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Fintech Deal Landscape to Remain Active in 2018

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A wide range of players participated in hundreds of financial technology (fintech) transactions in 2017, and the high level of global M&A and investment activity in fintech is expected to continue this year. Deals included multibillion-dollar, cross-border transactions between public companies (*e.g.*, Vantiv/Worldpay), private equity-backed take-privates (*e.g.*, Hellman & Friedman/Nets A/S), and acquisitions and strategic investments in fintech startups by banking organizations of all sizes (*e.g.*, JPMorgan Chase/WePay). In addition, according to KPMG, venture capital firms were on pace to invest approximately $12 billion in fintech firms across the world in 2017, following approximately $32 billion invested during the preceding two years combined. The fintech ecosystem is flush with capital and continuing prospects for growth.

Transactional activity in the fintech space often plays out at the intersection of Silicon Valley and Wall Street, which can lead to unique challenges. The disparate cultures and approaches have important effects on deal dynamics that are often observed in legal, regulatory and compliance aspects of fintech transactions. For example, large banking organizations typically have very different compliance expectations and risk appetites than do young, fast-growing and entrepreneurial fintech firms. We expect these issues will continue to be an important element in these deals in 2018.

Trends in Fintech M&A

Some areas of fintech were especially active in 2017. The payments industry experienced more than 165 M&A transactions with aggregate deal value of almost $30 billion. Consolidation among the largest payment processors headlined that activity; Vantiv's $11.6 billion acquisition of U.K.-based Worldpay Group was the largest fintech transaction of the year. Many of the payments M&A transactions were cross-border deals, driven in large part by the growth of e-commerce, which facilitates cross-border commerce. Higher user numbers and volumes of digital payments, and the need for merchants to process those payments, have driven revenues and valuation of payment processors. We expect cross-border M&A to continue to play a central role in payment processors' growth strategies.

Another important component of fintech M&A activity has been the interest of traditional banking and financial institutions in acquiring or making strategic investments in innovative fintech firms. In October 2017, JPMorgan Chase agreed to acquire WePay Inc., an online payments provider for technology platforms, for a reported $220 million. Many other large financial institutions, including those that have mostly sat on the sidelines since the financial crisis, are gearing up for or actively exploring fintech acquisitions or investments, which we expect to come to fruition throughout 2018.

Finally, consortiums continue to be an important deal vehicle in the fintech space. In particular, companies developing blockchain technologies (see "Rise of Blockchain and ICOs Brings Regulatory Scrutiny") have embraced consortium structures to combine fundraising with customer acquisition and product-testing partners. For example, R3CEV,

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a consortium of approximately 80 members devoted to developing distributed ledger technologies, raised more than $100 million from more than 40 banks in 2017. The Enterprise Ethereum Alliance, which launched in 2017, is an open-source blockchain alliance that has over 200 members, including prominent financial institutions, the University of New South Wales and the Indian government.

Other participants in the fintech market have used consortiums in creative ways to provide industry solutions. For example, in November 2017, four large financial institutions announced that they had formed TruSight, an industry utility that will provide vendor management services to the financial services industry. Consortiums likely will continue to be an effective investment vehicle in developing financial technology products and services. They allow financial institutions to enter new ventures more cheaply, as costs and risks are shared across similarly situated investors. They also enable firms to leverage existing expertise across multiple investors, bringing broader expertise and skill profiles. The enterprise's chances of success also increase because it has a committed customer base from the start.

Considerations in Fintech Deals

Transactions in the fintech space present important legal, regulatory and compliance considerations, such as the following:

- Is the target's business subject to licensing or regulation?
- Does the target's business present legacy or ongoing consumer-related litigation or reputation risk?
- What regulatory approvals are needed for the transaction?
- Are the parties in a position to obtain those approvals on a timely basis?
- What commitments or conditions might the regulators impose?
- Will the transaction cause the target's business to become subject to any new type of regulatory restrictions?
- Are any changes required for the target's business to fit within the buyer's compliance framework and risk management environment?
- What are the parties' rights with respect to the underlying technology and intellectual property?
- Who controls the timing and terms of an exit transaction?

Buyers and targets often will have very different answers to these questions. Fintech companies that provide services to regulated financial institutions generally have some familiarity with the regulatory framework applicable to their clients. Indeed, many technology service providers to regulated banking institutions are themselves subject to some form of supervision and examination by federal banking regulators. Nevertheless, many fintech companies seeking investment from, or partnership with, a traditional financial institution are surprised by the level of scrutiny their regulated counterparties give compliance and risk management matters. For such financial institutions, uncertainty or concern about regulatory or compliance matters can be a showstopper.

Fintech companies contemplating a transaction (such as investment, strategic partnership or M&A) with a traditional regulated financial institution should consider conducting a gap analysis or other type of readiness review of their own compliance and internal controls. This will prepare the fintech company for the questions and diligence to come and position it to leave a stronger impression, avoid delays and head off concerns.

Additionally, when innovative fintech firms are acquired by more traditional or larger financial institutions, a tension often exists between the target's desire for independence and continuing flexibility for innovation, and the buyer's risk appetite and enterprisewide internal controls. In addition, transactions in the fintech space often involve important negotiations related to the employment and efforts of key persons or innovators at the target. The success of many fintech transactions depends on the buyer and the target (and their respective management teams) finding a balance when it comes to these key considerations.

As activity in the fintech deal landscape remains active in 2018, cultural dynamics will continue to shape deal negotiations, and participants will have to navigate the resulting legal, regulatory and compliance issues for successful outcomes.