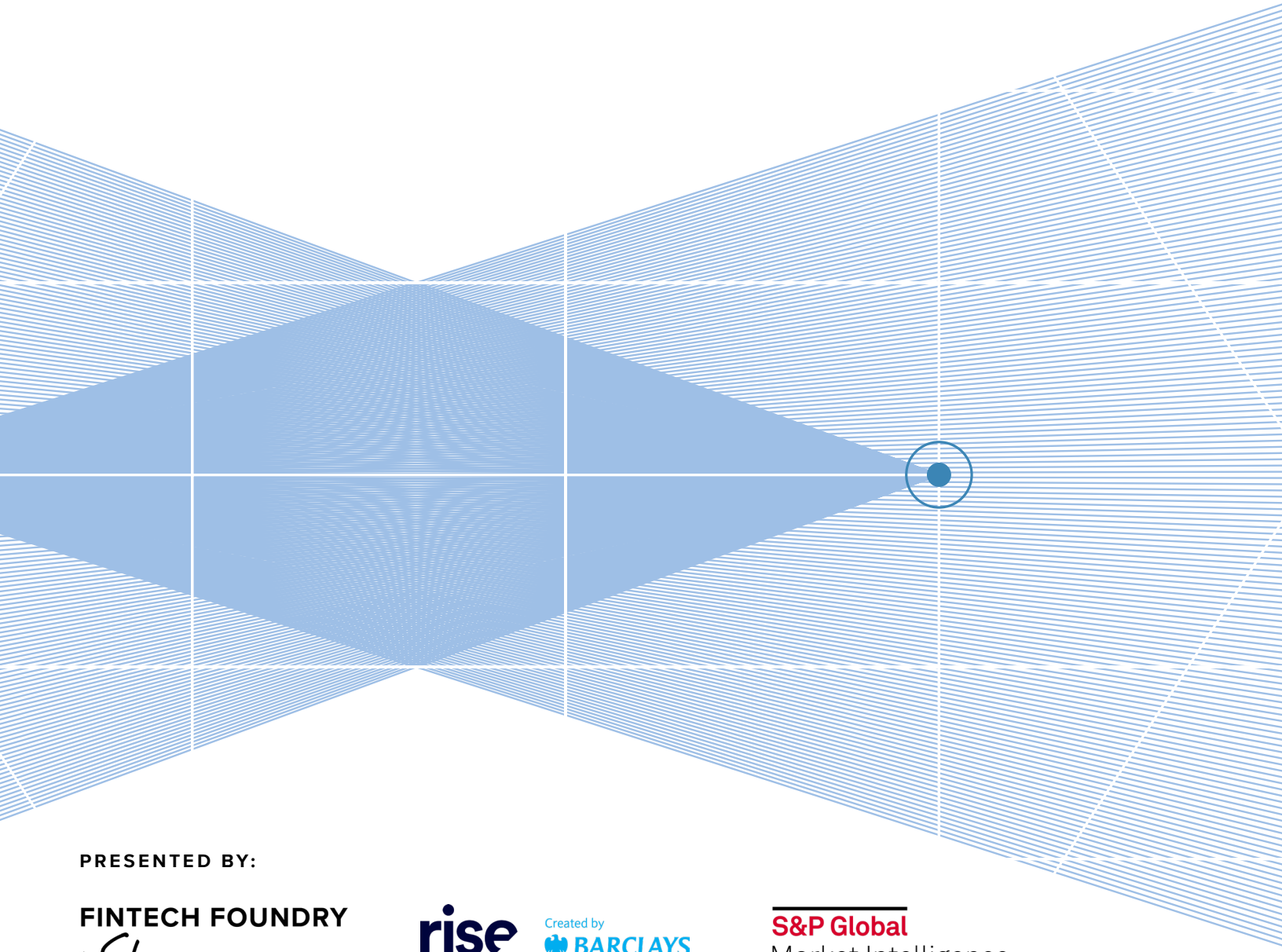
The Changing FinTech Landscape:

A Snapshot of M&A Themes and Trends



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INTRODUCTION

Financial technology—or "FinTech"—is redefining the manner and pace in which financial products and services are delivered. The COVID-19 pandemic, in particular, has accelerated demand for digital products and services in fundamental ways and put in sharp relief the extent to which FinTech presents challenges and opportunities for traditional banks.

The growth of FinTech has been cited as among the enormous competitive threats facing banks, with many traditional banking products and services, from payments to lending, increasingly moving out of the banking system. As one bank executive recently described, the competitive threat posed by FinTech is "everywhere," and FinTechs' "ability to merge social media, use data smartly and integrate with other platforms rapidly (often without the disadvantages of being an actual bank) will help these companies win significant market share."

It is against this backdrop that Shearman & Sterling LLP, S&P Global Market Intelligence, and Rise, created by Barclays, teamed up to produce this report on the prospect for greater consolidation and investment in the FinTech sector. From our respective vantage points, established players are increasingly evaluating investments or acquisitions involving FinTechs, and venture capital and private equity investors are eying the FinTech sector with greater intensity.

The purpose of this report is to provide an overview of FinTech deal activity, discuss its drivers, and offer insights into how financial institutions, FinTechs, and investors can prepare for transactions in the remainder of 2021 and 2022.

FINTECH M&A OVERVIEW

After record-breaking years in 2018 and 2019, M&A activity in the FinTech sector slowed in 2020 as the COVID-19 pandemic roiled the financial markets. In spite of difficult economic conditions, a number of major deals were completed. Some of the most notable transactions announced in 2020 were in the payments space, with Worldline's $8.6 billion acquisition of Ingenico and Nexi's $17.8 billion merger with SIA and subsequent $9.2 billion acquisition of Nets. Intuit's $7 billion acquisition of Credit Karma and American Express' acquisition of FinTech lender Kabbage are other high-profile examples of leading financial services companies leveraging M&A deals to make inroads in the FinTech sector.

In addition to its impact on the economy and financial markets, the COVID-19 pandemic forced a dramatic change in the way that most consumers access financial services. The explosive growth in consumer adoption of mobile payments, banking, insurance, and investment services has made consolidation in the FinTech sector inevitable, as traditional banks and service providers race to acquire or partner with technology companies to meet their customers' needs. The growth in mobile payment options will also be rich for M&A as banks enhance their mobile platforms or offer transactions in digital currencies.

FinTechs themselves will also be a source for M&A as the sector expands. Coupled with record low interest rates, healthy venture capital flows, and a sizzling SPAC market in the early part of the year, 2021 is already a watershed year for M&A activity in the FinTech sector. Indeed, the first half of 2021 has seen a flurry of primarily U.S.-based M&A activity, from credit reporting agency Equifax Inc.'s $640 million deal to buy anti-fraud specialist Kount Inc. to NCR Corp.'s $1.84 billion announced merger with ATM network operator Cardtronics. Research from S&P Global Market Intelligence shows that the average deal volume in the first half of 2021 was higher than the average in 2020.

As the FinTech industry rapidly matures, our forecast for the remainder of 2021 and 2022 sees a wave of consolidation on the horizon.

The noticeable pickup in deal activity in the U.S. and abroad, along with the convergence of several important industry trends, point to a very promising period for FinTech M&A.

As the FinTech industry rapidly matures, our forecast for the remainder of 2021 and 2022 sees a wave of consolidation on the horizon. Rapid changes in consumer behavior are leaving traditional banks—particularly smaller regional and community banks—racing to improve their mobile banking platforms and apps. Similar trends are emerging in the insurance sector, where we have seen a proliferation of apps and platforms that allow individuals to apply and shop for policies online. The same is true for consumer investment platforms, which allow individual consumers to access sophisticated investment products such as options and derivatives.

FinTech M&A and consolidation will rise to meet consumer demand, as financial institutions buy FinTech companies to add digital services to their offerings and as competing FinTech companies consolidate and acquire other FinTechs to remain competitive in the sector. Consolidation will also allow more established FinTech players to broaden their reach to other areas of financial services. Recent noteworthy examples include JPMorgan Chase's announced acquisitions of Nutmeg, a U.K. robo-advisor, and OpenInvest, an ESG-focused investment management platform; Fifth Third Bank's announced purchase of Provide, a digital healthcare banking platform; and Visa's planned acquisition of Tink, a European open banking platform.

In the second half of 2021 through 2022, we anticipate that the FinTech M&A landscape will be shaped by three critical factors. First, we will witness a change in the ranks among FinTech firms, with strong and stable companies rising to the top and competitors being acquired. Second, the trend of traditional banks offering more robust mobile services will continue, which will drive more bank acquisitions and partnerships with FinTech companies. Finally, we expect to see greater scrutiny from financial regulators, as the Biden Administration begins implementing new policies.

QUALITY MATTERS

The FinTech sector is saturated with startups and early-stage companies that are vying to establish new business models, products, and services. Globally there are thousands of FinTech startups attempting to disrupt or complement the traditional provision of financial services in varying ways and with varying success. M&A will prove critical to next-generation successes, with "individual companies [vying] to become undisputed leaders by size and breadth, and ecosystems that have a tight grip on customer loyalty" (McKinsey)[1]. As this sector matures, we expect to see a reduction in the number of weaker FinTech companies, as customers and counterparties place an even greater emphasis on quality providers that demonstrate strong compliance cultures, value customer privacy, and have operational resiliency and overall stability.

BANKS NEED NEW DIGITAL SERVICES AND REVENUE MODELS

Traditional banks and financial institutions are aggressively investing in FinTech as banking needs continue to digitize and traditional sources of fee revenue become more constrained. A review of leading banks' annual reports and earnings-call transcripts highlights the banking sector's desire to increase noninterest income and pursue revenue diversification. Strategic M&A, including bank/FinTech partnerships and minority investments, will enable banks to obtain digital expertise and provide new products and services to their clients. For many FinTech companies, this will provide the resources they need to scale operations and services and enter new markets.

The U.S. banking market is particularly ripe for FinTech M&A activity due to the large number of community banks and credit unions across the country. Regional banks are also trying to catch up, as they begin to offer more robust mobile banking and financial apps to customers, in order to compete with the much larger players in the sector. Suddenly, a customer's physical proximity to a branch is much less of a selling point—customers want the flexibility to conduct transactions remotely, either online or on a mobile device. To stay competitive, and offer their customers a full range of services, these regional banks must acquire or partner with FinTechs.

EVOLVING REGULATIONS ON THE HORIZON

As U.S. Federal Reserve Governor Michelle Bowman described it, COVID-19 may have ushered a "quantum leap in the use of digital deposit, digital payments, and online lending." As these digital use cases have gained broad adoption by consumers, regulators have continued to increase their focus on digital matters. The U.S. Department of Justice's (DOJ) opposition to the Visa / Plaid merger reemphasises that antitrust regulators will carefully scrutinize M&A in the FinTech sector, particularly when it involves established players with large market shares and nascent competitors with the ability to innovate and potentially disrupt a market.

Currently, the U.S. offers a variety of agencies, programs, and regulations that can oftentimes be a challenge for both FinTech startups and newly digitized banks. While regulators have generally advanced "pro-innovation" positions, they continue to focus real scrutiny on FinTech, particularly on banks' relationships with FinTech companies and on FinTechs' consumer- and data-related practices. Regulatory complexity is not new to the financial sector. However, it poses a challenge for many early-stage FinTech businesses. We expect that the Biden Administration will take a tougher stance toward some FinTech companies, which may lead some of them to partner with more established FinTechs and banks. This increased regulatory scrutiny should drive even more consolidation in the FinTech sector, which could result in additional attention from antitrust regulators.

> The pandemic has demonstrated the importance and unique role of technology in responding effectively to new challenges. In the financial sector, I believe we may be seeing a quantum leap in the use of digital deposit, digital payments and online lending.
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> — **U.S. Federal Reserve Governor Michelle Bowman**
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> *Remarks at the Independent Community Bankers of America ThinkTECH Policy Summit (Dec. 4, 2020)*

1 Dietz, Miklos, et al. "Bracing for Seven Critical Changes as Fintech Matures" McKinsey & Company, Nov. 2016.

DEAL PLAYERS IN FINTECH M&A

The arena of FinTech M&A, partnerships, and investments is comprised of a diverse set of players with different aims. Here, we briefly breakdown the key players and their motivations.

FINTECHS

FinTechs are generally targets of M&A and investments, but increasingly they are becoming acquirers themselves as they seek to expand their customer base and product range. As successful startups, FinTechs typically begin by developing a single product and serving a single customer type, but M&A presents the opportunity to scale more quickly or diversify into other products or services.

Deal activity for FinTechs is also driven by a wider re-bundling of financial services and a quest, by some FinTechs, to become a “single money app” for certain client segments. In many cases, partnerships with banks or other financial institutions have been the initial route for growth. For digital advisor platforms, which include robo-advisor technology, partnerships have been a key means for FinTechs seeking to build out their wealth products. Since digital advisors are generally keen to offer their customers bespoke banking products, they partner with a banking institution to provide deposit accounts and other banking products. For example, Stash offers its users a “Stash banking” account through a partnership with Green Dot Bank.

BANKS AND OTHER LENDERS

The FinTech sector offers a myriad of products and services: mobile payments, personal financial management, overdraft protection, fraud protection, auto-investing, crypto investing, cash advances, personal loans, and reward programs. As that list continues to grow, traditional banks face a challenge from faster-moving FinTechs and so-called "neobanks," or digital banks that operate without branches. FinTech M&A, investments, and partnerships are an effective route of adding or improving digital capabilities, and perhaps more quickly than doing so organically.

Regional banks in the U.S. increasingly look to "buy" whereas smaller or community banks generally see partnerships with FinTechs as a way to grow fee income. In contrast, global systemically important banks view investments in FinTechs as preferable in light of existing statutory and regulatory limitations on their acquisitions of banks.

Regional banks, in particular, appear poised to be significant acquirers of FinTech technologies and applications that will enable them to enhance their traditionally "higher touch" relationship banking capabilities. In addition, regional banks will look for ways to compete more fiercely against consumer-friendly neobanks, like Chime or Varo, including by eliminating overdraft fees or offering early direct deposit or other account features.

Other lenders, as well as community banks, will seek out FinTech transactions to broaden their business, such as by targeting a new customer base of individual investors. A natural fit exists with digital advisor platforms, which can provide direct access to individual investors. For example, SoFi's customers can now check prices and buy certain cryptocurrencies through SoFi Invest®, developed in partnership with Coinbase.

NON-FINANCIAL FIRMS

The financial services sector is not the only industry focused on FinTech deals. A range of non-financial firms, from retailers to exchanges, now offer embedded financial products that seek to add value to consumers and to leverage valuable consumer data that they may have collected through other channels. Walmart, for example, recently announced a partnership with PayNearMe, a payments firm, to enable shoppers to pay utility bills through in-store cash payments. Walmart has also partnered with Western Union to allow consumers to transfer money at Walmart locations, and has formed a FinTech startup with Ribbit Capital to bring, according to a press release, "Walmart's retail knowledge and scale with Ribbit's FinTech expertise to deliver tech-driven financial experiences tailored to Walmart's customers and associates." Some FinTech firms have niche specialties targeting individual industries, such as medical services or sports. For example, Cardless, a consumer credit card FinTech, has announced co-branded credit card programs with individual sports franchises, such as the Cleveland Cavaliers.

INVESTORS

As key sources of funding, private equity and venture capital investors provide various levels of debt and equity financing and also engage in full take-out acquisitions of FinTech companies. Buyout firms, in particular, are sitting on significant dry powder that can be deployed to invest or acquire FinTechs with strong recurring revenues and generally positive tailwinds, particularly in payments and financial SaaS companies. The current low-interest environment has enabled liquidity events and allowed consortium deals and minority investments to continue despite the pandemic. Indeed, the pandemic itself has sharpened the perception of the financial services sector as ripe for disruption, with banks burdened by legacy systems and less adept at providing a "frictionless" digital experience for customers.

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PREPARING FOR THE FINTECH CONSOLIDATION WAVE: 10 THINGS TO CONSIDER

Consolidation will be an important foundation for the continued digital transformation of the financial services industry. The FinTech sector is maturing in profound ways, and the search for greater scale and diversification will be a critical driver for firms in the near term. Consolidation will take various forms, from traditional M&A to strategic partnerships and investments. While transactions will vary in ways that are reflective of the diversity of the FinTech sector itself, here are 10 things that should be considered.

01. STRUCTURING ISSUES AND FUTURE PLANS FOR THE BUSINESS ARE CRUCIALLY IMPORTANT

The investment in or acquisition of a FinTech business may take a number of different forms, but in all cases there will need to be thoughtful consideration on how a transaction is structured. Will it be in the form of a minority investment or full acquisition? Will the business be integrated into the buyer's business or operated on a standalone basis? Are any parties sensitive to "control" issues under specific legal and regulatory regimes? Answers to these questions will drive a number of other important issues, including the appropriate due diligence strategy, the negotiation of certain representations and warranties, and other contractual provisions.

Another chief concern is the future plans for the business and its integration. For an established FinTech buyer, there may be a desire to integrate the business into its own to maximize synergies. For a bank-affiliated buyer or investor, plans will vary depending on the nature of the transaction and the need to integrate the target into its existing compliance infrastructure. Other buyers and investors, particularly from private equity or venture capital, may prioritize retaining management and ensuring the target's innovation-focused culture is maintained to maximize growth and increase the prospect for a successful exit.

Giving priority to structuring and integration-related issues at the onset will help acquirers and investors to avoid transaction pitfalls.

02. ASSESSING "COMPLIANCE CULTURE" AND ADAPTING TO A MORE ONEROUS REGULATORY ENVIRONMENT

Acquirers and investors need to understand a target's existing "compliance culture" and its ability to adapt to more onerous regulatory requirements. An important task, as part of a larger due diligence effort, is to understand how a FinTech is tracking and complying with all of the rules and regulations to which it is subject. This goes beyond merely assessing whether it is in "good standing" in the jurisdictions where it operates. There needs to be an understanding of how the FinTech views compliance as part of its overall business, and how products and services are reviewed for legal and regulatory compliance.

Acquirers and investors also should examine how the FinTech is preparing for new laws and regulations that could undermine its business prospects and growth trajectory. In both the near term and long term, the FinTech sector should expect more regulatory scrutiny over, as well as legislative interest in, consumer protection and financial inclusion matters, operational resiliency, and the financial stability risks posed by non-bank financial intermediation. As a diligence matter, acquirers and investors should have a good handle as to how the target is not only scalable for future growth but adaptable for new or heightened regulatory pressures.

03. ANTITRUST SCRUTINY OF FINTECH WILL BE INTENSE

As the financial services industry undergoes "massive transformation," the DOJ is taking on a "muscular" role for antitrust in FinTech[2]. In October 2020, a senior DOJ official identified three areas where it is "leaning in." First, the DOJ will strictly enforce existing antitrust laws to police the financial markets. Second, the DOJ is updating its modes of analysis. Structurally, it reorganized its Antitrust Division by creating a new "Financial Services, FinTech, and Banking" section. Substantively, it is focusing on two trends: a greater number of transactions involving acquisitions of nascent competitors in emerging technologies and an increasing number of vertical mergers that involve various financial products and services, such as data platforms and infrastructure that are potentially inputs to the acquiring firms' products.

The DOJ is also rethinking its bank merger competitive review guidelines, which have not been changed in almost two decades[3]. In particular, the DOJ is evaluating whether the Herfindahl-Hirschman Index, a common measure of market concentration, should be updated and non-traditional banks (such as online lenders) should be incorporated into analyses of competitive effects involving bank mergers.

The third component of the Antitrust Division's "lean in" agenda is to improve coordination with the U.S. Securities and Exchange Commission (SEC). The two agencies recently entered into a first-ever memorandum of understanding that sets forth information sharing and other protocols to better incorporate competition and securities law concerns in analyses of financial exchange and securities markets.

Examples of how the DOJ exercises a muscular approach to FinTech antitrust issues will undoubtedly emerge as the FinTech industry rapidly consolidates, but the broader trends in antitrust (as well as the Visa / Plaid experience) suggest there will be particular scrutiny of transactions that involve a firm with market power buying a nascent competitor. In addition, vertical transactions (*i.e.*, transactions involving firms that do not compete as horizontal competitors) traditionally have been considered pro-competitive and generally approved by the antitrust agencies. But there are calls for greater scrutiny of such deals, and the Federal Trade Commission (FTC) recently filed a high-profile lawsuit challenging a vertical transaction – the first such action by the FTC in many years. Particularly where a vertical transaction could enable the combined firm to deny data or other tools that competitors need to be viable, significant antitrust scrutiny is likely.

The Biden Administration is poised to make a major mark in the evolution of FinTech. Based on early appointees in the antitrust space, including the designation of Lina Kahn as FTC chair, it appears that the Biden Administration will take a tougher approach to antitrust enforcement, particularly in technology markets.

Of course, the DOJ and FTC are not alone in setting the tone for how FinTech transactions are to be scrutinized. For example, the U.K. Competition and Markets Authority (CMA) will need to be carefully considered for FinTech transactions implicating the CMA's jurisdiction. In June 2019, the CMA cleared PayPal's acquisition of iZettle nearly a year after the transaction had formally closed. The companies were prevented from integrating their operations until the CMA had completed its review.

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2 Remarks of Michael Murray, Acting Principal Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice (Oct. 14, 2020) (link).

3 Press Release, Antitrust Division Seeks Public Comments on Updating Bank Merger Review Analysis, U.S. Department of Justice (Sept. 1, 2020) (link); "FinTech Boom Prompts Justice to Revisit Bank Merger Guidance," Roll Call (Oct. 13, 2020) (link).

04. FOREIGN INVESTMENT RESTRICTIONS MAY APPLY

FinTech transactions may implicate foreign investment restrictions that can significantly delay or prohibit closing. In the U.S., the reach and authority of the U.S. government over what it considers to be "national security" concerns are broad, increasing, and often not subject to judicial appeal. The Committee on Foreign Investment in the United States (CFIUS) may review transactions for the protection of U.S. critical technologies, resources, and infrastructure.

Traditionally, CFIUS jurisdiction was based on whether a merger or acquisition could result in control of a U.S. business by a foreign person. However, under the Foreign Investment Risk Review Modernization Act of 2018 and its implementing regulations, CFIUS has jurisdiction over certain non-controlling foreign investments in U.S. businesses that own or operate critical infrastructure, deal in critical technologies, or collect and maintain large amounts of personal data of U.S. citizens.

Although presidential orders blocking or unwinding transactions are rare, they have increased in recent years. Ant Financial's inability to obtain CFIUS clearance in 2018 for its proposed acquisition of MoneyGram is a notable example. In addition, authorities in the U.S. have prohibited or unofficially discouraged transactions with certain Chinese payment platforms including Alipay, WeChat Pay, QQ Wallet, and others.

CFIUS may require the entry into "mitigation agreements" to resolve identified national security threats presented by a transaction. Features of these agreements range from prohibitions on transfers of sensitive technologies to protections for U.S. customer data and restrictions on physical and logical access to sensitive U.S. facilities, networks and systems.

While CFIUS is regarded as setting the standard on how to scrutinize foreign direct investments, it is by no means alone. The European Union adopted a new mechanism for screening foreign direct investments, which became fully operational in October 2020, and in the U.K., a new framework intended to play "catch up" with the U.S. and other jurisdictions is expected to be adopted this year, with retroactive effect from November 2020.

Foreign investment restrictions will need to be evaluated carefully, particularly for U.S. companies that use sensitive customer data or involve critical technologies. Even U.S. acquirers or investors in U.S. FinTech firms will need to consider whether CFIUS and other restrictions are implicated, especially when venture capital or private equity investments are structured through funds that have sizeable foreign investors.

05. FOUNDERS AND OTHER KEY PERSONNEL NEED TO BE INCENTIVIZED

A critical consideration in many FinTech acquisitions will be how to incentivize and retain founders and key personnel. The real value is often the talent that built the business. Founders and other employees, especially those with technological and design know-how, can be central to capturing innovation-led growth and unlocking deal value.

In structuring deals, acquirers should identify those individuals who are critical to the overall objective of the transaction. Incentivizing founders and other key personnel may entail the granting of equity compensation and using "earn-outs," which make additional consideration contingent on the acquired company achieving certain financial or other performance metrics within an agreed-upon period (such as three years from closing). In addition, acquirers should consider the use of non-competes and non-solicits for founders and key personnel. Because the enforceability of these restrictive covenants varies by jurisdiction, it is important that they are drafted narrowly to protect legitimate business interests and contain appropriate time and geographic restrictions.

06. VALUATION MAY BE MORE DIFFICULT FOR CERTAIN FINTECH TARGETS

FinTechs have commanded significantly higher valuation multiples in recent years, as compared to traditional financial institutions. There has been a thirst for market share, aided by the perception that certain types of FinTech firms, unburdened by regulation and not dependent on outdated legacy systems, will be dominant players in the future financial landscape.

Early stage FinTech firms present unique valuation challenges, especially those perceived to be valuable for reasons other than established revenue history. These firms have limited operating histories, nascent compliance cultures, and generally do not operate under the highly complex and operationally burdensome regulatory constraints applicable to banks or other financial institutions.

Valuation necessitates a highly sophisticated due diligence process. Traditional financial diligence must be accompanied by legal and strategic regulatory reviews of the target's existing business model to assess how it may be fundamentally impacted by expected industry and regulatory changes. In addition, an effective due diligence process must involve specialized inquiries into other key areas—from intellectual property ownership to data security—that are critical to effectively valuing a target.

07. CUSTOMER DATA USES MUST BE EXAMINED CAREFULLY

FinTechs, and the innovative technologies and analytics they are associated with, generate or handle enormous amounts of data. For regulators, financial institutions, and customers, some very tough questions have emerged. Who owns the data? Where is it stored? What rights should customers have over their data? What laws and regulations are implicated when FinTechs interact with data? Careful attention needs to be given to these questions by banks, FinTechs, and private equity and venture capital investors when evaluating transactions. There are no easy answers.

Acquirers and investors must fully understand the relationship between a target and the data that is integral to its business. Apart from data security, which is discussed below, there is the issue of data ownership and access. Understanding who owns customer-specific data (including data that is generated from that data) will be critical not only to valuation but in scoping what legal and contractual requirements and technical standards may apply vis-à-vis existing customers or bank partners.

In addition, the issue of third-party access must be considered. In the U.S., the Consumer Financial Protection Bureau is actively scrutinizing how FinTechs and data aggregators (companies that have consumer authorization to collect data from multiple financial accounts to provide insights and services to the consumer) use and provide access to consumer data. For example, it is developing regulations on how to implement Section 1033 of the Dodd-Frank Act, which requires consumer financial services providers to make information in its control or possession—including transaction information, costs, and usage data—available to consumers. Similarly, in the European Union, the Second Payment Services Directive (PSD2) requires EU banks and other online payment account providers to grant access on customer account data to third-party payment service providers if authorized by the underlying customers.

An effective due diligence process should also reveal all the ways in which a FinTech obtains, uses, transmits and stores customer data. A litany of legal and regulatory requirements will be implicated depending on the nature of the business. Developing an inventory of data touchpoints and an assessment of how applicable requirements are being satisfied will have many benefits, not least of all understanding the target's potential legal exposure.

In addition, acquirers and investors should consider how a target uses artificial intelligence applications or machine learning models, particularly in the areas of credit underwriting and credit risk analysis. Increasingly, regulators are expressing concern with how technological tools may reinforce longstanding inequities or reflect racial bias. Especially for online lenders, technological tools that rely on non-traditional data (*e.g.*, education history, digital "breadcrumbs" such as social media activity) instead of credit scores or cash flow data could implicate fair lending and credit reporting laws or constitute unfair or deceptive acts or practices. Understanding how consumer protection laws evolve to address these concerns will be important.

08. SECURITY AND OPERATIONAL RESILIENCY ISSUES ARE PARAMOUNT

FinTechs that have access to personal and proprietary information are attractive targets for cybercriminals to steal valuable data and disrupt critical operations. Acquirers and investors need to probe these issues when evaluating FinTech transactions. Specialized diligence should be made into the history of data breaches and cyber incidents, as well as related governmental enforcement actions and private litigations, as these may materially alter the economics of a deal. In addition, there should be visibility into the results of any gap analyses or "tabletop" exercises, including the status of any open or ongoing remediation efforts. The adequacy of existing staffing, policies and procedures, and insurance coverage should also be understood, especially if the target is to be operated on a standalone basis post-acquisition. An effective diligence exercise will also aid buyers and investors in assessing the robustness of cyber/data-related representations and warranties, indemnities and other contractual provisions in relevant deal documentation.

09. DUE DILIGENCE OF IP ASSETS AND KEY CUSTOMER RELATIONSHIPS IS CRITICAL

A FinTech's value may be rooted in its IP and the strength of its customer relationships. These are two distinct areas that need to be given early attention in the diligence process. Adverse findings may significantly affect deal value. They can also delay a transaction's closing until resolved or mitigated.

First, an effective IP diligence process will need to examine how a target's IP was developed. Acquirers and investors must gain comfort that the FinTech company has full ownership of its IP assets and that no party has viable claims to assert joint ownership or other rights. A FinTech company's use of open source code must also be understood, as it could result in its proprietary IP having to be made available freely, including to competitors. In addition, if the FinTech company relies on any licenses of other parties' IP assets, then the terms and conditions of those licenses must be analyzed.

A second important item relates to customers. Acquirers and investors in FinTech companies need to have a full inventory of all material customer relationships, including the contracts that memorialize those relationships. Customer contracts should be analyzed from economic, legal, and operational perspectives. Among other things, diligence should uncover any contractual "landmines" that may restrict a change of control of the target or assignment of the contract or attempt to bind affiliates.

10. REGULATORY CONSIDERATIONS MAY AFFECT DEAL TIMING AND NARROW THE SCOPE OF ELIGIBLE BUYERS

FinTechs may engage in activities that are subject to specialized licensing and regulatory regimes. For example, if a FinTech engages in money transmission, lending, loan brokerage, loan servicing, or cryto-asset activities, separate licensing may apply. In any transaction, it is essential that a buyer or investor identify where a FinTech target is licensed. If it is asserted that a license in a particular jurisdiction is not required, diligence should be conducted to understand how that assessment was made and whether it is correct. In addition, a buyer or investor should understand whether the FinTech's business plan involves new activities or services that will eventually require licenses and in which jurisdictions.

Understanding the scope of a target's licenses will inform a buyer or investor whether any approvals or consents are required to close a transaction. For example, nearly every U.S. state must be notified of a change in "control" of a FinTech with a money transmitter license, and some states, such as New York and California, must approve the transaction prior to closing. A determination of control depends on each state's statute. Although most states will find control has been triggered based on 25% or more of voting ownership, some states use lower thresholds.

The process of obtaining regulatory approvals can be time-consuming and costly. This should not be underestimated. Applications generally require background information on the acquirer and its plans for the business. This usually entails the submission of detailed information regarding the acquirer's organizational structure and on parties in the "chain" of ownership. Significant investors in the acquirer may also be required to submit background information, including personal biographical and financial information for individuals who are ultimately deemed to control the acquirer.

FinTech transactions involving bank-affiliated buyers or investors raise additional complications and, in some cases, may narrow the scope of eligible buyers or investors. Control under the U.S. Bank Holding Company Act (BHC Act), for example, is implicated if a bank holding company or any of its affiliates acquires 25% or more of the FinTech target's voting stock, controls a majority of the board, or otherwise has a "controlling influence" over the company.

Controlling influence can be found at extremely low levels, even for an investment between 5% and 24.99% if the bank has significant business relationships or contractual arrangements that restrict the FinTech's ability to make major operational or policy decisions. The legal and regulatory ramifications of a FinTech being deemed to be controlled by a bank holding company can be significant: the FinTech would be subject to comprehensive regulation and oversight by the Federal Reserve, and its activities would be limited to those permissible under the BHC Act. In some cases, this may be incompatible with a FinTech's business model or culture, but not always. Therefore, careful attention will need to be given to structuring issues to ensure each party's objectives can be achieved.

SPOTLIGHT ON BANK ACQUISITIONS AND CHARTERS

For FinTechs that seek to go "all in" on banking and look beyond bank partnership arrangements, there are generally two options: acquire an existing bank or establish a new one.

Several high-profile FinTechs have expanded recently by acquiring depository institutions. For example, LendingClub, the marketplace lender, acquired Radius Bank, and Jiko, a FinTech startup, acquired Mid-Central National Bank, resulting in both LendingClub and Jiko becoming bank holding companies. Other FinTechs have pursued and obtained new federal or state banking charters. While Varo, SoFi, and Anchorage received approval from the Office of the Comptroller of the Currency (OCC) to organize national banks, Square and Nelnet obtained industrial loan company charters from Utah, including deposit insurance from the Federal Deposit Insurance Corporation (FDIC). Brex is also pursuing a Utah industrial loan company charter and FDIC deposit insurance. SoFi, on the other hand, has abandoned its plan to seek a national charter from the OCC and is instead acquiring an existing national bank, which if successful, would result in SoFi becoming a bank holding company like LendingClub and Jiko.

Other forms of state charters or licenses, such as the New York limited purpose trust company and the Wyoming special-purpose depository institution, have been pursued by FinTechs engaged in cryptocurrency exchange. In other instances, FinTechs have been committed to the partnership model to leverage technological capabilities and offer innovative products, such as the recent partnership between PayPal and Paxos to provide PayPal customers with cryptocurrency trading capabilities.

FinTechs are also demonstrating diversity in their business focus. Companies such as Daylight and Climate First Bank have chartered banks to pursue mission-driven goals such as serving the LGBTQ+ community and organizations committed to environmental sustainability, respectively. Purpose-driven companies seeking to provide financial services to niche markets continue to push the boundaries of what is considered a traditional, regulated financial services firm.

Not Every Charter is the Same

The terms "bank" and "bank charter" are used loosely by many in the FinTech industry. However, FinTechs marketing themselves as "banks" while lacking the necessary licenses can face adverse consequences under U.S. federal or state banking laws. FinTechs interested in obtaining a charter, either by acquisition or de novo, also need to understand the powers of each type of charter and its limitations. In short, not every charter is created equal.

The U.S. operates under a "dual banking system" in which banks can charter under federal or state law. This means, among other things, that the powers and limitations of a particular charter may vary. For example, while national banks and federal savings associations may rely on federal preemption to avoid state usury limits and other laws that impermissibly conflict with their federally authorized powers, state-chartered banks cannot.

LendingClub, Jiko, Varo, and similar transactions are unique because they involve FinTechs embracing the heightened regulatory and supervisory burdens associated with bank holding company status. As bank holding companies, they are subject to Federal Reserve supervision and to limits on nonbanking activities under the BHC Act. By contrast, some charters do not technically constitute "banks" for purposes of the BHC Act, such as certain trust companies, credit card banks, and industrial loan companies (industrial banks or ILCs) and, for this reason, are perceived as highly valuable by commercial firms engaging in activities that are impermissible under the BHC Act.

Industrial banks, in particular, have attracted significant interest over the years by commercial firms, particularly retailers, and more recently, by FinTechs. As state-chartered depository institutions, they benefit from all the privileges of a commercial bank (*e.g.*, deposit insurance access to the Federal Reserve's discount window and payments system), but because they are exempt from the definition of "bank" under the BHC Act, their corporate parents and affiliates are not subject to Federal Reserve supervision and regulation. Attempts by Walmart and Home Depot in the mid-2000s to charter or acquire industrial banks drew intense public and political scrutiny. Such scrutiny led to formal and informal moratoria on industrial bank charters and acquisitions. From 2006 through 2019, no application for deposit insurance involving a commercial firm was approved.

In 2020, the FDIC approved deposit insurance applications from Square and Nelnet, both of which established de novo industrial banks in Utah. The successful applications by Square and Nelnet for ILC charters was regarded by many in the industry as an inflection point for FinTechs. To date, many FinTechs have relied on partnerships with chartered banks or ILCs to provide loan origination services. The FDIC's recent approvals may pave the way for more FinTechs to consider ILCs as part of their business strategy. In addition, the FDIC's adoption of a final rule in December 2020, setting forth requirements that commercial firms must satisfy when seeking to control or establish an ILC, suggests that the FDIC expects more firms to pursue ILC charters.

Notably, FinTechs have not embraced the OCC's controversial "FinTech charter," a type of "special purpose national bank" charter for FinTechs that are engaged in the business of banking but do not accept deposits. The purported benefit of this charter centers on FinTechs being able to preempt various state-level licensing and consumer protection laws. However, state banking regulators, particularly the New York State Department of Financial Services (DFS), have challenged whether the OCC is authorized under the National Bank Act to grant such a charter. Lawsuits by states against the OCC have faced procedural roadblocks, faltering on constitutional standing and ripeness grounds because no firm has yet to receive, or even apply for, a FinTech charter. Most recently, in early June 2021, the U.S. Court of Appeals for the Second Circuit reversed a lower court judgment in the OCC's favor, determining that the DFS lacked standing and that its claims were unripe. Since these dismissals have been on procedural grounds, there remains significant uncertainty as to how the substantive legal question—whether the National Bank Act requires firms to accept deposits to be eligible for a charter from the OCC—will be resolved. That uncertainty will continue to cloud the prospect of the FinTech charter being a viable route in the near term.

SPOTLIGHT ON BANK PARTNERSHIPS: THE STAYING POWER OF THE BANK PARTNERSHIP MODEL

Innovation is at the heart of financial services. Traditionally, banks used one of three models—buy, build, or partner—when some form of technology innovation is identified as a solution to a business need.

BUY.

After reviewing potential vendors and conducting pilot projects, the bank purchases an existing FinTech or technological solution. In very simple terms, it installs a software product on-premise or through the cloud. This is the easiest of the three options, and in most cases it requires the least capital investment. However, it means the bank cannot customize the product in any significant way and cannot claim any intellectual property rights on it.

BUILD.

The bank develops a technological solution or capacity itself to meet its specific needs. Building a solution is the best approach when the bank needs to retain the IP inherent in the product's features or its underlying code. Reasons to build a bespoke solution include selling the product to others or needing the most secure option for a core bank operation. This is probably the costliest and most complex option, not least of all because of the need to recruit and retain product engineers and other highly skilled personnel.

PARTNER.

The bank collaborates with a FinTech, affording it a high-level of customization. With technology solutions, the firm may be a large enterprise with "off-the-shelf" products or a small FinTech focusing on a niche area or using a highly creative approach. For community banks, this is typically the most cost-effective and efficient option.

Of the three models, the partner approach is an increasingly common way of producing results that mutually benefit both the bank and the third party, whether that is a client collaborating with the bank on new product lines or a FinTech achieving scale while at the same time helping the bank expand into new markets.

Early-stage FinTech companies have very different working practices and cultures from large, incumbent banks. This might explain why FinTechs have historically been viewed as challengers to their businesses and even to traditional banking models, but in recent years this mindset has changed. We now see a shift toward banks, especially those keen to innovate with cutting-edge solutions, partnering with the innovative and nimbler FinTech sector.

In the U.S., these partnerships have been led by the private sector and corporate innovation teams. In Europe, they are also encouraged through public sector initiatives. For example, the U.K. Government's FinTech Pledge, of which Barclays was an early signatory, was launched in September 2020 to formalize how banks can improve guidance, clarity, and good practice when working with the FinTech sector. Such public policy initiatives, coupled with Open Banking regulation, have allowed an environment in which FinTechs can not only flourish but also work closely with banks, solidifying the staying power of the bank-FinTech partnership model.

Any bank entering into a partnership with a third-party FinTech company must undergo an analysis of the risks inherent in the farming out of responsibilities and services, and conduct diligence on the FinTech companies with which it partners. The diligence should cover both commercial and regulatory risks, accounting for the risks inherent in operating in such a highly regulated space. The partnership should also provide for ongoing monitoring, reporting, testing, and other means of oversight. In addition, banks should take into account the expectations of U.S. state and federal bank regulatory agencies when structuring their FinTech partnerships.

DUE DILIGENCE

Diligence of FinTech partners should, at minimum, cover legal entity status and foundational documentation, financial information and stability, insurance (*e.g.*, cyber insurance), management qualification, examinations (*i.e.*, audits, testing) and reports, applicable licensing, and policies and procedures (*e.g.*, BSA/AML, OFAC, Record Retention, Cybersecurity, Privacy). In some bank-FinTech partnerships, banks may expose their internal operating systems, customer information, or both to potential weaknesses of a partner FinTech company. Banks should pay particular attention to cyber security, data privacy, disaster recovery, and business continuity risks of the FinTech company.

With increased innovation in FinTech also comes more sophisticated bad actors who attempt to illegally access data, defraud customers and companies, and launder money. The ability to detect and prevent fraud and other financial crimes should also be scrutinized. Additional diligence of a FinTech company will be necessary depending on the nature of the partnership and the services the FinTech company will provide the bank.

REGULATORY SCRUTINY

Banks entering into FinTech partnerships should address the regulatory risks posed by such relationships. Of particular importance is a partner-FinTech company's compliance with laws and regulations applicable to its business and activities (of which a bank should have an independent understanding), the company's relationship with its regulators, and maintenance of appropriate licenses, registrations, or certifications in order to ensure the company's own regulatory risks do not affect the bank's commercial relationship with it or, even worse, become imputed upon the bank.

The U.S. state and federal financial regulators have developed, at times consistent and other times conflicting, positions on bank-FinTech partnerships, which presents a potentially complicated array of considerations for banks when engaging FinTech companies. State-level financial regulation in the U.S. presents a patchwork of 50 potential regulatory schemes to which a FinTech company and, by extension, its partnering bank may be subject.

In addition, federal regulation of banking activities is spread across several bank regulatory agencies whose interests in bringing certain bank-FinTech partnerships under their regulatory umbrellas may compete with those of prominent state bank regulatory agencies, such as those in California, New York, and Utah.

Recent litigation between state and federal regulatory agencies, in addition to rules promulgated by federal regulatory agencies in an effort to both clarify regulatory uncertainty for the industry and prevent so-called "rent-a-charter" schemes in which FinTech companies circumvent (intentionally or not) certain state or federal licensing requirements, present an ongoing challenge to banks and FinTech companies seeking to offer innovative products and services across U.S. state borders.

Banks entering into partnerships with FinTech companies must stay up to date with developments in this space and ensure that their relationships do not run afoul of both existing and still percolating regulatory requirements.

With increased innovation in FinTech also comes more sophisticated bad actors who attempt to illegally access data, defraud customers and companies, and launder money.

SPOTLIGHT ON SPACS

One of the most noteworthy developments in M&A transactions in 2020 and 2021 has been a significant increase in the number of private companies, including many FinTech companies, combining with special purpose acquisition companies, or SPACs, resulting in the formerly private company becoming a public company. In the four-year period from 2016 to the end of 2019, a total of 104 combinations with a SPAC were announced[4]. By comparison, in just the 15-month period from January 1, 2020 to March 31, 2021 a total of 197 combinations with a SPAC were announced[5].

SPAC BASICS

A SPAC is a shell company that is formed for the purpose of completing a business combination transaction—commonly referred to as a "de-SPAC transaction"—with one or more unidentified target businesses within a specified period of time (typically 18 to 24 months). SPACs do not have any revenues or operations—their sole purpose is to raise capital to complete a de-SPAC transaction.

SPACs are typically sponsored by an investor and management team with experience identifying, acquiring, and operating businesses in a public company setting. A SPAC will raise the capital necessary to fund a de-SPAC transaction through the proceeds from its initial public offering (IPO) and, to the extent required, additional financing sources (often through private investments in public equity, or PIPE, transactions). A SPAC cannot identify targets for a de-SPAC transaction prior to the closing of its IPO. The amount that a SPAC raises in its IPO is typically one-third to one-fifth of the expected enterprise value of potential targets.

Once a SPAC has identified a target for a de-SPAC transaction and has entered into definitive agreements with the target, the SPAC typically will need to obtain shareholder approval of the transaction or commence a tender offer process. As part of this approval or tender offer process, the SPAC must provide its public shareholders with the right to redeem their public shares in the SPAC in exchange for an amount of cash that is approximately the amount paid by the shareholders in the SPAC's IPO. If shareholder approval is obtained (or the tender offer process is successfully completed), and the other conditions to the transaction are satisfied, the de-SPAC transaction will be consummated and the SPAC and the target business will combine, resulting in a publicly traded operating company.

BENEFITS AND CONSIDERATIONS

For a private company, a SPAC may be an attractive vehicle to become a public company without going through a traditional IPO process. One potential benefit is with respect to timing. The timeline for a SPAC transaction can be as quick as three to five months, while the timeline for an IPO is typically four to six months (and will often take longer).

Furthermore, the company's valuation is established through a negotiation by the company and the SPAC, rather than through the book-building process that is typical for an IPO. Investments by sophisticated PIPE investors can also help validate the valuation in advance of the company going public.

Although SPAC transactions have a number of potential benefits, there are additional considerations that should be assessed. At the formation of the SPAC, the sponsor will typically receive 20% of the SPAC's shares (often referred to as the "promote" or "founder shares"), which are purchased by the sponsor for a nominal amount. These shares will convert into publicly traded shares as part of the de-SPAC transaction, which has the effect of diluting the shares that will be received by the target company's shareholders. Additionally, it is common for the public shareholders of the SPAC, as well as the sponsor, to purchase warrants that are exercisable for publicly traded shares—once exercised, these warrants will also dilute the shares held by the shareholders of the target company.

Moreover, because a de-SPAC transaction will typically require a shareholder vote and the SPAC shareholders will have the right to redeem their shares prior to completion of the de-SPAC transaction, there is a risk that the transaction will not be approved or significant shareholder redemptions might leave the company with less capital than is contemplated.

LOOKING AHEAD

What does the future hold for SPACs? Will SPAC transactions remain a popular vehicle for companies to go public in the long term? Only time will tell, and those questions have become more complicated and difficult to answer in light of recent interest in SPACs from regulators, including the SEC. In April 2021, the SEC released public statements regarding the liability risks under U.S. securities laws with respect to SPACs and regarding accounting and reporting considerations for warrants issued by SPACs[6]. Although it is not clear what the SPAC market will look like going forward, SPACs will very likely continue to be a topic closely watched by investors, regulators, and advisors in the second half of 2021 through 2022.

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4 Source: www.dealpointdata.com (last visited on April 29, 2021).

5 Source: www.dealpointdata.com (last visited on April 29, 2021).

6 The statements are available at https://www.sec.gov/news/statements.

FINTECH M&A ACROSS VERTICALS

A number of factors are driving consolidation in the FinTech industry. Here, we examine recent mergers, acquisitions and other large deals within the key verticals of the FinTech ecosystem.

The Pandemic Has Accelerated Consolidation

In a period marked by the pandemic, the FinTech industry saw several major developments that will have a great impact on the future course of the industry.

M&A activity picked up in the latter half of 2020 and into 2021 with several important transactions announced. Some sectors saw consolidation as major players sold, while in other sectors incumbents acquired new capabilities as they competed for opportunities.

Venture capital was 20% higher in 2020 relative to 2019 according to estimates from S&P Global Market Intelligence, as private investors vied to increase their exposure to the ongoing digitalization of financial services. FinTech companies have also started going public at an increasing rate. As they access capital markets more broadly, it is likely that FinTech companies will increasingly become acquirers themselves.

Several Trends Are Converging to Drive Deal Activity

In 2020, several key trends were apparent across most verticals within FinTech. Digital-first financial products are growing due to the pandemic driving increased use of blockchain, cryptocurrencies, and alternative assets. FinTechs are focusing on diversifying product lines and tapping into new markets.

Payment networks are also expanding into platform providers by providing a variety of different payment and non-payment services. We are seeing a new "banking stack" being built by a burgeoning host of "infrastructure" companies that are leveraging API-based products to unlock banking functionality for all kinds of organizations.

Mastercard's purchase of Finicity is one example of where these trends converge. The resulting streamlined credit and payment infrastructure is made possible by Finicity's APIs. The purchase also allows MasterCard to expand into the mortgage and lending space thanks to Finicity's partnerships. From a global ecosystem perspective, the tie-up represents an example of how Open Banking in the U.S. continues to be driven by the corporate sector rather than being mediated by government regulation, as it tends to be in other countries.

Tie-ups like this also demonstrate the obvious fit between a big financial institution and the right FinTech startup, but M&A can also mean a Big Tech enterprise acquiring a FinTech, or a big FinTech acquiring another FinTech. An example of the latter is neobank SoFi and its newfound willingness to act as an acquirer. In April 2020, SoFi bought payment processor Galileo Financial Technologies, supplementing its consumer-led offering with new B2B components (like Mastercard by growing an API-driven infrastructure). Within a year, it had also announced an agreement to acquire Golden Pacific Bancorp, fast-forwarding its plan to become a national bank.

10 Largest FinTech M&A Deals Announced Since January 2020

Ranked by deal value at announcement
Excludes deals involving Special Purpose Acquisition Companies (SPACs)

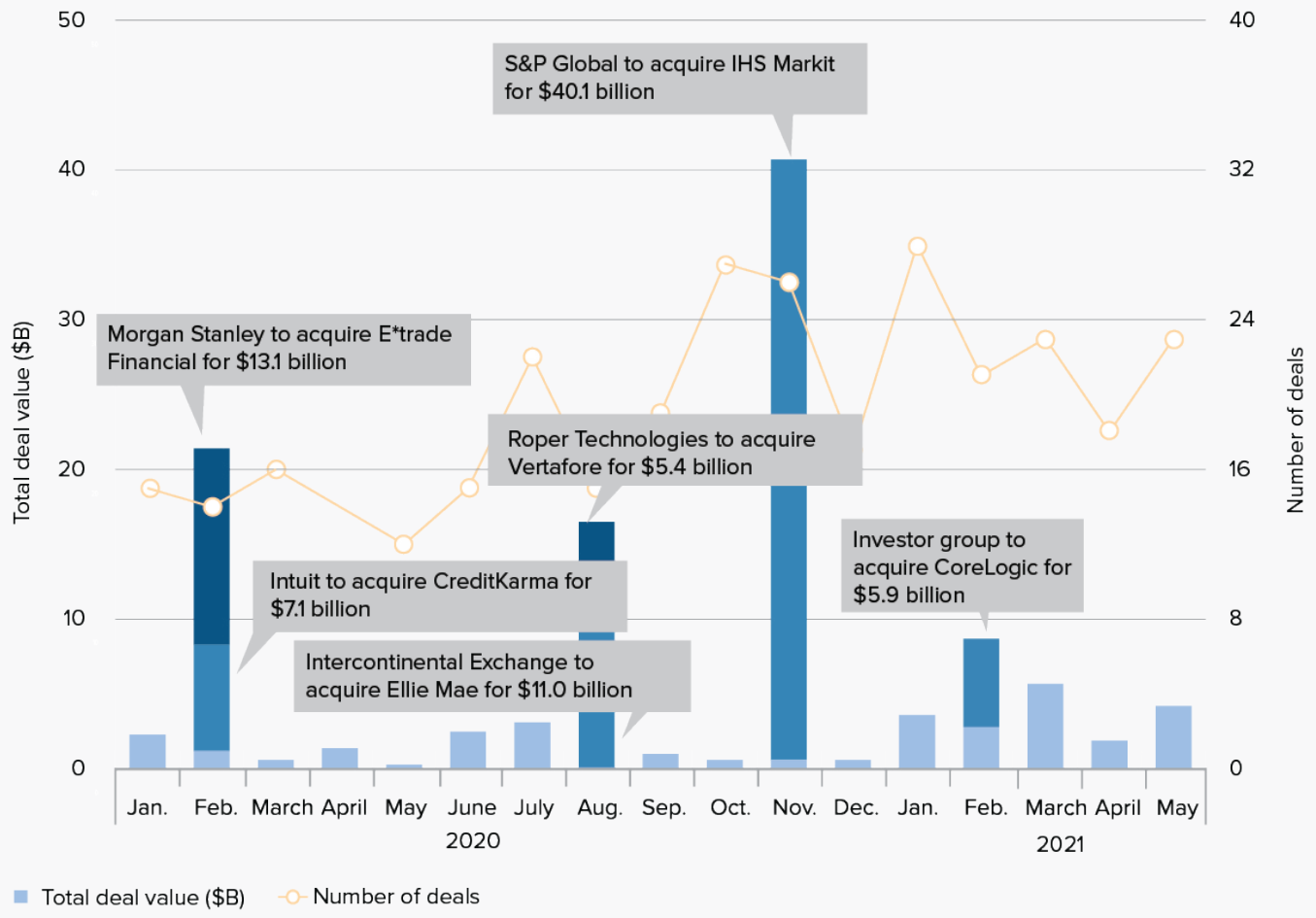
BUYER (TICKET)	TARGET	TARGET COUNTRY	ANNOUNCEMENT DATE	DEAL VALUE ($B)	FINTECH SECTOR
S&P Global Inc. (NYSE: SPGI)	IHS Markit Ltd.	United Kingdom	11/30/20	40.1	Financial Media and Data Solutions
Morgan Stanley (NYSE: MS)	E*TRADE Financial Corp.	USA	2/20/20	13.1	Investment and Capital Markets Technology
Intercontinental Exchange Inc. (NYSE: ICE)	Ellie Mae Inc.	USA	8/6/20	11.0	Banking Technology
Intuit Inc. (NASDAQ: INTU)	Credit Karma Inc.	USA	2/24/20	7.1	Financial Media and Data Solutions
Investor group*	CoreLogic Inc.	USA	2/4/21	5.9	Financial Media and Data Solutions
Roper Technologies Inc. (NYSE: ROP)	Vertafore Inc.	USA	8/13/20	5.4	Insurance Technology
Thoma Bravo LLC	Calypso Technology Inc.	USA	3/22/21	3.8	Investment and Capital Markets Technology
Bill.com Holdings Inc. (NYSE: BILL)	DivvyPay Inc.	USA	5/6/21	2.5	Payments
Tyler Technologies Inc. (NYSE: TYL)	NIC Inc.	USA	2/10/21	2.3	Payments
NCR Corporation (NYSE: NCR)	Cardtronics plc	USA	1/11/21	1.9	Payments

Data compiled June 16, 2021.
* Investor group comprised of Stone Point Capital LLC and Insight Venture Management LLC.
Data includes transactions announced between Jan. 1, 2020 and May 31, 2021.
Source: S&P Global Market Intelligence

Among These Transactions, Deal Volume Skewed Toward the Latter Half of 2020 and Early 2021

Excludes deals involving Special Purpose Acquisition Companies (SPACs)

FinTech deal volume for U.S. and U.K. FinTechs elevated in the latter half of 2020 and early 2021



Data compiled June 16, 2021
*Investor group comprised of Stone Point Capital LLC and Insight Venture Management LLC.
Analysis includes financial technology and payments deals where acquisition targets were based in the U.S. or U.K., announced between Jan. 1, 2020, and May 31, 2021.
Excludes terminated deals, bids, renegotiations, letters of intent, and deals involving special purpose acquisition companies.
Deal value as of announcement date.
Source: S&P Global Market Intelligence

Payments

The volume of digital payments and the number of digital accounts increased significantly in 2020 as online commerce represented a larger share of overall commercial activity, according to data from the U.S. Department of Commerce. As they have grown, the major players have targeted feature expansion as a growth strategy, breaking away from their traditional role as peer-to-peer or contactless payment providers into broader financial ecosystems. Examples include PayPal accepting cryptocurrency payments, Venmo allowing direct deposits and releasing a credit card product, and Cash App providing commission-free trading.

The growing importance of Embedded Finance has also led to several acquisitions. For example, Square's purchase of TIDAL allows it reach SME and niche markets with new product lines and customer segments, in this case helping artists and content creators to collect revenue and manage their finances.

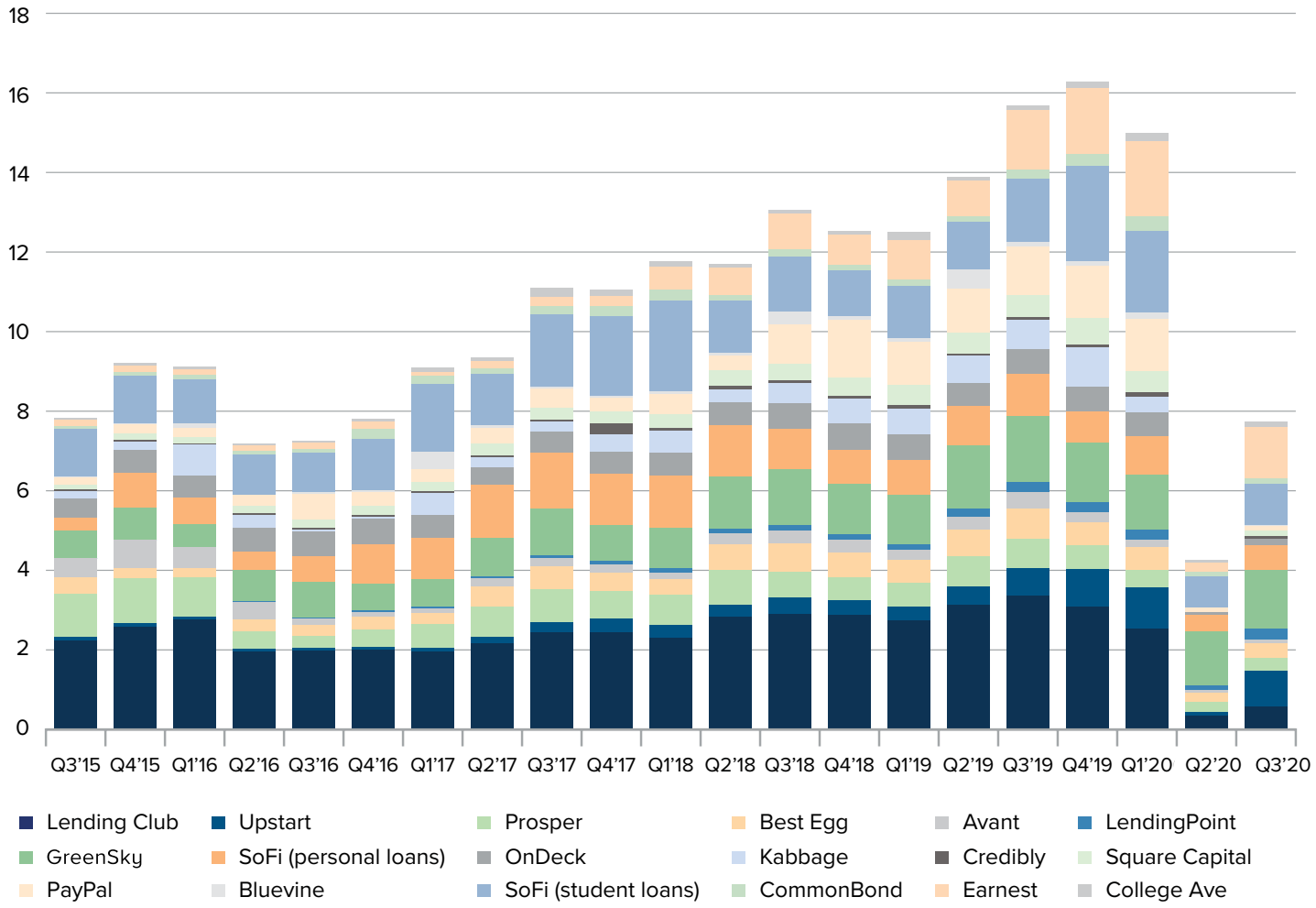
Payments infrastructure has also seen significant deal activity, with Galileo's purchase by SoFi and startup Marqeta's capital raise as examples.

Digital lending

Several digital lenders, just like lenders broadly, saw credit deteriorate in early 2020 and had to create significant forbearance initiatives to help borrowers manage payments. Origination volumes collapsed as lenders tightened underwriting criteria, pulled back on lending, and demand for loans in certain sectors declined amid broader economic uncertainty. By the third quarter of 2020, many of the forbearance programs had declined significantly relative to their peaks and we saw origination volumes begin to climb again, with some major digital lenders returning to near-2019 levels.

Two major small-business-focused digital lenders sold their businesses, Enova International's purchase of OnDeck and Amex's purchase of Kabbage. Both deals allowed the acquirers to scale and diversify consumer and small business financing options.

Quarterly Originations ($B)



Data compiled between December 11, 2020 and Jan 3, 2021
SME-focused lender originations do not include Payment Protection Program loans
Source: S&P Global Market Intelligence

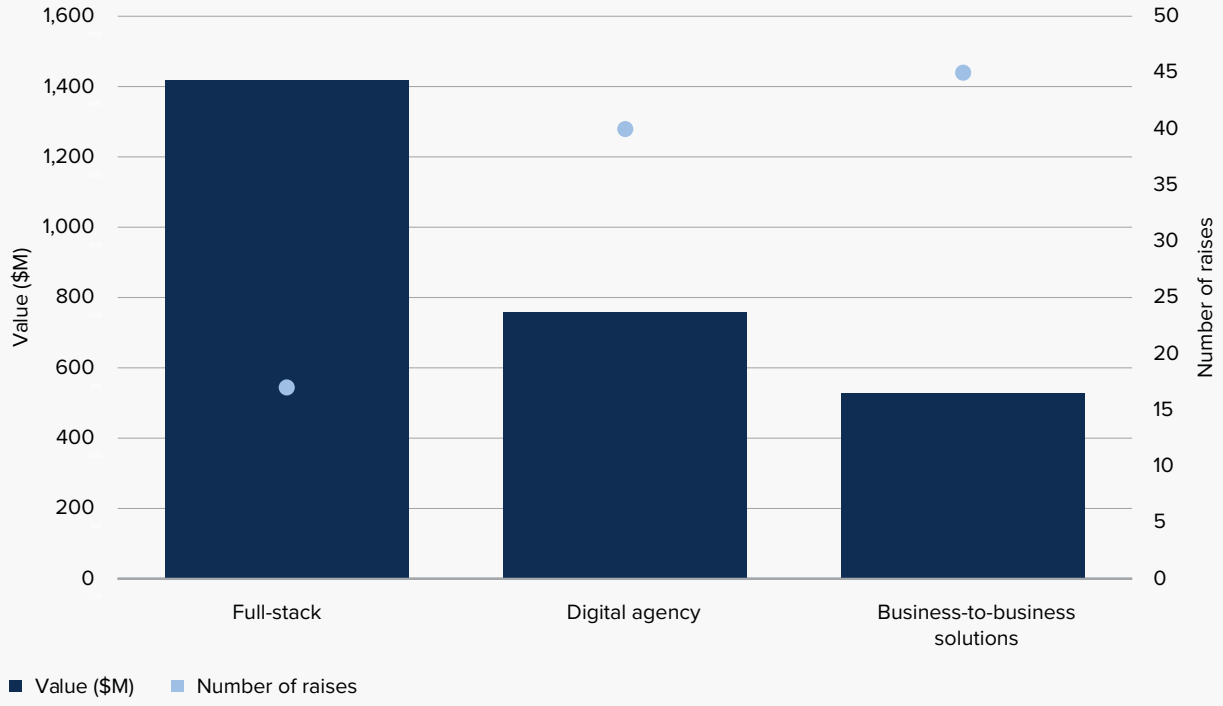
Insurance

In 2020, providers of the software used by the insurance sector also were involved in large transactions. For example, Roper Technologies' $5.4 billion purchase of Vertafore extended the company's product line into cloud-based property and casualty insurance.

We also saw the full-stack trend gain traction as major players opted to combine online distribution with in-house underwriting. Pie Insurance Holdings and Hippo Enterprises Inc. both announced the acquisition of small carriers to establish their underwriting arm in 2020.

When companies grow quickly, they can reach a point where selling rather than going public can make the most sense for investors. Brown & Brown's purchase of CoverHound and Allstate's purchase of SquareTrade are two examples of this trend. S&P Global Market Intelligence anticipates that this approach will be popular for many in this sector, particularly digital agencies, for which industry incumbents have already demonstrated an appetite.

Full-stack companies fueled a large increase in U.S. insurtech funding in first three quarters of 2020



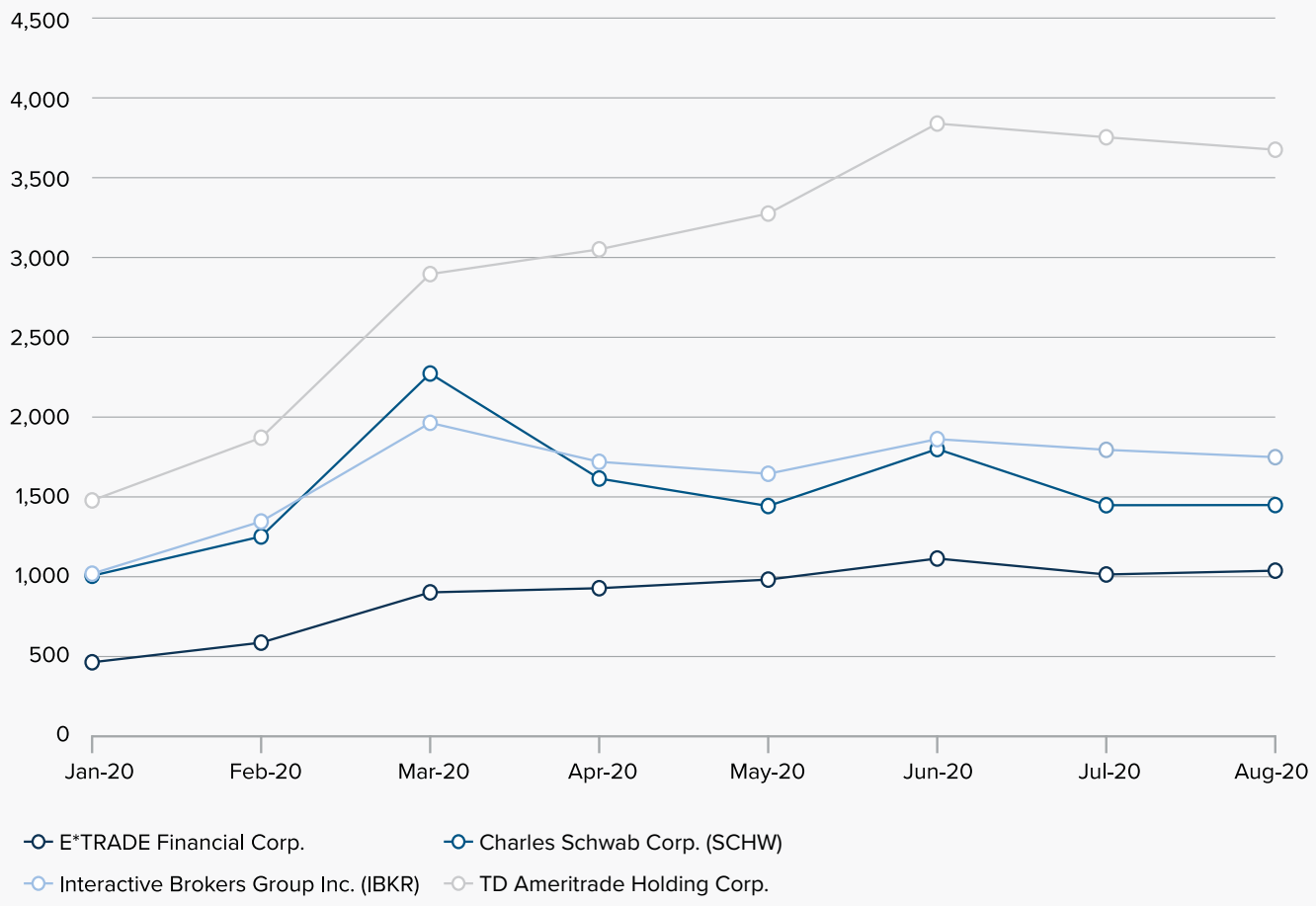
Data compiled Dec. 10, 2020.
Reflects private placements for private, U.S.-based insurance technology companies, as defined by S&P Global Market Intelligence. Excludes debt transactions.
Based on the assumed closing date of the offering as of the time the data was compiled. Rounds might be subsequently extended.
The analysis uses a best-efforts approach to capture only the portion of the offering that was raised during the first three quarters of 2020, excluding tranches that closed prior to that time frame.
Source: S&P Global Market Intelligence

Consumer trading

Competitive pressure on fee income continued to push the industry toward consolidation in search of scale. The growth of Robinhood's free service has been a major contributor to this pressure, and new entrants are adding to the competition. In addition, increased retail usage during the pandemic has created a sense of urgency to scale and to capture new users, as Charles Schwab demonstrated with their purchase of TD Ameritrade and Morgan Stanley's acquisition of E*TRADE.

In crypto-asset trading, mobile payment player Square, through its Cash App, allows users to buy and sell stocks and Bitcoin. Major banking institutions like J.P. Morgan, Morgan Stanley, and Goldman Sachs are also augmenting their services in this space.

Trading activity spiked in March 2020 for online brokers, based on daily average trades (000)



Data compiled Sept. 24, 2020.
E*TRADE's figures are daily average revenue trades, Interactive Brokers' are total client daily average revenue trades and TD Ameritrade's are average trades per day, as reported in monthly disclosures. Charles Schwab's amounts are derived from clients' daily average trades, which are reported weekly; S&P Global Market Intelligence aggregated these into monthly figures by multiplying the weekly figures by the ratio of trading days that week that were in a given month shown to the total trading days in that week.
Sources: S&P Global Market Intelligence

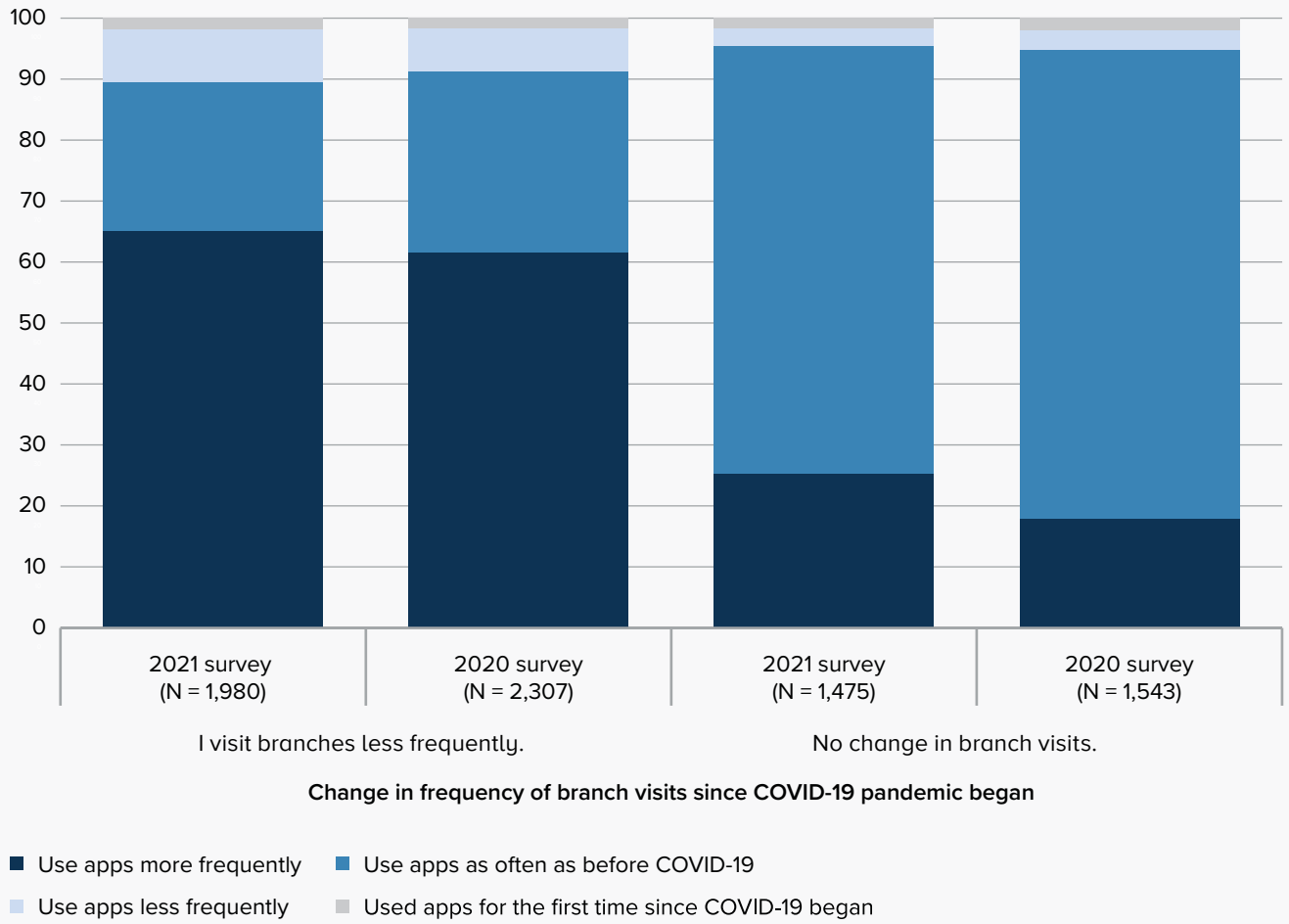
Digital banking

The pandemic drove increased usage of digital channels across the retail banking industry, a trend that was already well underway, and acted as a tail-wind for digital banking.

Data from a 2019 survey conducted by the FDIC showed that mobile and online banking were used much more frequently to access banking services than ATMs or in-branch services, and the importance of mobile specifically had increased significantly, well before the pandemic began. Survey data from S&P Global Market Intelligence showed that more than half of mobile banking users visited branches less frequently during the pandemic. Nearly 62% of those respondents saw a coincident increase in their usage of mobile banking services.

Many non-banks seem to be interested in taking advantage of this trend. Several companies applied for banking charters in 2020 with plans to launch digital-only banks, and many major corporations like Walmart, Google, and Walgreens have announced intentions to provide digital banking services directly to customers. Major investments for FinTechs in this sector include Chime's Series F funding round and Varo Money's Series D raise along with its charter approval.

Majority of people visiting bank branches less frequently are using mobile banking apps more often since COVID-19



Data compiled April 9, 2021.
N = number of respondents
Based on responses to the following questions: Since the COVID-19 outbreak began, how has your behavior related to branch visits changed? Since the COVID-19 outbreak began, how has your usage of your mobile bank app changed?
Sources: S&P Global Market Intelligence 2020 U.S. Mobile Banking Survey, an online survey of nearly 4,000 U.S. mobile bank apps users conducted June 2020-July 2020; S&P Global Market Intelligence 2021 U.S. Mobile Banking Survey, an online survey of over 3,800 U.S. mobile bank app users conducted February 2021-March 2021.

CONCLUSION

As the COVID-19 pandemic nears its end, the FinTech industry is poised for greater M&A and investment activity in the remainder of 2021 and 2022. The shift to digital financial services in the last year has been dramatic, with consumers adopting new technologies at a record pace and with FinTechs becoming fiercer competitors of financial services institutions. As FinTechs continue to transform the way in which financial products and services are delivered, they will increasingly become targets of banks seeking to narrow technological gaps and to combat market share loss. FinTechs may also become acquirers themselves, joining forces to become more robust competitors. The most promising FinTechs will also be sought after by private equity and venture capital investors seeking the "winners" that may displace or complement incumbent players.

This report has explored the drivers of increased consolidation and investment in the FinTech sector and some of key issues that should be considered when evaluating transactions. It has also highlighted recent high-profile transactions and trends within the key verticals of the FinTech ecosystem. This report is not a comprehensive summary of all the issues and trends in this rapidly changing space. Rather, its intent is ultimately to spark meaningful conversations about where FinTech transactions may be headed.

This report was prepared by Shearman & Sterling LLP; S&P Global Market Intelligence; and Rise, created by Barclays. Shearman & Sterling actively advises on all aspects of the M&A process and frequently helps banking organizations, FinTechs, and investors to navigate the dynamic regulatory and competitive FinTech landscape. S&P Global Market Intelligence's FIG Research team provides independent forecasts and real-time analysis of the banking, insurance and financial technology sectors, across multiple geographies. Rise, created by Barclays, is a global community of the world's top innovators and entrepreneurs working together to create the future of financial services.

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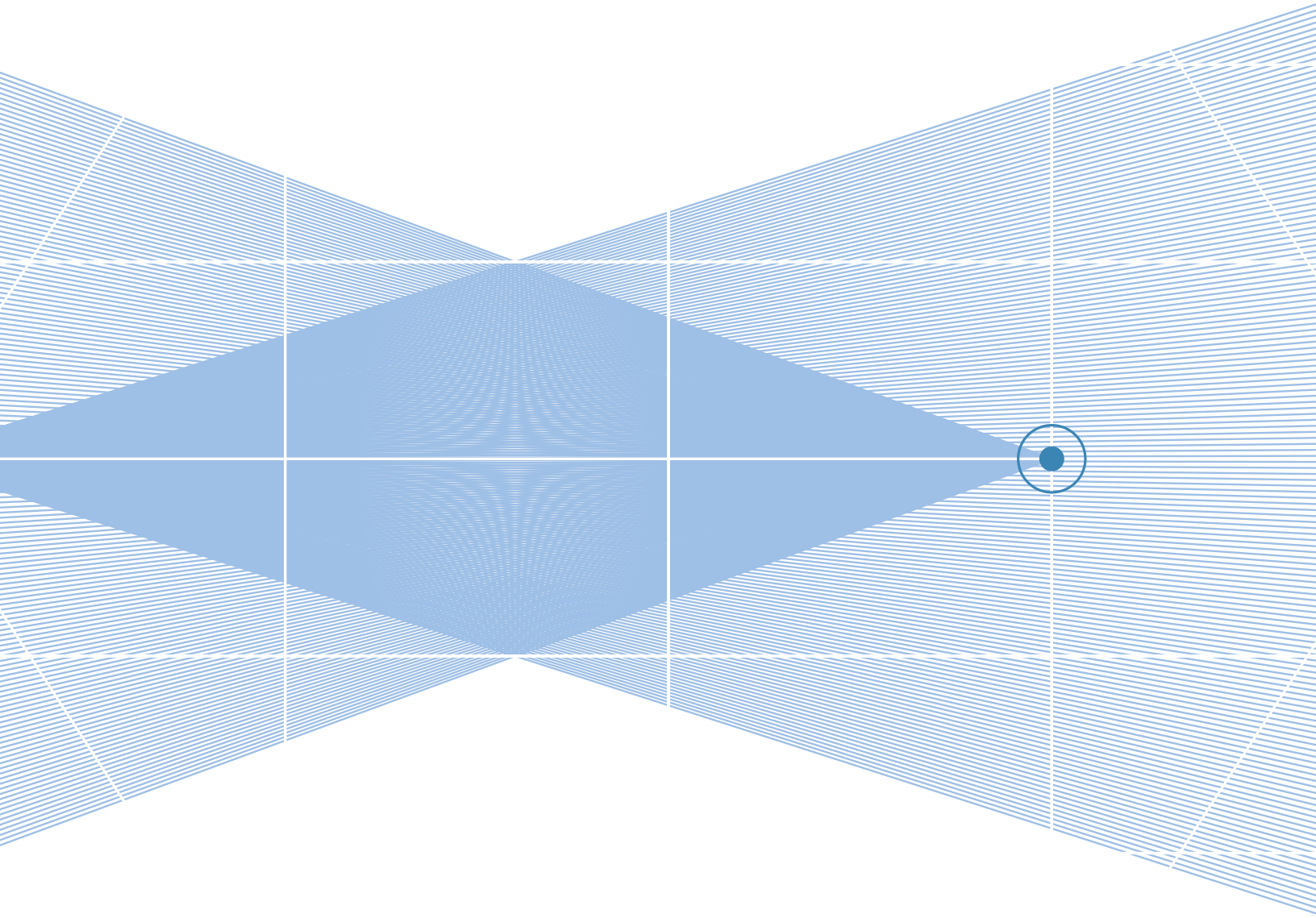

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