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Brexit and UK FinTech

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The UK's decision in June 2016 to exit the European Union has caused disruption and uncertainty across virtually every UK industry. The country's future relationship with the EU27 and its ability to agree a deal on access to the single market are important issues which must be addressed, and quickly if the damage caused to the economy is to be minimised.

For certain industries, such as the FinTech sector, the freedom of movement of labour offered by membership to the EU single market is crucial given the UK's technology skills gap. If the UK is unable to agree a suitable post-Brexit deal on the single market, the loss of that freedom, as well as the passporting of services to other EU markets, could have a disastrous effect on the UK FinTech industry and the financial services space as a whole.

Many companies in the FinTech sector and the broader investment community are pausing for thought while the future relationship between the EU and the UK comes into sharper focus. For many FinTech firms the main question is whether London will remain the 'FinTech capital of Europe' following Brexit or be surpassed by the likes of Paris or Berlin, which have their own thriving FinTech industries.

"Brexit will have a big effect on FinTech in Europe. London's position as Europe's FinTech centre may be under threat," says Mark Adair, a partner at Mason Hayes & Curran. However, the city's standing in the financial services industry, as well as its established legal infrastructure, rich talent pool, cultural cache and access to investment, will likely see it remain at the forefront of the European and global FinTech industry in the short term at least.

A survey of 1500 European FinTech firms by Early Metrics found that, for the time being at least, the UK is still viewed favourably. According to Antoine Baschiera, chief executive of Early Metrics: "The UK is currently facing its most serious challenge so far as the FinTech

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hub of Europe. Although it is too early to draw any definitive conclusions on what impact Brexit will have, companies are already assessing the implications of fundraising, talent acquisition and talent retention. Many FinTech businesses rely on fast developing technologies in order to maintain a competitor advantage. This requires a company to be able to move quickly and have access to the right talent across borders. However, amid the long-term Brexit uncertainty and competition from elsewhere, London remains an attractive hub for talent and a dense cluster of financial institutions."

"So far, London has proven resilient to fears over the state of the UK economy following the Brexit vote."

Regardless, there are a number of other European cities vying to replace London as the premier seat of European FinTech. According to EY, Dublin and Berlin stand to benefit the most from the Brexit vote. The cities have attracted 14 and 12 companies respectively since July 2016 and that looks set to continue in the coming years. Berlin, for example, has emerged as a frontrunner thanks to its strong and developing tech ecosystem, as well as its cheaper cost of living.

So far, London has proven resilient to fears over the state of the UK economy following the Brexit vote. And though certain sectors are beginning to see a slowing of investment, the FinTech industry has continued to attract high levels of investment. Around £1bn was invested into the UK FinTech industry in 2017, almost double the amount raised in 2016, according to research by London & Partners. "The UK market is still strong and holding up well despite the uncertainty and disruption created by Brexit", says Angus McLean, a partner at Simmons and Simmons. "It looks like this year may be a record year for investments in UK FinTech businesses, which is really encouraging. Even more encouraging is that there does not appear to have been an obvious drop off in the number of start ups coming through or any significant movement of more established businesses out of the UK."

However, given the direction the Brexit negotiations appear to be taking, it is entirely possible that the UK will lose its access to the single market, and all of the benefits that brings. That loss, along with the loss of 'passporting' rights, could lead to investors and start-ups turning their backs on the UK. "Brexit could put obstacles in the way of a FinTech accessing and retaining the right talent from overseas," notes Mr Adair. "It may also impact UK FinTechs 'passporting' rights, in other words, rights that allow them access to EU financial markets and customers. FinTechs rely on evolving technology to maintain a competitive advantage. Brexit has the potential to restrict how FinTechs access the third-party technology that they need, for example if tariffs are imposed. We have already seen financial services organisations that are expanding their footprint in Europe postpone a decision to move into the UK pending the final outcome of the Brexit negotiations."

Access to talent will be a major concern for FinTechs operating in post-Brexit Britain. The UK economy and its tech sector are dependent on European workers. A loss of access to this talent pool could create issues in the future. Eastern European countries, which place a strong emphasis on science and mathematics, for example, are regular suppliers of talent to the UK. Without their input, the industry in Britain could flounder. Accordingly, the government has begun to take action. In November 2017, it announced plans to double the amount of tier 1 work visas granted to 'exceptional talent' to 2000 a year, specifically to quell any fears over a so-called Brexodus of highly-skilled tech workers from Europe employed in the UK, or a failure to recruit any more in the future. British prime minister Teresa May said she was in no doubt that the UK "would remain a brilliant place to build a tech business" post-Brexit. However, the plan has not received universal acclaim. For some industry leaders, more needs to be done to ensure that the UK still has access to the best tech talent that Europe has to offer after 2019. There have been calls to extend the programme to the provision of tier 2 work visas for mid-ranking web and software engineers that are currently in short supply.

Others want to see the government ensure freedom of movement for financial services workers across Europe and the UK for at least three years following Brexit as part of a UK-EU free trade agreement that is based on mutual acceptance of regulatory and supervisory cooperation and reciprocity. Any withdrawal of freedom of movement would undoubtedly have an impact on talent attraction and retention, both for individuals already operating in UK FinTech, as well as future generations of specialists entering the industry.

"A post-Brexit UK that aims to thrive in the digital economy needs its citizens to have strong digital skills," says Mr Adair. "To bridge the skills gap and compete with other nations post-Brexit, I would recommend the UK government invests heavily in education and training. This needs to start early at the primary school stage where all the evidence shows that Britain's youngsters are lagging behind the rest of Europe. And there is a need to invest in continuous training as the digital landscape is constantly evolving and changing."

With competing FinTech centres emerging as genuine rivals to London, the technology skills gap across the UK will widen if businesses lose talented developers and struggle to hire people from outside the country going forward. In Lithuania, for example, FinTech regulation has been greatly reduced. The country's central bank has streamlined its licence approval processes and has adopted a pro-FinTech attitude. With other countries in Scandinavia and the Balkans similarly pursuing greater FinTech investment, the UK cannot afford to be left behind. This will require a considerable governmental effort, particularly as the European Commission (EC) is developing legislation designed to remove the hurdles faced by crowdfunding platforms and marketplace lenders in operating and scaling across single market member states. These rules will apply to members of the European Union as well as members of the single market.

The removal of barriers can be seen as the creation of a 'digital single market' across Europe, which will allow European FinTechs to develop and achieve the same scale as their US and Asian counterparts. Through the 'digital single market', the EU hopes to regain some of the ground lost to the US and Asia, which have emerged as the global FinTech hotspots. The EU's plans will also create 'regulatory sandboxes' which will allow FinTech companies to 'beta test' any new services they want to offer in a limited, supervised way, without having to comply with existing regulations. As a result of these measures, investment into European FinTech is expected to grow in the coming years. Increased investment will likely influence talent pipelines.

"Unless the government is able to come up with an alternative solution, then access to talent will undoubtedly be affected," says Mr McLean. "In the short term I do not think access to capital will be affected – the investment data for this year suggests interest in UK businesses is as strong as ever. However, over the longer term, if it becomes harder for businesses to find people of the right quality to help build market leading products, then access to capital may be affected." The sharp decrease in venture capital-led investment in UK FinTech in the second half of 2016, for example, suggests that Brexit is a major consideration for investors, and could have a huge impact on future access to capital.

Looking ahead

Compared to the wider financial services industry, the FinTech market is still relatively modest in size. The European FinTech industry, for example, is worth just £4.5bn, yet the UK holds around an 80 percent share of that market, according to Bruegel. To date, UK regulators have been very sympathetic to the FinTech sector and the UK has become a hub for start ups. Programmes such as Project Innovate have successfully promoted competition and fuelled innovation. Though Brexit will have an impact, investment will not disappear overnight. London's status as Europe's FinTech hub has been built largely on its standing as a leading global financial services centre and the ease of doing business through Europe due to harmonisation. If regulatory harmony is no longer on offer in the UK, the country's FinTech industry may suffer.

While considerable confusion still reigns over the final form of Brexit, the UK FinTech industry in is likely to be adversely affected in the long term. However, it will take time for Europe's emerging FinTech centres to become established. FinTech's continuing evolution will drive change in the financial services industry and the UK will have a key role to play in that evolution. However, it is impossible to determine the full impact of Brexit on financial services, the tech sector and FinTech in particular. Maintaining regulatory equivalence with the EU will go a long way to solidifying the UK's place in the FinTech industry.

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