ENTERING THE U.S. MARKET:

A GUIDE FOR FINTECH FIRMS

Shearman
SHEARMAN & STERLING

FINTECH FOUNDRY

In association with:

Department for International Trade

HM Treasury

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INTRODUCTION

The United States is the largest financial services market in the world. For an international business, expanding operations to the U.S. can facilitate capital-raising efforts, provide access to one of the world's deepest talent pools and create significant market opportunities.

However, entering the U.S. market can be daunting for international businesses due in large part to its complex regulatory framework. This is especially true in the FinTech space, as a FinTech firm may be subject to oversight from a multitude of federal and state regulators, which can lead to regulatory uncertainty and significant compliance burdens.

This guide provides an overview of the likely legal considerations, as well as potential pitfalls, for a FinTech firm looking to expand its business to the U.S. While this overview is not exhaustive, and every factor may not be relevant to every business, the considerations outlined below are intended to help direct your further questioning and are intended to focus your attention on potential issues that should be addressed.

Shearman & Sterling is one of the leading firms advising financial institutions globally, and we have had the opportunity to work with many FinTech firms growing their businesses in both the U.S. and abroad. We have a breadth of experience advising clients in the FinTech space, including matters related to blockchain, digital assets, payments, peer-to-peer lending, AI and big data. We recognize that growing a FinTech business can be both challenging and exciting and requires a great deal of commitment. We will work closely with you to ensure that your entry into the U.S. is as seamless as possible and that you are best positioned for success.

Attorney Advertising. This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

FOREWORD

Department for
International Trade

HM Treasury

The United Kingdom is a global leading, international centre for financial services. Alongside the United States, our economies represent over 41 percent of global financial services exports, and the U.S. represents the U.K.'s largest net financial services export market.

Moreover, and perhaps in more recent times, the value of the U.S. market hasn't escaped U.K. FinTech firms. From its consumer base and number of transactions, to the availability of venture capital – over $10.5 billion in FinTech in 2018 – it is clear why U.K. FinTech firms seeking to grow internationally have identified the United States as their priority export market.

It is for this reason that the U.K. Department for International Trade (DIT) and HM Treasury, in association with Shearman & Sterling, have sought to produce this guide for FinTech firms looking to enter and expand their operations in the United States, and to increase cross-border trade in FinTech activity.

The information contained in this document aims to provide expert commentary on the key questions FinTech firms may ask as they continue their transatlantic journeys from startups to scaleups and to support smooth growth into the U.S. market.

The rise of FinTech has connected global financial markets like never before. While this global reach presents significant growth opportunities for FinTech firms, it also can expose them to overlapping and, at times, overwhelming regulatory frameworks and legal implications.

At Shearman & Sterling, we are committed to fostering the growth of the global FinTech industry through our FinTech Foundry program, a program dedicated to support the FinTech-related activities of our clients and the wider global FinTech ecosystem. Our deep understanding of cross-border regulatory considerations, along with our emerging growth, M&A and capital markets expertise, makes us an ideal partner to support the expansion of FinTech firms every step of the way.

This guide provides firms wanting to expand into the U.S. with a helpful overview of considerations they should be aware of when setting up in the U.S. We hope this overview will allow firms to better focus on their products, strategy and fundraising. Innovation is a journey, with many critical decisions made along the way. Shearman & Sterling's FinTech Foundry helps clients understand the big picture and ask the right questions, enabling them to turn great ideas into new realities.

DAVID BEVERIDGE
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OVERVIEW OF THE U.S. FINTECH LANDSCAPE

FinTech has received enormous interest, popularity and regulatory attention in the U.S. Players in the U.S. FinTech ecosystem come in various forms and sizes and are offering their institutional and retail customers an increasing variety of products and services. While the U.S. FinTech regulatory environment is still developing, the increase in new FinTech startups and investment in the sector show no signs of slowing.

The United States is well-known for its developed, liquid capital markets that create opportunities for expansion, acquisitions, asset sales and fundraising. In 2018, U.S. venture capital firms invested over $10.5 billion in FinTech firms across 1,042 deals, a 52% increase in capital invested in 2017.[1] Of the 48 FinTech "unicorns" valued at over $1 billion, the United States is home to 28.[2]

FinTech firms are based all over the country, although the majority are headquartered in Silicon Valley and New York City. The types of FinTech firms that have garnered popularity in the U.S. provide an array of financial services, such as payments, online lending, robo-advice, insurance and digital asset financial products that rely on distributed ledger technology (DLT), with many services being provided on mobile platforms.

Digital asset offerings, such as initial coin offerings (ICOs) and token sales, have garnered significant regulatory scrutiny over the past several years, as regulators and courts have taken steps to ensure that the appropriate securities and commodities laws are being followed. DLT has also received significant interest from regulators and market participants due to its transformational potential. Robo-advising has generated increased attention by consumers and regulators alike, as assets under management by such firms grew to $200 billion worldwide at the end of 2018, with Wilshire Phoenix projecting $1 trillion in global AUM by 2024.[3]

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1 Innovate Finance, "2018 FinTech VC Investment Landscape": https://cdn2.hubspot.net/hubfs/5169784/Innovate-Finance-2018-FinTech-VC-Investment-Landscape.pdf
2 CB Insights, "Global Fintech Report Q2 2019" https://www.cbinsights.com/research/report/fintech-trends-q2-2019/
3 Wilshire Phoenix, "Robo-Advisor Trends (Part 1)" (Jan. 30, 2019): https://www.wilshirephoenix.com/robo-advisor-trends-part-1/
4 See footnote 2.
5 KPMG, "Global Venture Capital Funding Holds Strong in Q2 '19: KPMG Enterprise Venture Pulse Report" (Jul. 11, 2019): https://home.kpmg/xx/en/home/media/press-releases/2019/07/enterprise-venture-pulse-report-q2.html
6 See footnote 5.
7 S&P Global Market Intelligence, "2018 US Fintech Market Report" : https://www.spglobal.com/marketintelligence/en/documents/2018-us-fintech-market report.pdf
8 PwC and CB Insights, "US MoneyTree Reporting: 2019": https://www.pwc.com/us/en/industries/technology/moneytree.html

FinTech firms have also started to more frequently partner with traditional brick-and-mortar banks to offer financial services to consumers, providing mutual efficiencies that can serve to further increase financial inclusion and access to these technologies. While the FinTech industry was once seen solely as a threat to consumer dependence on traditional banks, banks' partnerships with, and investments in, FinTech firms have helped to alleviate at least some of these concerns, as traditional banks have found ways to participate in new platforms for traditional bank products.

Finally, there has also been an emergence of innovative technology aimed at helping financial institutions achieve effective compliance with regulations, also known as "RegTech." These solutions cover a variety of market segments, including those related to enterprise risk management, regulatory reporting, anti-money laundering and "know your customer" requirements and trade monitoring, among other things.

U.S. FIGURES

The U.S. is home to

28

of the world's 48 FinTech unicorns[4]

In Q2 '19, U.S. venture-backed companies raised $31.5 billion, approximately

62%

of total global VC funding[5]

Of the 3,855 global venture deals in Q2 '19,

2,379

of them took place in the U.S.[6]

In 2018, **U.S. payments firms received the most funding**, but investment and capital markets technology firms secured the greatest number of deals[7]

AI-focused firms raised approximately

$4.9 billion

in funding in Q2 '19, while cybersecurity firms raised $2.1 billion during that period[8]

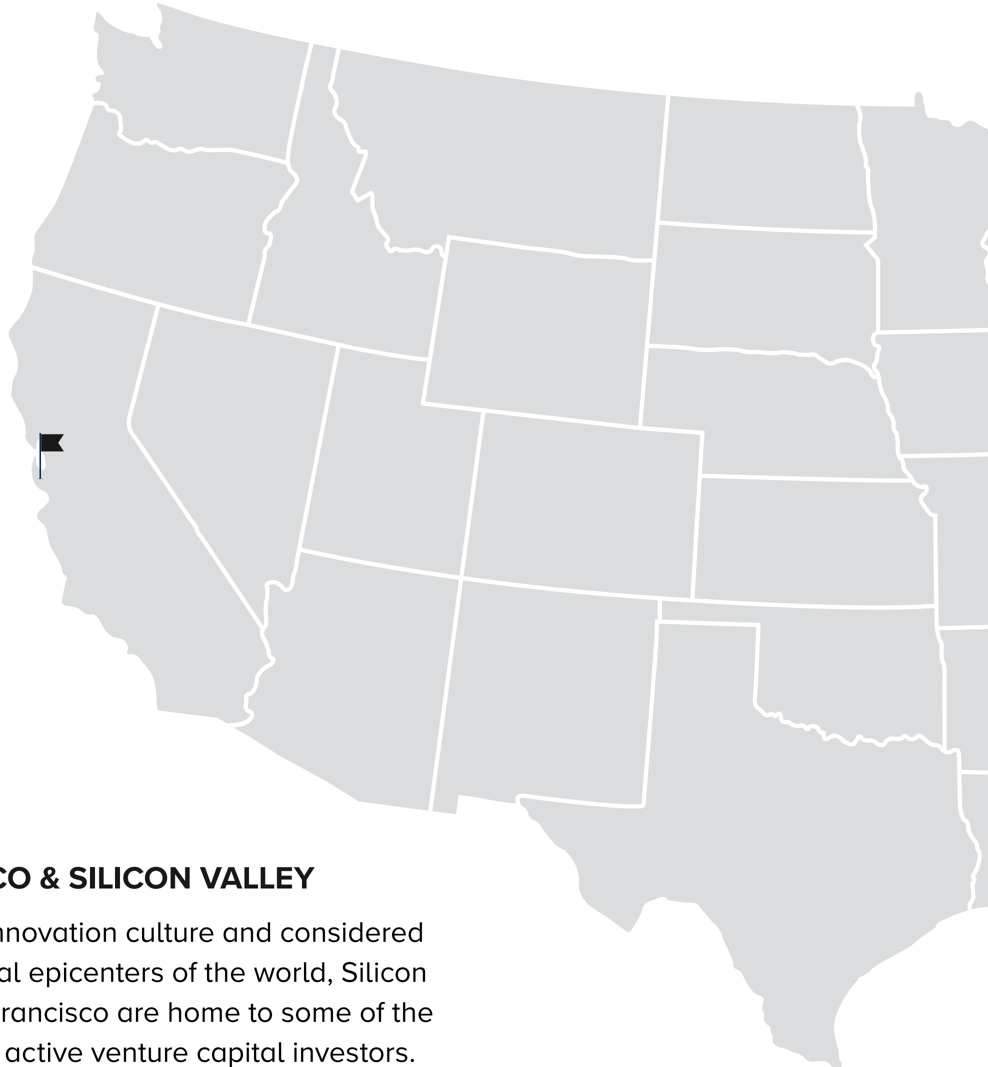
REGIONAL FINTECH HUBS

The U.S. FinTech landscape can generally be broken down into regions where local governments and industry groups are actively encouraging new business formation and technological innovation. Each FinTech hub has its own distinct characteristics and specialties, and each ecosystem is supported by a number of community builders.

This map highlights each regional FinTech hub, and also provides testimonials from some of the top players in each hub that shed additional light on what makes each hub unique.

CHICAGO

Chicago is one of the fastest-growing FinTech hubs in the U.S. It is also the largest financial hub in the Midwest and responsible for a significant portion of the country's derivatives trading. Chicago is also home to some of the country's top business schools and is known for providing government support for innovative technologies.



SAN FRANCISCO & SILICON VALLEY

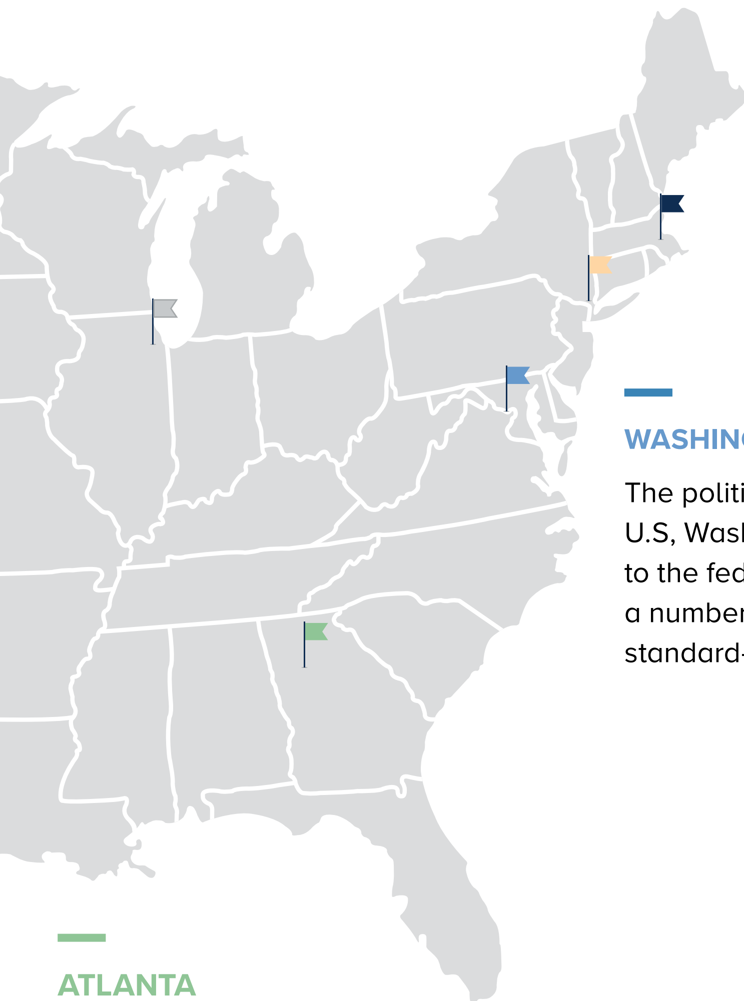
Known for their innovation culture and considered the venture capital epicenters of the world, Silicon Valley and San Francisco are home to some of the largest and most active venture capital investors. The region has also produced the most FinTech unicorns in the U.S. and is home to some of the world's largest technology companies.

BOSTON

Boston is home to a number of the country's large financial institutions, hedge funds, wealth management firms and insurance companies. Boston has developed a reputation as a hub for robo-advisers, and is also home to some of the world's top business schools and universities.

NEW YORK

The financial capital of the world, most of the world's largest financial institutions are headquartered or maintain a significant presence here. New York has become increasingly FinTech-friendly due to its deep financial roots and offers a number of incubator and accelerator programs. Several of the world's largest and most successful venture capital firms are also located here.



WASHINGTON, D.C.

The political epicenter of the U.S, Washington, D.C. is home to the federal regulators and a number of lobbying and standard-setting bodies.

ATLANTA

Considered one of the major payments hubs within the U.S. FinTech landscape, approximately 70% of all U.S. payments transactions are handled in Atlanta. The industry is supported by a number of lobbying groups, such as the Technology Association of Georgia and the American Transaction Process Coalition, which seek to promote and preserve the interests of the industry.

TESTIMONIALS

rise
new york
Created by BARCLAYS

Community is the name of the game in New York. The power of your network and support system can make or break your business. Rise created by Barclays brings together the best and brightest FinTechs, gathers top industry mentors and curates business development opportunities to holistically support growth.

9YARDS CAPITAL

We imagine San Francisco is like Florence during the Renaissance. It is intellectually stimulating, a place where global problems are being solved and vast amounts of wealth are being created. Successful founders here give back their time and money to new waves of up and coming entrepreneurs which in turn creates more successful entrepreneurs.

What sets Chicago apart is the diversity of this ecosystem. Best known for trading, derivatives and exchanges, Chicago is also a significant player in banking, insurance, payments, regulation, alternative lending, wealth management, cryptocurrency, cybersecurity and artificial intelligence. The diversity of Chicago's B2B and B2C customer base sets it apart. No single sector dominates the economy and consumers represent a broad range of demographics.

U.S. FINTECH REGULATORY OVERVIEW

FinTech firms in the U.S. are not subject to a FinTech-specific regulatory framework by any single federal or state regulator. Rather, depending on the FinTech firm's activities, that firm may be subject to a myriad of federal and state laws, regulations, licensing and registration requirements and, thereby, also subject to laws and regulations at both the federal and state levels. While this can at times lead to overlapping regulation, state and federal regulators have taken steps to clarify how their respective regulatory regimes may apply to certain FinTech activities.

At the federal level, the Consumer Financial Protection Bureau (CFPB) has jurisdiction over providers of financial services to consumers. Because many FinTech firms are aimed at providing services predominantly to consumers, the CFPB can enforce a range of consumer protection laws (such as consumer lending laws and anti-discrimination laws) that apply to the activities of such companies. The CFPB also has authority to enforce against the use of unfair and deceptive acts and practices generally.

To the extent that the activities of a FinTech firm fall within the licensing regimes of other federal regulators, such as the Securities and Exchange Commission (SEC) or the Commodity Futures Trading Commission (CFTC), such FinTech firms may be required to register with such agencies and become subject to rules and regulations. For example, robo-advisers, being a subset of investment advisers, may be subject to SEC registration requirements for such advisers. Finally, FinTech firms may also be required to register with the U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN) and thus, as described below, comply with the Bank Secrecy Act (BSA) and other anti-money laundering laws and regulations.

The Office of the Comptroller of the Currency (OCC), the primary federal bank regulator for national banks, announced in July 2018 that it would begin accepting special-purpose national bank charter applications from FinTech firms that receive deposits, pay checks or lend money. FinTech firms that choose to apply for and receive this special-purpose national bank charter would become subject to the laws, regulations, reporting requirements and ongoing supervision that apply to national banks, and be held to the same standards of safety and soundness, fair access and fair treatment of customers that apply to national banks. However, the chartering of FinTech firms by the OCC has been on hold due in part to pushback from certain state regulators.

Regulators with jurisdiction over FinTech firms have not shied away from issuing enforcement actions where such firms are conducting activities in violation of the law. In recent years, for example, FinTech firms have been subject to enforcement

actions by regulators, including the CFPB, SEC, CFTC and FinCEN. Enforcement orders have been issued for, among other things, insufficient data security practices, violations of federal securities laws (including anti-fraud laws), failing to obtain requisite licenses or registrations and unfair and deceptive practices.

At the state level, the types of licenses that may be required include consumer lending, money transmission and virtual currency licenses. Depending on the number of states and licenses that are required to be obtained, a FinTech firm may find the compliance burden to be extensive as each state has its own distinct set of rules and regulations. However, banking regulators of 23 U.S. states have recently agreed to simplify the way FinTech firms can apply for licenses.[9]

A number of states have also launched regulatory sandboxes where FinTech firms may test new products in a controlled environment before rolling out to the entire market, while several others have drafted legislation related to the development of regulatory sandboxes. Of course, compliance within an individual state's sandbox rules does not mean that other state or federal regulators will not have their own interest in a firm's operations.

To learn more, please visit Shearman & Sterling's Global FinTech Regulatory Sandbox map.

KEY CONSIDERATIONS FOR FINTECH FIRMS:

- Depending on a FinTech firm's activities, that FinTech firm may be subject to a myriad of federal and state licensing or registration requirements.
- The number and complexity of potentially applicable U.S. regulations to any single FinTech has drawn some criticism as a potential barrier to entry and hindrance to the growth of U.S. FinTech generally.
- At the federal level, key financial regulators include the CFPB, SEC, CFTC, OCC, FinCEN, Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Board of Governors.

9 In 2018, the Conference of State Bank Supervisors, a national standard-setting organization made up of the financial regulators from all 50 U.S. states, the District of Columbia, Guam, Puerto Rico, American Samoa and the U.S. Virgin Islands, launched Vision 2020, an initiative to modernize state regulation of nonbank financial companies. More information on Vision 2020 can be found here: https://www.csbs.org/vision2020.

SETTING UP IN THE UNITED STATES

The first steps in setting up a FinTech business in the United States are dependent on the answers to key threshold questions:

Will the Company move its corporate headquarters to or have a physical presence in the United States?"

How many and what type of employees does the entity expect to have over time?

Will the Company be fundraising in the United States?

How will this entity be governed?

What type of activities will the new entity be performing?

Which is more important, flexibility or certainty?

How active will the entity be initially?

What are the plans for the entity?

Although you may not know the exact answers to these questions, having a general indication will be helpful in determining the kind of entity structure and the state of incorporation.

Generally, a FinTech firm will want to form either a limited liability company (LLC) or a "C" Corporation,[10] (See Annex III), which both limit liability for the equity holders. Although a significant factor in this determination is driven by tax considerations (both United States and foreign), governance is also an important factor in selecting the type of entity. One of the overarching themes when choosing between an LLC or a Corporation is that LLCs have a more flexible governance structure, while corporations instead generally rely on statutory-prescribed framework (and a more robust and well-developed body of case law and precedent).

10 Foreign companies or persons are not eligible to establish an "S" corporation under United States federal tax law. For all intents, when referring to a corporation, we are referring to a corporation that is treated as a "C" corporation as provided in the United States federal tax code.

You will likely want to form the entity in Delaware or the state of residence (the state where you have your United States "headquarters" or are otherwise conducting your principal business). Each state in the United States has its own laws for the establishment of business entities, and the decision of where to incorporate depends on the expected sources of investment and the ultimate exit strategy.

Regardless of the type of entity, the newly formed company should adopt certain corporate policies and procedures, including, but not limited to, a corporate authorization policy specifying exactly what the company's management and officers (or their designees) may do in terms of financial matters (e.g., spending and investment authority) and other operational matters (e.g., real estate leases, general contracting and hiring and compensation of employees and consultants). Other policies may delineate who may sign on behalf of the company and withdraw or deposit monies. In addition, officers of the company who may undertake certain, more fundamental or extensive actions on behalf of the company should be specified. There is no requirement that an officer be a resident of any state of the U.S. or a U.S. citizen, so any foreign nationals may serve as an officer, though different regulatory regimes may have "consent to jurisdiction" requirements for both firms and individuals.

Our Setting Up in the U.S. Checklist can be found inside the back cover of this guide.

DELAWARE

The State of Delaware is a popular choice for both businesses and institutional investors due to its state-of-the-art and flexible statutes, its large body of common law regarding corporate governance and its sophisticated Court of Chancery specifically dedicated to resolving sophisticated business disputes and issues.

STATE OF RESIDENCE

The state of residence is also a popular choice. Delaware companies must qualify to do business in different states as a foreign corporation, which subjects the company to more than one set of state-level taxes (typically not material until the entity is much more sizable) and annual report fees. Private, closely held companies doing business primarily within a single state may choose to incorporate in the state of residence to avoid paying duplicate foreign registration fees and Delaware franchise taxes. The disadvantage in choosing the state of residence is that the corporate laws in that particular jurisdiction may not be as robust or sophisticated as Delaware.

OPERATING IN THE UNITED STATES

IMMIGRATION

Immigration for both entrepreneurs and their employees can be among the most daunting challenges that a new business will face, as the U.S. demands detailed and voluminous paperwork and applications for those seeking permanent residence. The process should begin as early as possible and can be guided by an expert immigration attorney.

Businesses in the U.S. are responsible for monitoring and reporting on the immigration and work status of their employees. As penalties for non-compliance, including innocent omissions, can be significant and sometimes criminal, non-U.S. business owners and U.S. owners alike should consult an immigration attorney before making a first hire.

A non-citizen can work in the U.S. if they have one of the following:

- A permanent resident card (known as a Green Card)
- An employment authorization document (EAD or work permit)
- An employment-related visa that allows the holder to work for a specific employer (this includes the H1-B visa for workers with "special skills")

Non-residents may seek to obtain a B-1 visa, which allows for travel to the U.S. to conduct business.

Applicants should, whenever possible, leave enough time to re-apply for visas or permanent resident status in case of rejection. Visa applications may be rejected for procedural errors or missing information, but non-citizens may also be denied entry to the U.S. for many more serious reasons including health or medical issues, previous immigration law infractions or a criminal record.

Finally, employees and entrepreneurs who achieve permanent residency in the U.S. should consider that holding a Green Card comes with certain restrictions on travel outside of the country. Because Green Card holders are considered permanent residents of the U.S., they can have their status revoked if they demonstrate the intention to live elsewhere. While there are no hard and fast rules, absences from the U.S. greater than one year tend to raise suspicion with immigration authorities. Permanent residents who may want to seek U.S. citizenship are advised not to travel outside of the country for longer than six months.

HUMAN RESOURCES AND EMPLOYMENT LAW

Human resources professionals help guide both a firm's recruitment and its culture. In the U.S., they can take advantage of a rich talent environment that has emerged around the FinTech space, building on structural advantages that existed before the rise of FinTech as a sector, including:

Regional FinTech hubs that have sprung up around established industries such as finance in New York and Chicago, technology in Silicon Valley and robo-advisors in the Boston area.

The rapid expansion of FinTech-focused practices by large and small recruitment firms and head hunters around the country.

A rich selection of top-tier graduate and undergraduate programs in finance, econometrics, computer science and information technology.

FinTech firms might also use professional recruitment services to find trustees, directors or members of advisory boards.

Firms recruiting talent should be sure to comply with federal and state fair hiring laws. Some states, for example, limit the extent of background checks for potential employees or limit permissible discussion of salary history. Federal, state, city and municipal laws govern the employment relationship in the U.S. Typically, these laws govern specific matters, including minimum wage and overtime pay requirements, leave time, discrimination and harassment restrictions, required notices and workplace standards. State and local standards may be more stringent than federal standards. However, most employment within the U.S. is "at-will," meaning that the employment may be terminated by either the employer or employee at any time, with or without notice or cause. While employment agreements are not required, they can be desirable for certain high-level employees and may be a useful recruitment tool.

Workers must be properly classified as employees or independent contractors for tax and other regulatory purposes. If a worker is an employee rather than an independent contractor, the employer must withhold income taxes and pay Social Security, Medicare taxes and unemployment tax on wages paid to an employee.

Employees receive many statutory protections that are not available to independent contractors, such as the opportunity for union representation, as well as health and safety standards governing employer operations, minimum wage, overtime and unlawful discrimination protections.

Employment agreements are not required under U.S. law and it is common that only the executives of a company will have contracts, while rank and file employees are typically at-will. However, employment agreements with key employees and executives may be desirable if the employer wishes to enforce certain restrictive covenants, such as the duties of non-competition, non-solicitation, non-disparagement or confidentiality. Employment agreements may also be helpful in recruiting certain employees. Employment agreements and restrictive covenants must be evaluated on a state-by-state basis. For example, several key states for FinTech activity, including California and Massachusetts, either prohibit or severely limit non-competes.

Many companies, both public and private, will grant equity compensation awards to employees to provide them an ownership interest in the company. Granting equity in the company may help attract and retain talented employees and other service providers, incentivize their performance, align the interests of executives with the company's shareholders generally and incentivize directors to protect the company's long-term future. When designing an equity compensation plan, an employer should consider the following factors:

APPROVAL OF EQUITY PLANS

All equity plans must be approved by the governing body of the entity issuing the equity. Shareholders may also need to approve the issuance of equity used for compensation plans.

SECURITIES LAWS

When issuing equity awards in the U.S., companies must either file a registration statement relating to the offering or meet an exemption from the registration requirements of the U.S. Securities Act of 1933. Each issuance of securities must also comply with state securities (blue sky) laws. Issuances involving equity-based instruments should be discussed with a knowledgeable advisor.

TAX IMPLICATIONS

Factors to consider include when an income tax event will occur and whether the income from the award will be taxed as ordinary income or as a long-term capital gain. Partnerships, LLCs and corporations must be careful to structure equity awards appropriately for their entity type.

At both federal and state levels, employers in the U.S. are required to ensure that no protected class of employee faces a "hostile work environment." A workplace is considered hostile if either individual supervisors, co-workers or the firm's culture tolerate unwelcome comments or conduct based on gender, race, nationality, religion, disability, sexual orientation, age or other characteristics that might interfere with an employee's work performance or create an offensive and uncomfortable environment. Not only might firms found to have tolerated such conduct find themselves in trouble with federal or state regulators, but they might be civilly sued (individually or by a class) by employees in state or federal court.

INSURANCE

Businesses operating in the U.S. require several forms of insurance, which can sometimes all be obtained from a single, well-informed broker or can be purchased directly from insurance companies piecemeal. Some insurance technology (InsurTech) firms already operating in the U.S. are disrupting the typical broker model to allow business owners easier comparison shopping for the best rates.

Types of insurance that a FinTech firm may need to acquire include:

ERRORS AND OMISSIONS

Also known as "professional liability insurance," this covers harms caused by negligence, mistakes or business failures.

WORKER'S COMPENSATION INSURANCE

Covers claims arising from injuries to workers sustained while performing their professional functions.

DIRECTORS AND OFFICERS COVERAGE

Indemnifies directors and officers from personal liability or defense costs for legal actions that allege wrongful acts. Such coverage is essential for recruiting high-caliber talent to these positions.

PROPERTY INSURANCE

Covers damage to equipment or property in the event of fire, natural disaster, theft or vandalism. This should be purchased whether a business owns or leases its property and equipment.

VEHICLE INSURANCE

If the business uses vehicles, they must be insured separately from other property and insured to cover the liability of drivers.

BUSINESS INTERRUPTION INSURANCE

Compensates a business owner for lost revenue if a natural disaster or other circumstances force the temporary cessation of activities.

This list is not exhaustive, and a complete audit of needs should be conducted. FinTech firms should also audit the insurance programs of their service providers.

GOVERNMENT SUPPORT PROGRAMS

While direct government funding of businesses is rare in the U.S., federal, state and municipal governments provide a variety of support services to encourage business formation. At the federal level, the most relevant agency is the Small Business Administration (SBA).

The SBA maintains a current list of Small Business Investment Companies (SBICs), which are private entities seeking to fund startups and emerging companies. SBICs invest in startups and other small businesses through debt, equity or a combination of both, typically over a period of three years.

The SBA also maintains an online database of lenders to small businesses and runs a grant-making program.

At the state and municipal levels there are prevalent "enterprise zones," which are neighborhoods where tax incentives and public grants may be offered to encourage new businesses to form there. In addition to local incentives, setting up shop in certain neighborhoods might make your business a more attractive borrower to banks seeking to meet Community Reinvestment Act requirements.

SMALL BUSINESS INVESTMENT COMPANIES

A private company licensed by the SBA to provide debt and equity financing to small businesses.

More information is available here: https://www.sba.gov/funding-programs/investment-capital#paragraph-11

SBA LENDER DATABASE

A database of known lenders to small businesses.

The SBA Lender Database is available here: https://www.sba.gov/funding-programs/loans/lender-match

SBA GRANTS

Grants made directly from the SBA to small businesses, entrepreneurs and trade groups to encourage new business formation and innovation.

More information is available here: https://www.sba.gov/funding-programs/grants/grants-programs-eligibility

ACCELERATORS AND INNOVATION LABS

The U.S. is home to some of the top accelerator programs in the world. Accelerators are a great resource for FinTech firms seeking to navigate the U.S. FinTech landscape and quickly scale their business. These cohort-based programs typically take place over the course of several months, and provide startups with mentorship, capital, education and networking opportunities. These programs often end with opportunities for members to pitch to prospective investors, creating a launch pad for startups as they continue to grow.

Some of the top U.S. accelerator programs include Y Combinator, SOSV and AngelPad, among several others. There are also several FinTech-focused accelerator programs in the major FinTech hubs, such as FinTech Sandbox in Boston, and Barclays Techstars and FinTech Innovation Lab in New York.

Many of the largest U.S. corporations and financial institutions have also created innovation labs that are similarly designed to accelerate startups' growth. These corporations and financial institutions often have a strategic interest in the companies and allow them to conduct live testing within their networks. In turn, these programs place startups in front of some of the world's largest companies and allow them to gain validity through these partnerships, while also providing them with enough space for creativity.

TESTIMONIALS

Founded in 2010 by the Partnership Fund for New York City and Accenture, the FinTech Innovation Lab was created to take advantage of New York's unique strengths including the high concentration of financial institutions, talent pool with domain expertise and established venture community. The Lab provides early- and growth-stage FinTech and InsurTech companies an opportunity to engage with senior financial services executives, industry experts, successful entrepreneurs and venture investors. The Lab has 69 alums that have raised over $1 billion, including CB Insights, Cutover, Digital Asset, Digital Reasoning, Enigma, Kasisto and Pymetrics.

The Barclays Accelerator powered by Techstars in New York has invested in more than 170 FinTech startups with a total value of over $1 billion. From InsurTech to lending, security to blockchain, capital markets to data and analytics, we have developed a worldwide network to help entrepreneurs succeed.

TESTIMONIAL

RocketSpace

The enormity of the U.S. economy makes focus important. People build big but specific businesses in the U.S., whereas in Europe you would need to have a far broader offering to reach scale. The challenges to find product market fit are the same as all over the world, but if you find it in the U.S. it scales incredibly quickly.

COWORKING SPACE AND OFFICE LEASING

Coworking spaces are becoming increasingly popular in the U.S. due to their generally affordable and flexible pricing models. These spaces include general coworking spaces like WeWork and Hana, which have locations around the U.S. and internationally, as well as more technology-focused coworking spaces, such as RocketSpace. Local coworking spaces are springing up in cities around the country, so it pays to comparison shop based on local conditions.

There are also dedicated FinTech coworking spaces in many of the U.S. regional FinTech hubs, including EY's wavespace, which has locations all over the country, and Rise New York. These spaces can often connect members with relevant service providers, including those in the banking, legal, tax and bookkeeping spaces. Other benefits include common recreational areas and opportunities to network with fellow entrepreneurs and members of the FinTech ecosystem.

With respect to office space, the terms of an office lease will depend upon what a landlord is willing to offer and factors such as the size, type and age of the premises. Term length typically ranges from five to 10 years, often with options to renew for one or two additional five-year periods.

Rent is a function of the local office market and is freely negotiated. Rent is usually payable monthly in advance of the first of each month. Base rents will typically increase on an annual basis, or will increase cumulatively over a five-year period, at a stipulated amount sized to keep pace with anticipated inflation.

Landlords typically pay for initial improvements to the space or provide an allowance to the tenant to pay for improvements, and they often will provide a period of free rent at the beginning of the lease to enable a tenant to complete initial construction of the premises and move in. The cost of these concessions is factored into the rent.

A tenant's right to assign its lease or sublet will vary. Tenants may be permitted to sublet the premises with the landlord's approval. The tenant will usually be required to give or share any sublease profits with the landlord. Tenants are not relieved from lease liability by assigning or subletting, and they remain jointly and severally liable with the assignee or subtenant.

U.S. TAX LAW

Taxation of business activities in the U.S. market will depend on the type of entity formed, how distributions are paid to owners, how the business is funded and local regulations based on the state where the business was formed.

Typically, a non-U.S. corporation will operate in the U.S. through a wholly owned U.S. corporation. A U.S. corporation generally will be subject to tax at a rate of 21 percent (plus any state and local taxes). A FinTech firm that needs multiple U.S. corporations to run its business generally would hold the multiple U.S. corporations under a single U.S. holding company and file a consolidated federal tax return under the U.S. consolidated return rules.

Distributions by a U.S. corporation to non-U.S. persons or entities are generally subject to a 30 percent withholding tax that may be reduced by an applicable tax treaty. U.S. companies funded by debt also may be able to deduct interest and expenses, subject to certain limitations.

While the United States does not impose a federal sales tax or value-added tax, many states impose a sales tax that an entity doing business in that state is required to collect. Additionally, a FinTech business considering operating in a state should analyze the tax rules in that jurisdiction, as all U.S. states have different rules and tax rates.

KEY CONSIDERATIONS FOR FOR FINTECH FIRMS:

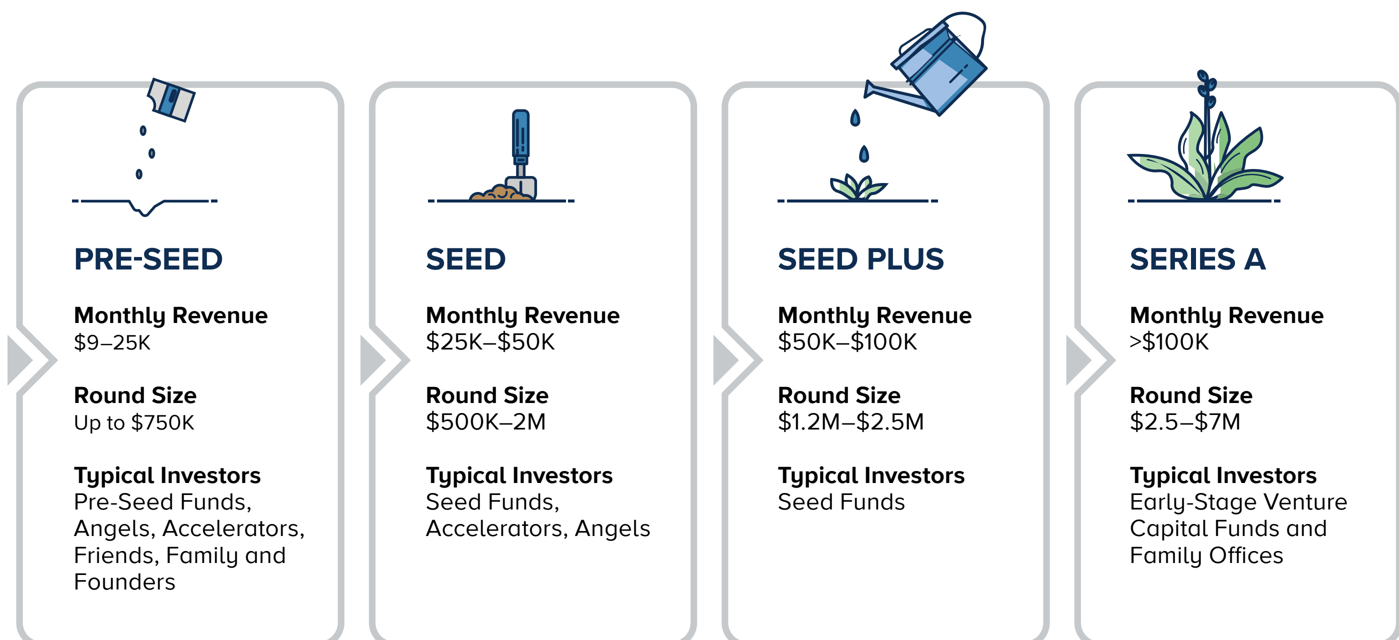
- How U.S. tax rules apply will depend on a variety of factors, such as type of entity, means of capital formation and business location, among many others.
- Non-U.S. FinTech firms that hold multiple U.S. corporations under a single U.S. holding company may file a consolidated federal tax return.
- Distributions by a U.S. corporation to non-U.S. persons or entities are generally subject to a 30 percent withholding tax; however, this rate may be reduced by an applicable tax treaty (i.e., the U.S.-U.K. tax treaty).
- In addition to federal tax rules, FinTech firms should also pay close attention to the tax rules of the states in which they operate.

FUNDRAISING

Venture stage and emerging growth companies in the U.S. can seek a variety of equity, debt and hybrid financing mechanisms. How a business chooses to raise capital is a function of the type of entity chosen and the motivations of the founders and early employees.

Investors in venture stage companies in the U.S. include wealthy individuals, family offices, dedicated venture capital or private equity funds and some hedge funds, among others. Though each investor has its own criteria, they are generally looking to invest in businesses with scalability, experienced management teams, defensible and proprietary technology, economic models that can achieve profitability and a sensible business plan to exploit a growing market. Investors will also expect visibility into potential exits, which might include an initial public offering, a sale to a strategic acquirer or a sale to another investor.

Early-stage companies typically proceed through one or more rounds of funding before achieving significant growth, such as the following:



The types of financing available to emerging growth companies generally include the following:

CONVERTIBLE NOTES

Convertible notes are the most common type of early-stage financing. The company will issue a note to investors with an interest rate, a maturity date and conversion mechanics, with the expectation that the notes will convert into the equity security issued in the company's first round of equity financing. The conversion mechanics include a conversion discount and often, a conversion cap.

SAFES (SIMPLE AGREEMENTS FOR FUTURE EQUITY)

SAFEs function much like convertible notes, but are not debt and do not have an interest rate or a maturity date. SAFEs are intended to convert into the equity security issued in the company's first round of equity financing. The conversion mechanics include a conversion discount and often, a conversion cap. SAFEs were created by Y Combinator and more details can be found at https://www.ycombinator.com/documents/#safe.

PREFERRED STOCK

When an emerging growth company raises a round of financing with equity, institutional investors will expect to receive preferred stock. Preferred stock is superior to common stock and includes rights, preferences and privileges including a liquidation preference, anti-dilution rights, negative control provisions, registration rights and the right to elect one or more directors, among other rights. Equity financings using preferred stock are often completed using forms sponsored by the National Venture Capital Association, which may be found at https://nvca.org/resources/model-legal-documents/. There are also several other variations of preferred stock financing forms; early-stage firms may want to consider abbreviated forms such as Techstars' Seed Preferred Stock.

BANK DEBT

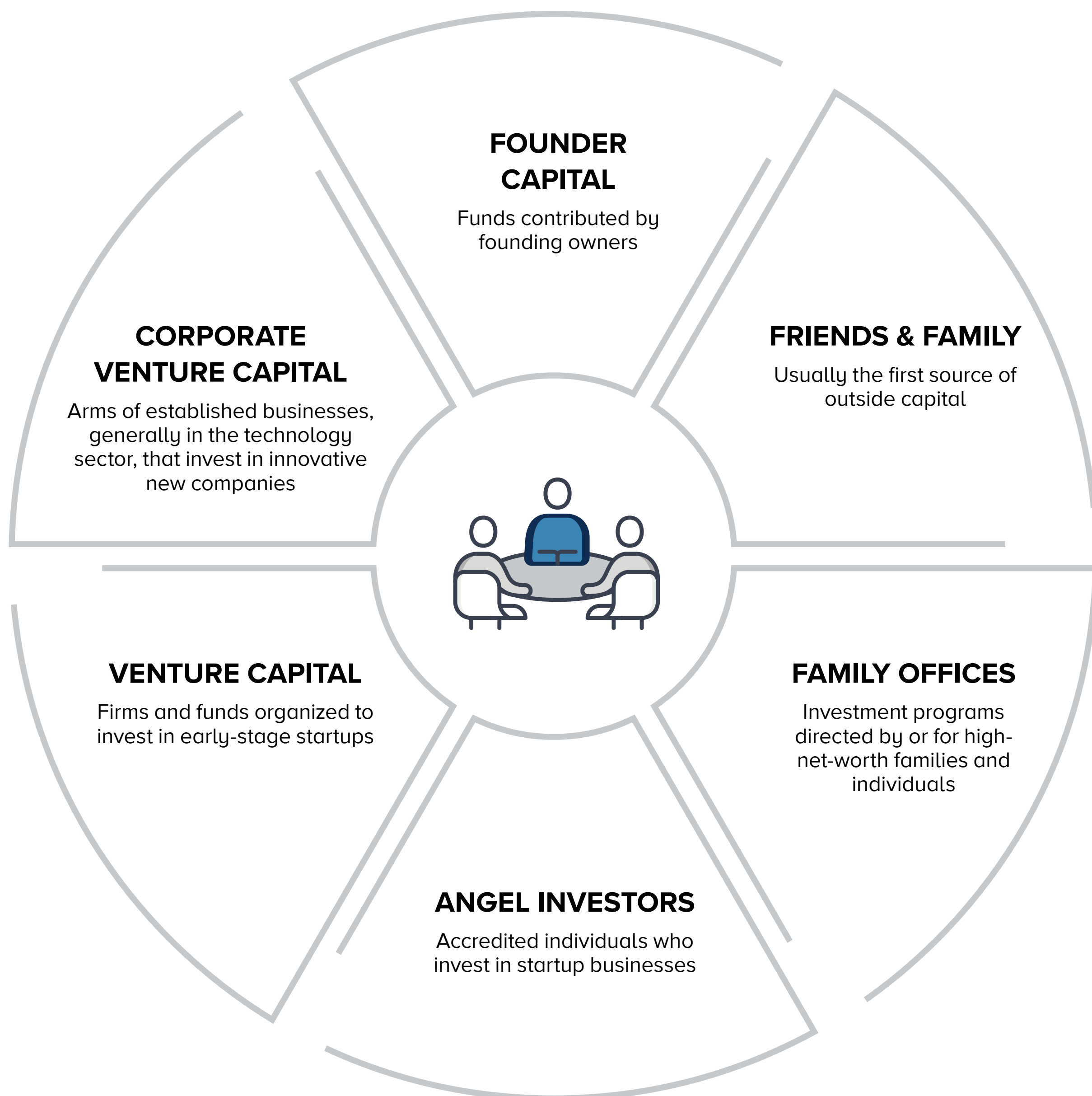
Once an emerging growth company has raised money from institutional investors, it may be able to borrow money from a lender who specializes in lending money to emerging growth companies. This type of financing is traditional debt, with an interest rate, a term, sometimes an equity component in the form of a warrant, reporting obligations and negative covenants for certain actions that require the lender's consent.

SUBORDINATED DEBT

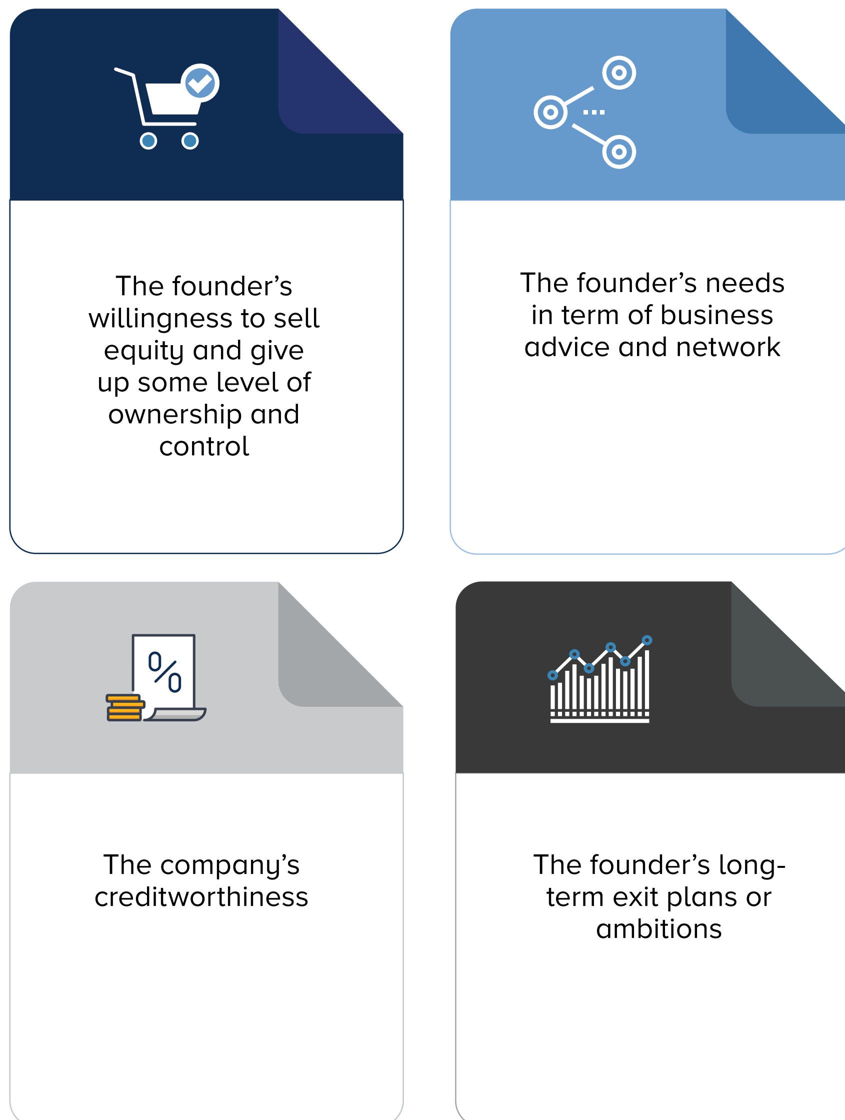
Later-stage companies may also be able to raise debt capital from specialized lenders that lend money that is subordinated to other lenders. This form of financing requires a company to have substantial revenues and is often expensive, with a high interest rate, a fixed term and typically requires that some form of equity instrument be issued to the lender.

The U.S. has overlapping federal and state securities laws, so it is important to consult a securities attorney when issuing any security in order to ensure compliance with applicable securities laws. Generally, companies should seek to raise money only from "accredited investors," including high-net-worth individuals or dedicated funds.

Types of investors that early-stage companies will encounter typically include:



The type of funding or funding partner that a business owner chooses will depend greatly on the company's circumstances. An entrepreneur will seek appropriate funding based on what stage of business they're in, targeting friends and family early and outside venture capital once taking in revenue. But there are other considerations, including:



Shearman & Sterling's commitment to the entrepreneurial community helps clients access strategic connections. Our Austin-based Emerging Growth practice and global platform provide the geographic reach required for the 21st century economy while leveraging relationships with investors – angel, venture and corporate – to connect clients with capital.

Contact shearmanfintech@shearman.com to learn more.

DIGITAL BANKING AND NONBANK ACTIVITIES

FinTech firms that engage in the business of banking or that partner with regulated banks in the U.S. will be subject to U.S. banking regulations and regulatory oversight.

The U.S. employs a dual banking system where banks can be chartered either by the federal government or a state government. If a bank accepts deposits, it generally must obtain insurance from the FDIC, thereby subjecting it to FDIC oversight. State banks may also elect to become "state member banks" of the Federal Reserve System (FRS), entailing a different federal regulator in the Federal Reserve Board.

The term "bank" is generally defined in the U.S. as an institution that accepts deposits as well as makes loans and is typically an institution whose deposits are insured by the FDIC. Banks may not have to obtain FDIC insurance if they do not accept deposits, e.g., trust companies, though there are other fiduciary activities that are regulated by federal and state agencies. Services that are often offered under the fiduciary umbrella include:

TRUSTS FOR EMPLOYEES, CORPORATIONS OR INDIVIDUALS

TRANSFER AGENCY

SECURITIES CLEARANCE

INVESTMENT MANAGEMENT

CUSTODIAL SERVICES

DIGITAL BANKING

Banks without traditional brick-and-mortar branches, commonly referred to as digital banks, offer mobile, online and kiosk financial services and are often able to pass on the savings from their lower overhead by either charging lower fees, offering free services or paying higher yields for deposits. These digital banks are subject to the same regulatory oversight that traditional banks operate under. Many are pursuing or have obtained bank charters, while others have partnered with traditional banks to store funds and process transactions.

Startups beware, though. Much of the digital banking space in the U.S. is already being claimed by incumbent, bulge bracket banks. While total deposits in digital banks topped $1 trillion in 2018, most of those assets are going to high-profile launches like Marcus, the digital banking arm of Goldman Sachs.

Still, independent digital and mobile banks like Chime Bank have found their niche in the marketplace. While better known, incumbent banks benefit from their credibility and reliance on an established infrastructure, upstart mobile and digital banks have typically led the way with innovative interfaces, mobile banking wallets, low fees and no minimum balances. Technology companies do not need to become banks to do this. Chime, for example, uses a partnership with The Bancorp Bank to deliver FDIC-insured banking services.

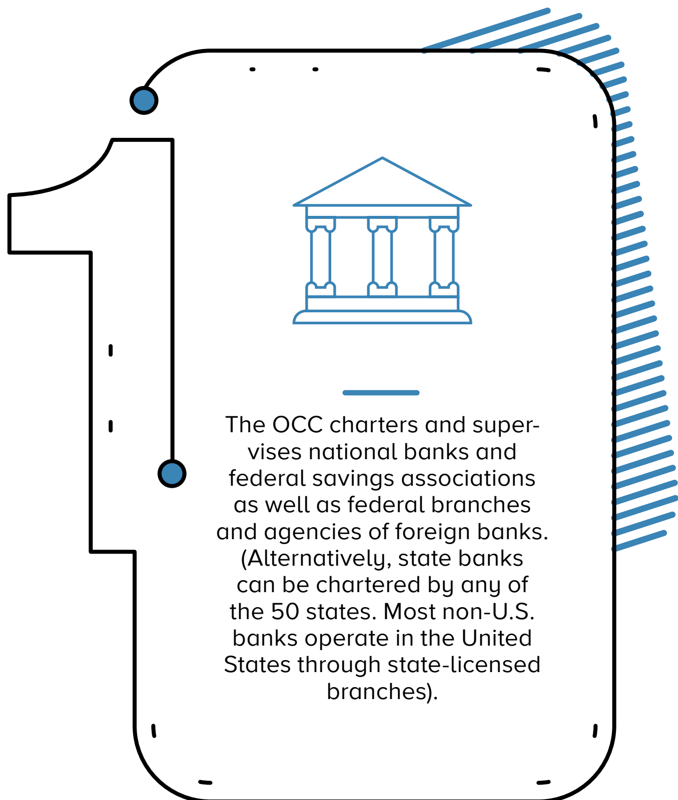
A number of international digital banks have launched or announced plans to launch operations in the U.S. as well. For example, N26 and Monzo have both launched operations in the U.S., while others, such as Revolut, have announced their intentions to expand to the U.S. market in the coming months.

NONBANK ACTIVITIES

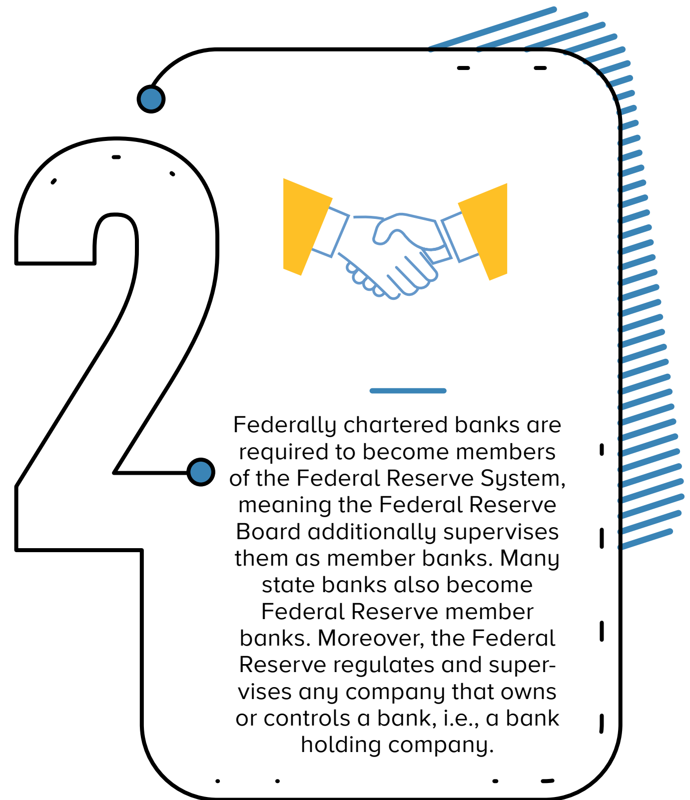
FinTech firms that engage in business lines typically pursued by chartered banks may be subject to regulations even if they do not have a banking charter. At the state level, licenses from state regulators may be required for businesses engaged in nonbank financial activities like lending (in isolation from deposit-taking), money transmission or certain digital asset transactions. Certain nonbank institutions, such as those deemed a “money services business” under federal law, may also need to register and report to FinCEN.

Nonbank financial services business activities are typically overseen by a panoply of state-level regulators and are under the enforcement authority of federal as well as state attorneys general. Additional federal oversight may also be implicated depending on the nature of those activities, such as FinCEN registration for money services businesses discussed above, as well as with respect to anti-money laundering compliance requirements pursuant to BSA requirements.

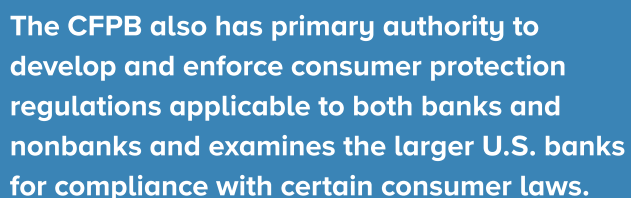
There are three primary federal U.S. bank regulators. These regulators have overlapping regulatory and supervisory authority:



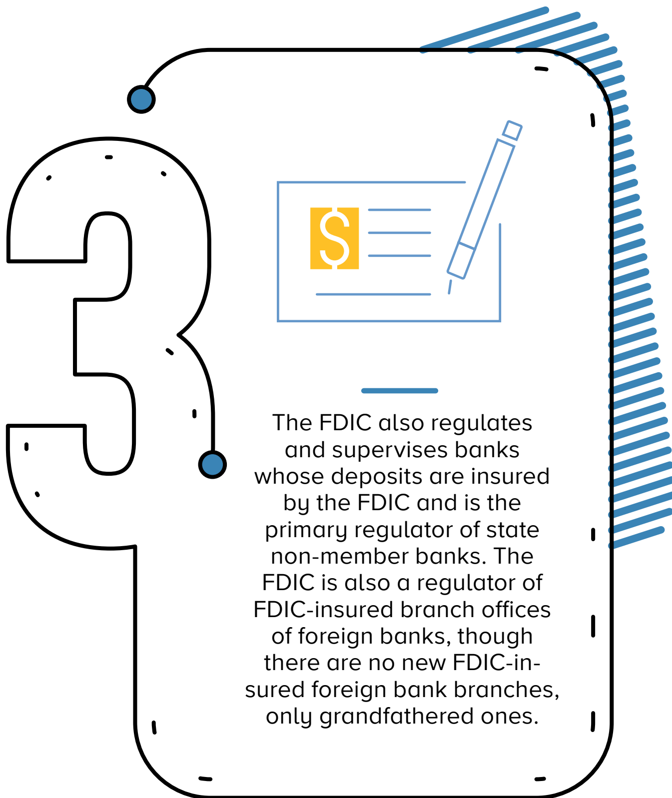
The OCC charters and supervises national banks and federal savings associations as well as federal branches and agencies of foreign banks. (Alternatively, state banks can be chartered by any of the 50 states. Most non-U.S. banks operate in the United States through state-licensed branches).



Federally chartered banks are required to become members of the Federal Reserve System, meaning the Federal Reserve Board additionally supervises them as member banks. Many state banks also become Federal Reserve member banks. Moreover, the Federal Reserve regulates and supervises any company that owns or controls a bank, i.e., a bank holding company.



The CFPB also has primary authority to develop and enforce consumer protection regulations applicable to both banks and nonbanks and examines the larger U.S. banks for compliance with certain consumer laws.



KEY CONSIDERATIONS FOR FINTECH FIRMS:

- FinTech firms that accept deposits and make loans or partner with regulated banks in the U.S. are subject to U.S. banking regulations and regulatory oversight.
- State banks may choose to obtain insurance from the FDIC and/or to become a member of the Federal Reserve System.
- Some all-mobile banks have applied for a national bank charter from the OCC, with one firm having its application preliminarily and conditionally approved.
- Licenses may be required at the state level for FinTech firms engaged in nonbank financial activities like lending (in isolation from deposit-taking), money transmission or certain digital asset transactions.

DIGITAL ASSETS AND TOKENIZATION

Whether, when and how a digital asset is regulated in the United States requires careful analysis as to the nature and purpose of the asset. Foremost is determining whether the digital asset is treated as a commodity or a security, as this will have a profound impact.

Digital assets deemed securities will be regulated by the SEC. While many digital assets may not be designated securities, for those that are, SEC regulations will govern initial coin offerings, or other coin or token issuances, that constitute capital-raising activities through the issuance of securities.

If the asset is deemed a commodity, it will generally fall under the CFTC's regulatory authority. While this will include most digital assets, the CFTC's jurisdiction is generally limited to transactions in digital assets involving derivatives and leveraged spot transactions with certain market participants, as well as policing fraud or manipulation.

Different states have taken varying views on the treatment of virtual currency under their existing state licensing laws, such as money transmitter laws. New York currently has the most expansive virtual currency regulation that can require licensing for any entity engaged in custody, exchange or other virtual currency business activity.

Additionally, the act of transmitting digital assets can fall under FinCEN's jurisdiction depending on the manner of transmission and the role that a person or entity plays in that process. To the extent that you are creating, obtaining, distributing, exchanging, accepting or transmitting digital assets, you may need to be registered with FinCEN and conform to certain reporting requirements.

Firms that transact with digital assets are also subject to Internal Revenue Service (IRS) oversight to the extent that a digital asset transaction may incur a tax liability for one or more parties to the trade, and to the Treasury Department's Office of Foreign Assets Control (OFAC) to the extent the firm facilitates or engages in online commerce or processes transactions using digital assets.

The U.S. is also active within several international standard-setting bodies that have published statements or guidance related to digital assets, such as the International Organization of Securities Commissions (IOSCO), the Basel Committee on Banking Supervision (BCBS) and the Financial Action Task Force (FATF), among others.

The targeted users and markets for activities with respect to digital assets should be closely scrutinized to determine if additional U.S. state laws and regulations apply, including licensing and registration requirements, in addition to restrictions on the manner and types of activity in which one may engage.

KEY CONSIDERATIONS FOR FINTECH FIRMS:

- Digital assets are regulated by a multitude of federal and state regulators, often on a "facts and circumstances" basis.
- Digital assets deemed securities will be regulated by the SEC, and digital assets deemed commodities (e.g., bitcoin and ether) will be regulated by the CFTC.
- Capital-raising activities generally are subject to SEC rules and regulations. Further, initial coin offerings and other token issuances oftentimes will constitute an investment contract and hence a security that is subject to federal securities laws.
- Firms and individuals that transmit digital assets may be subject to FinCEN oversight, depending on the manner of transmission and the role that the person or entity plays in that process.
- Firms that engage in digital asset activities may be subject to IRS and OFAC oversight.
- Firms that engage in digital asset activities should be cognizant of whether additional U.S. state laws and regulations apply (e.g., New York's BitLicense regime).

DATA PRIVACY

The U.S. has often been mistakenly perceived as lacking in data privacy law, especially compared to the EU, where the General Data Protection Regulation (GDPR) provides a unified legal framework for protection of personal data and grants rights to individuals to control how their data is used.

However, this view is misguided. Since 1970, the U.S. has passed laws that address the use and protection of personal information based on industry, categories of personal information, categories of data subjects, consumer protection, cybersecurity incidents and more. This "patchwork" of U.S. data privacy laws includes numerous laws enacted at both the federal and state levels. Depending on the relevant law, enforcement and rulemaking may implicate various federal agencies, state agencies, state attorneys general, law enforcement and civil lawsuits. At the state level, many states have enacted their own versions of the laws discussed above, and all 50 states have data breach notification laws. For example, under New York Department of Financial Services (NYDFS) cybersecurity regulations, financial services companies doing business in New York must implement cybersecurity programs that meet regulatory requirements. (But at least there are no data localization requirements in the U.S.)

The effects of this patchwork of laws are not limited to direct participants in the relevant industries. SaaS and other cloud-based service providers may also become subject to U.S. privacy laws based on the type of data that they process. A FinTech firm that provides services to banks must understand and comply with Gramm-Leach-Bliley Act (GLBA) and Fair Credit Reporting Act (FCRA) requirements, for example, or a service provider to health insurers is likely to be subject to the Health Insurance Portability and Accountability Act (HIPAA) Privacy Rule.

The Federal Trade Commission (FTC) is the principal privacy regulator in the U.S. and prohibits "unfair or deceptive acts in or affecting commerce." The CFPB and SEC are similarly empowered to enforce certain data privacy laws, and state attorneys general may also bring enforcement actions for violations of state and federal laws relating to data privacy, or under consumer protection laws.

Within the FTC, the U.S. Department of Commerce is responsible for administration of the EU-U.S. Privacy Shield, a program established to facilitate transfers of personal data from the EU to the U.S. Under the Privacy Shield, a U.S. company may certify to the FTC that it adheres to the data processing principles of the Privacy Shield Framework, and after acceptance of its certification, that U.S. company may receive personal data from the EU based on adequate protections supplied by the Privacy Shield Framework.

Data privacy is a rapidly evolving field in the U.S., especially as recent high-profile cybersecurity incidents have increased public attention to data privacy issues. When the California Consumer Protection Act (CCPA) comes into effect on January 1, 2020, it is expected to overhaul individual rights and protections for California residents' personal information and affect almost all firms doing business in California. Several new privacy laws have been proposed at the federal level, and various federal regulators have taken a greater interest in data protection issues.

CCPA accomplishes three broad goals:

GRANTS INDIVIDUAL RIGHTS TO CONSUMERS REGARDING PERSONAL INFORMATION COMPANIES COLLECT ABOUT THEM, INCLUDING RIGHTS TO ACCESS AND DELETE INFORMATION.

GRANTS CONSUMERS A RIGHT TO OPT OUT OF SALES OF THEIR PERSONAL INFORMATION BY COMPANIES, AND PROHIBITS COMPANIES FROM DISCRIMINATING AGAINST CONSUMERS FOR EXERCISING THIS OR OTHER RIGHTS.

ESTABLISHES A PRIVATE RIGHT OF ACTION FOR DATA SECURITY BREACHES THAT RESULT FROM INSUFFICIENT SECURITY, WITH STATUTORY DAMAGES UP TO $750 PER CUSTOMER PER INCIDENT.

KEY CONSIDERATIONS FOR FINTECH FIRMS:

- Despite common misconceptions, the U.S. has a strong data protection framework.
- Significant areas of focus in U.S. data protection laws include nonpublic personal information held by financial firms and the use of consumer credit reports.
- The U.S. data protection framework is made up of a patchwork of laws and regulations that are governed by several state and federal regulators.
- Data privacy is a rapidly changing field in the U.S. that has garnered significant attention, and several proposed federal and state laws (including CCPA) could have a significant impact on the U.S. data protection landscape.

INTELLECTUAL PROPERTY PROTECTION

Intellectual property (IP) in the U.S. is generally protected by a combination of patents, copyrights, trademarks and trade secrets, depending on the boundaries of subject matter, and each with varying relevant laws and rules:

PATENTS

Patents are used to protect inventions, such as processes, machines, manufactured products and biological and chemical materials, and a patent must be applied for and granted by the U.S. Patent and Trademark Office (USPTO).

COPYRIGHTS

Copyrights exist in works of authorship, including software code. Elements of software and applications, such as visual design features and original text, are also protected by copyright. Copyrights exist as a function of authorship and do not necessarily need to be registered.

TRADEMARKS

Trademarks protect indicators of origin of products and services, such as names and logos referring to businesses, products or services. Trademark rights may arise from use of a mark in commerce, and additional protections are available if registration is applied for and granted by the USPTO.

TRADE SECRETS

Trade secrets are often used to protect know-how, ideas, concepts, information and innovations that may not qualify for patent protection and would not be adequately protected by copyright.

Ownership is a key issue in IP. Regardless of how an invention or other innovation may be protected, the initial owner of IP will usually be the developers or authors of that IP. Generally, IP may only be transferred by a written instrument under U.S. law, so firms must enter into proper agreements with officers, employees, consultants, etc. to secure ownership of their IP. Collaborations and joint ventures must also address rights and ownership in both pre-existing and developed IP.

IP rights may also be affected by the use of open source software. Open source resources can facilitate rapid and cost-effective development of technology by supplying software for use and adaptation free of charge, but firms should understand and take care in how open source materials are used. There are many different types of open source licenses, and various legal obligations may be imposed on firms that utilize open source in developing proprietary technologies. While many open source licenses permit commercial use and only require attribution of the open source components used, others, the so-called copyleft licenses, may obligate a firm to distribute and license developments free of charge or disclose source code for others to use and adapt in turn.

In order to understand their rights and ownership of IP, technology companies should consider performing IP audits periodically. IP audits may be useful not only to determine the value of IP owned by the company, but also to identify and evaluate any deficiencies in IP ownership, sufficiency of rights in licensed IP and the effectiveness of IP practices and procedures. At its conclusion, the IP audit should provide an inventory of owned IP as well as remediation plans to repair any deficiencies in IP ownership, obtain additional rights in IP that may be required for the business and address gaps in the company's IP practices and procedures.

Technology companies operating in the U.S. may find themselves under special scrutiny if they are engaged in cross-border business. Issues of IP and technology transfer on a cross-border basis have been a topic of much recent discussion and, as recent events have shown, may play out on a larger global socioeconomic scale.

The U.S. government can even block foreign companies from acquiring or making minority investments in a U.S.-based technology firm, or even a foreign-based firm operating in the U.S., if the government believes that the deal will lead to technology transfers that could impact national security. Such determinations are made by a multi-agency review of such mergers and acquisitions by an organization known as The Committee on Foreign Investment in the United States (CFIUS).

Finally, IP owners should be aware that the U.S. has an ongoing problem with "Patent Trolls." A patent troll either files for or acquires the patents to myriad inventions and innovations, with no intention of developing them commercially. They look for similar ideas that have been realized and brought to market and sue those businesses, usually demanding lump sum payments and ongoing royalties. Though courts have taken a dim view of this and have sought to curb the practice by throwing out suits based on the weakest patents, issues with patent trolls persist in the U.S..

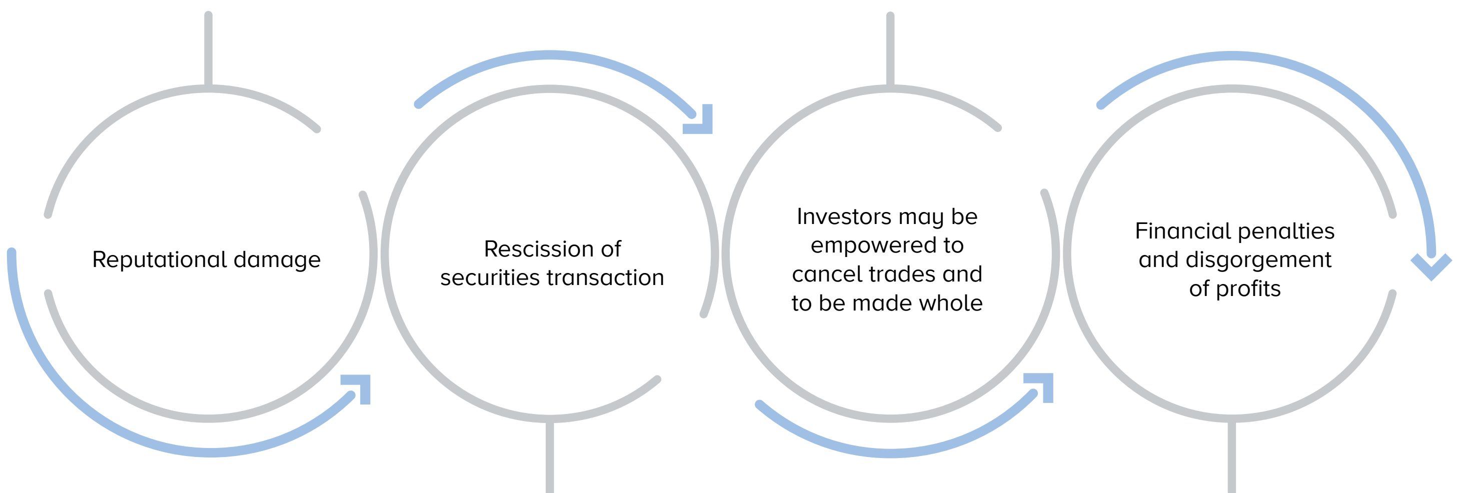
KEY CONSIDERATIONS FOR FINTECH FIRMS:

- IP in the U.S. is generally protected by a combination of patents, copyrights, trademarks and trade secrets.
- FinTech firms must enter into proper agreements with officers, employees, consultants and others to secure ownership of their IP.
- Firms that exchange IP on a cross-border basis may be subject to heightened scrutiny.
- FinTech firms should be wary of patent trolls that may demand lump sum payments or ongoing royalties.

BROKER-DEALERS

Under the U.S. Securities Exchange Act of 1934, as amended, a "broker" is any person, including companies, engaged in the business of effecting transactions in securities for the account of others. A "dealer" is any person engaged in the business of buying and selling securities for their own account, through a broker or otherwise. Whenever a person or company is paid a success fee for executing a securities transaction, they have engaged in broker-dealer activity that requires registration with the SEC.[11] Many digital assets may be classified as securities under U.S. law. FinTech firms entering the U.S. must consider whether their activities, including those related to digital assets, implicate broker-dealer registration.

If the SEC determines that a firm has conducted broker-dealer activities without being duly registered or falling within an exemption, the consequences can be significant and include the following:



11 Speech Before the American Bar Association Trading and Markets Subcommittee, "A Few Observations in the Private Fund Space," David W. Blass, Chief Counsel Division of Trading and Markets, U.S. Securities and Exchange Commission (April 5, 2013).

Other federal agencies that regulate broker-dealers include the U.S. Department of the Treasury, the CFTC and the Securities Investor Protection Corporation (SIPC). Broker-dealers are also subject to further government oversight through the various state securities authorities.

In most instances, a broker will also have to become a member of a self-regulatory organization (SRO), the largest of which is the Financial Industry Regulatory Authority, Inc. (FINRA), the principal regulator of broker-dealers. Any natural person who engages in broker-dealer activity must register with a broker-dealer and have the requisite licenses in order to engage in such activity.

Aside from FINRA, national securities exchanges such as the New York Stock Exchange (NYSE), Nasdaq and BATS function as SROs.

SROs are non-governmental organizations that have been delegated significant authority over broker-dealers by the SEC to regulate the industry. Under the supervision of the SEC, SROs are empowered to:

adopt and enforce rules

impose fines and other sanctions

conduct member inspections and hear testimony from member firms and their associated persons

KEY CONSIDERATIONS FOR FINTECH FIRMS:

- Broker-dealer activity requires
  - Registration with the SEC; and
  - Membership with an SRO, typically FINRA.
- FinTech firms should consider whether their activities, including with respect to digital assets, implicate broker-dealer registration and regulation.
- Failure to register as a broker-dealer when engaging in related activities can have significant consequences.

INVESTMENT MANAGEMENT

The U.S. regulates the activities of providers of investment advice. It does so both federally under the U.S. Investment Advisers Act of 1940 (which empowers the SEC) and, especially for smaller firms, under state laws.

A basic principle of U.S. law is that investment advice that is personalized to the recipient is regulated, while impersonal investment commentary often is not. For example, helping clients craft portfolios that fit their investment objectives and appetite for risk is subject to regulation, while more general discussion of the merits of certain securities—as with business news television programs or websites analyzing market trends or companies' commercial prospects—might remain unregulated.

Unfortunately, these lines get muddled quickly. Examples include:

WEBSITES/CHATROOMS: In the late 1990s, a celebrity investor set up websites where he wrote about his stock picks. While none of this content was specifically tailored to individuals, he also offered a VIP chatroom feature where he personally facilitated discussions. The SEC prevailed in court when it argued that the personal interactions with VIP subscribers crossed the line and represented tailored investment advice.

AUTOTRADING PROGRAMS: In the early 2000s, the SEC sued another website operator for failing to register as an investment adviser. The operator wanted subscribers who received its emailed tips to be able to seamlessly execute on them through an auto-trading feature. Because each autotrade was specific to the investor's portfolio, the court found it to be personalized investment advice.

Providers of market data are not considered investment advisers if they present clients with "raw data" in a manner that does not suggest any particular investment view. That is so even if it is targeted at people who will use the data to inform their investment decisions.

Providers of investment analytics tools are generally not considered investment advisers if the tools allow the users to perform their own calculations, if the users are generally sophisticated and the models are standardized across the platform. More customized tools may cross the line into financial advice.

The lesson here is that content-based or data-based businesses relating to securities—with securities generally meaning stocks and bonds, but also including some digital tokens, loans and other assets that may not be readily assumed to be securities—must tread carefully. There is always a risk that the service delivered might be investment advice.

When FinTech firms choose to do business as registered advisers in the U.S., they will find local variances with practices in other developed economies, including:

DISCRETIONARY AND NON-DISCRETIONARY INVESTMENT ADVICE TREATED LARGELY THE SAME

Many other countries more closely regulate "discretionary" advice (where the client has granted trading discretion to the adviser) and more loosely regulate "non-discretionary" investment advice (where the client receives advice and acts on it or not as it chooses).

NO CAPITAL REQUIREMENTS

Many countries require investment advisers to meet regulatory capital requirements. The United States largely does not.

NO FEDERAL "FITNESS" REVIEW DURING REGISTRATION

The SEC reviews investment adviser registration applications mainly to confirm the application is complete.

LICENSING OF PERSONNEL

The SEC does not require testing or licensing of investment adviser personnel. States, however, can require licensing even for personnel at federally registered investment advisers.

KEY CONSIDERATIONS FOR FINTECH FIRMS:

- FinTech firms that offer personalized investment advice will be subject to SEC or state oversight (although these lines can be muddled).
- Providers of market data and investment analytics tools might not be considered investment advisers, subject to certain exceptions.
- Content-based or data-based businesses relating to securities (including some digital assets) must tread carefully.
- There are several differences in the U.S. investment adviser framework as compared to other developed economies.

CONCLUSION

The U.S. is home to the world's most vibrant capital markets and deepest pool of venture capital funding. Successful expansion to the U.S. can cement a FinTech firm's status as a top player in the global landscape and can provide FinTech firms with opportunities for exponential growth. However, with these opportunities also come significant regulatory responsibilities and considerations that FinTech firms must navigate.

While entering the U.S. market may seem like a daunting task, as one of the leading firms advising financial institutions and FinTech firms globally, Shearman & Sterling is well-positioned to guide you throughout the entire U.S. expansion process and beyond, allowing you to seize these opportunities while focusing on building out your product and growing your business.

The U.K. Department for International Trade and HM Treasury also provide advice and practical support for U.K. FinTech firms that wish to scale to the U.S. There is an extensive network of specialists in the U.K., the British Embassy in Washington, D.C. and the British Consulates General located throughout the U.S., that can signpost firms to knowledge, expertise and opportunities in-market.

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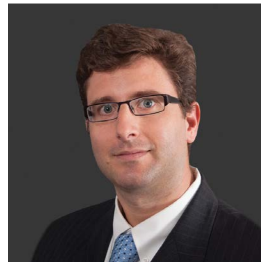

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OTHER RESOURCES

For more information and to get in touch with key representatives from the U.K. Department for International Trade (DIT) or HM Treasury, please email **fsofintechs@trade.gov.uk** or **fintech@hmtreasury.gov.uk**.

For more information on the FinTech Foundry:
Website: **https://www.shearman.com/industries/fintech**
Twitter: **@ShearmanFintech**
Insights: **https://fintech.shearman.com/**

For more information on Shearman & Sterling:
Website: **www.shearman.com**
Twitter: **@ShearmanLaw**
LinkedIn: **https://www.linkedin.com/company/shearman-&-sterling-llp/**

APPENDIX I: GLOSSARY OF RELEVANT REGULATORS AND INNOVATION ARMS

Commodities Futures Trading Commission (CFTC):
The CFTC is the primary U.S. regulator for derivatives markets and their participants, including trading facilities, clearing organizations and market intermediaries such as swap dealers, futures commission merchants and commodity trading advisors.

PHONE: 202.418.5000
EMAIL: Questions@cftc.gov
INNOVATION ARM: LabCFTC (LabCFTC@cftc.gov)

Conference of State Bank Supervisors (CSBS):
The CSBS is a national organization of the financial regulators from all 50 U.S. states, the District of Columbia, Guam, Puerto Rico, American Samoa and the U.S. Virgin Islands.

PHONE: 202.296.2840
CONTACT PAGE: https://www.csbs.org/contact-us
INNOVATION ARM: Emerging Payments and Innovation Task Force (https://www.csbs.org/emerging-payments-and-innovation-task-force)

Consumer Financial Protection Bureau (CFPB):
The CFPB has the primary authority to develop and enforce consumer protection regulations applicable to both banks and non-banks. The regulator also examines the larger U.S. banks for compliance with certain consumer laws.

PHONE: 855.411.2372
EMAIL: info@consumerfinance.gov
INNOVATION ARM: Office of Innovation (OfficeOfInnovation@consumerfinance.gov)

Federal Deposit Insurance Corporation (FDIC):
The FDIC is the primary federal regulator for state non-member banks whose deposits are insured by the FDIC. The FDIC is also a regulator of FDIC-insured branch offices of foreign banks, though there are no new FDIC-insured foreign bank branches, only grandfathered ones.

PHONE: 877.275.3342
CONTACT PAGE: https://www.fdic.gov/about/contact/ask/
INNOVATION ARM: None

Federal Reserve:
The Federal Reserve supervises federally chartered banks. The Federal Reserve also supervises bank holding companies and the U.S. activities of foreign banking organizations.

PHONE: 202.452.3000
CONTACT PAGE: https://www.federalreserve.gov/apps/contactus/feedback.aspx
INNOVATION ARM: None

Federal Trade Commission (FTC):
The FTC is, among other things, the principal privacy regulator in the U.S. through its power to prohibit "unfair or deceptive acts in or affecting commerce" against inadequate and misleading data practices. The FTC has also been empowered to enforce numerous privacy regulations.

PHONE: 202.326.2222
CONTACT PAGE: https://www.ftc.gov/contact
INNOVATION ARM: None

Financial Crimes Enforcement Network (FinCEN): FinCEN is a bureau of the U.S. Treasury Department that is responsible for the oversight and registration of money services businesses. Further, FinCEN is responsible for the enforcement of BSA/AML/OFAC requirements for such entities.

PHONE: 800.767.2825
EMAIL: FRC@fincen.gov
INNOVATION ARM: Innovation Hours Program (https://www.fincen.gov/contact/fincen_innovation_registration)

Financial Industry Regulatory Authority (FINRA):
FINRA is a Congressionally authorized SRO that is the principal regulator of broker-dealers. In addition to registering with the SEC, a broker-dealer applicant must become a member of at least one SRO (typically FINRA, a national securities exchange or both).

PHONE: 301.590.6500
CONTACT PAGE: https://tools.finra.org/cc_support/
INNOVATION ARM: Office of Financial Innovation (https://www.finra.org/industry/fintech)

Internal Revenue Service (IRS):
The IRS is the federal tax administrator of the U.S. The IRS is responsible for enforcement of federal tax laws and the collection of federal taxes.

PHONE: 202.622.5000
CONTACT PAGE: https://www.irs.gov/help/contact-your-local-irs-office
INNOVATION ARM: None

National Association of Insurance Commissioners (NAIC): The NAIC is a national standard-setting organization made up of the insurance regulators from all 50 U.S. states, the District of Columbia, Guam, American Samoa, the U.S. Virgin Islands, Puerto Rico and the Northern Mariana Islands.

PHONE: 202.471.3990
EMAIL: help@naic.org
INNOVATION ARM: Innovation and Technology Task Force (https://naic-cms.org/cmte_ex_ittf.htm)

Office of the Comptroller of the Currency (OCC):
The OCC charters and supervises national banks and federal savings associations as well as federal branches and agencies of foreign banks (although most non-U.S. banks operate in the United States through state-licensed branches). The OCC does not supervise state-chartered banks.

PHONE: 202.649.6800
EMAIL: publicaffairs3@occ.treas.gov
INNOVATION ARM: Office of Innovation (innovation@occ.treas.gov)

Securities and Exchange Commission (SEC): The SEC is the primary securities regulator in the U.S. The SEC has oversight authority over U.S. securities markets and the key participants in such markets, including securities exchanges, broker-dealers, investment advisers and mutual funds, among others.

PHONE: 202.551.6551
CONTACT PAGE: https://www.sec.gov/contact-information/sec-directory
INNOVATION ARM: Strategic Hub for Innovation and Financial Technology (FinHub) (https://www.sec.gov/finhub-form#no-back)

Small Business Administration (SBA):
The SBA is an independent federal agency responsible for supporting small businesses in the U.S. The SBA provides aid and counseling to assist and protect the interests of small business concerns.

PHONE: 800.827.5722
EMAIL: answerdesk@sba.gov
INNOVATION ARM: Office of Investment and Innovation (https://www.sba.gov/offices/headquarters/ooi)

United States Patent and Trademark Office (USPTO): The USPTO is a federal agency within the U.S. Department of Commerce that is responsible for granting U.S. patents and registering trademarks.

PHONE: 571.272.1000
EMAIL: usptoinfo@uspto.gov
INNOVATION ARM: Office of Innovation Development (innovationdevelopment@uspto.gov)

APPENDIX II:
OTHER CONTACT INFORMATION

9YARDS CAPITAL

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https://9yardscapital.com/contacts

FinTEx:

https://www.fintex.org/contact-us

Barclays Accelerator, powered by Techstars

https://www.techstars.com/contact/

Rise New York:

nyc@thinkrise.com

FinTech Innovation Lab:

info@fintechinnovationlab.com

RocketSpace:

https://www.rocketspace.com/contact-rocketspace

APPENDIX III: CHARACTERISTICS OF C CORPORATIONS AND LLCS

	C CORPORATION	LIMITED LIABILITY COMPANY
Ownership Requirements	• One or more stockholders. • No restrictions on the types of owners.	• One or more members (two or more members required if LLC is to be taxed as a partnership). • No restrictions on the types of owners.
Form of Equity and Restrictions	• Two basic types of capital stock: common stock and preferred stock. • Permissible to have multiple classes and series of stock with different rights and preferences. • Distributions must be proportionate to stock ownership within each class of stock.	• Permissible to classify membership interests (or units) into numerous different classes (like common and preferred stock) with different rights and preferences. • Distributions do not need to be proportionate to ownership.
Levels of Tax	• At the corporate and stockholder level.	• Default is single level of taxation; at member level; may elect corporate.
Liability	• Limited (to potential loss of amount of capital contributed).	• Limited (to potential loss of amount of capital contributed).

	C CORPORATION	LIMITED LIABILITY COMPANY
Management	• A C corporation is governed by a Board of Directors that designates officers to manage day-to-day operations. • Certain major decisions need to be approved by the stockholders. • A well-developed body of corporate case law and statutes provides greater certainty about rights and responsibilities, though less flexibility than other structures.	• Management initially vested in members who can delegate management responsibilities to a managing member, non-member manager or board of managers. • Major decisions typically must be approved by the members. • Business structure is flexible and primarily determined by the members and set out in the limited liability company agreement.
Employee Incentive Considerations	• Stock options • Stock appreciation rights (SARs) • Restricted stock • Restricted stock units (RSUs) • Performance awards	• Profits interests • Non-qualified options (to acquire a membership interest) • Other equity compensation arrangements can be deployed but are uncommon. • Receipt of LLC units can be disadvantageous to employees who may become “partners” under U.S. tax law.
Capital Raising Considerations	• C Corporations raise capital through the issuance of equity (stock) and the incurrence of debt. • C Corporations are the most common form of publicly traded companies.	• LLCs raise capital through the issuance of equity (membership interests) and the incurrence of debt. • LLCs are not typically publicly traded and may be required to restructure prior to an IPO, which may result in taxation for members depending on the final structure.

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