular, with regard to CBDC, the ECB has set Q2 of 2021 as the date to decide whether to launch a digital euro project in order to be prepared for the potential issuance of a digital euro at some point in the future. ●