

The UK's Fintech Industry Support Policies and Implications

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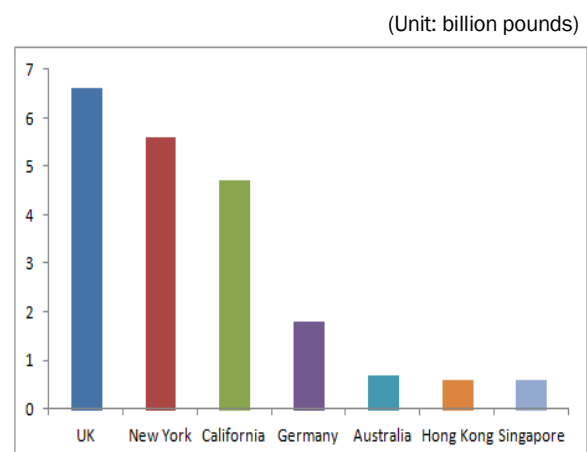
The UK Fintech Industry

During the past 4 to 5 years, the UK has emerged as a leading global fintech hub. The outstanding growth of the UK fintech industry can be attributed to its connectivity to global financial markets, government policy on building a business-friendly regulatory environment, and easy networking with other fintech hubs, among other factors. While there is no doubt about the competitiveness and global leading status of the UK's financial services industry, based on the London financial market over the past hundreds of years, it is interesting that the fintech industry, which is an icon of new industry and necessarily requires some of the most innovative ideas and the newest information technology, has seen immense growth in the UK.

The fintech industry in the UK has seen rapid growth since the global financial crisis in 2008. In 2015, the size of the UK fintech industry

was 6.6 billion pounds and around 61,000 persons were employed in this sector.¹ In terms of size, this is only second to the US fintech industry, which has two global fintech hubs in New York and California, each with different characteristics.

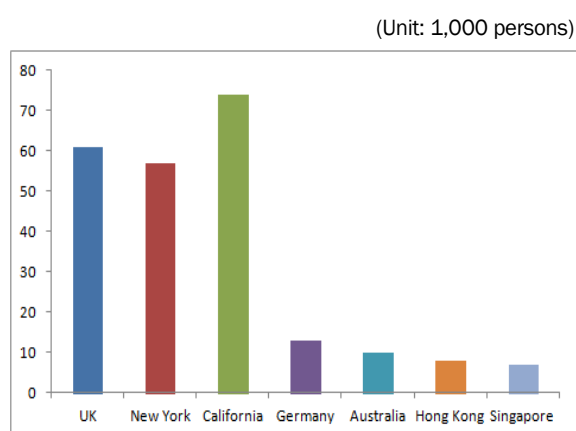
Figure 1. Market Size of Global Fintech Hubs (2015)



Source: EY (2016).

¹ EY. 2016. "UK Fintech: on the cutting edge."

Figure 2. Number of Employees in Fintech Industry (2015)



Source: EY (2016).

Since the global financial crisis in 2008, the level of customers' trust in traditional banks has sharply declined and the demand for conventional financial services has also decreased while the need for structural reform in the financial services sector has increased globally.² This request for reform was very strong in the UK as the financial services industry has been one of the most important industries for the British economy. In this context, the UK government has emphasized the concept of innovation in its new economic policies as a means of recovering from the financial downturn and discovering new sources of growth. Following the call for improving customers' benefits and competitiveness of the financial services market, the UK fintech industry has rapidly evolved by utilizing a competitive financial infrastructure and providing innovative ways of providing financial services.

From 2008 to 2013 the size of transactions related to the fintech industry has increased 74% each year and the amount of investment has increased by eight-fold.³ While the Brexit

decision has significantly increased the level of uncertainty in the UK economy, it is interesting to note that London ranked as the top international financial center (IFC) in 2016 according to the Financial Times.⁴ While the future of financial markets in the UK is still uncertain due to the Brexit decision, its negative impact on the fintech industry has not been visible so far. According to a survey of 1,200 CEOs and executive officers in major UK fintech companies following the Brexit referendum, most of the respondents expected that the negative impact of Brexit on the fintech industry would not be serious, when considering the rapid growth of the UK digital economy and that more than 40% of new fintech companies in Europe valued at a billion dollars or more are located in the UK.⁵ The confidence indicates that the growth of the UK fintech industry is not based on short-term foreign investments or certain fintech companies or products. Instead, the innovative and business-friendly regulatory policy of the government has led the UK fintech ecosystem.

UK's Fintech Ecosystem

The rapid growth of the UK fintech industry is closely linked to the high quality of its fintech ecosystem. The global consulting agency Ernst & Young analyzed the quality of fintech ecosystems based on four categories: talent, capital, policy, and demand (Ernst & Young 2016). According to this analysis of the quality of fintech ecosystems, the UK has the best ecosystem among global fintech hubs. While California is ranked at the top in the level of capital due to the abundant venture

growth."

⁴ The Banker. 2016. "London Leads as Brexit Beckons: IFC rankings." (October)

⁵ Tech City UK. 2016. "Cause for Optimism as UK Tech Rises to Brexit Challenge." (July 13)

² Patrick Imbach. 2015. "10 reasons London is becoming the FinTech capital of the world" KPMG

³ UKTI. 2014. "Fintech: The UK's unique environment for

capital markets located in Silicon Valley and the UK was ranked as third, the UK greatly outweighed other fintech hubs in terms of its

quality of government policy, including regulatory regimes, government programs, and taxation policy.

Table 1. Benchmarked Ranking of Fintech Ecosystems

Region	Talent ►Talent availability ►Talent pipeline	Capital ►Seed ►Growth ►Listed	Policy ►Regulatory regimes ►Government programs ►Taxation policy	Demand ►Consumers ►Corporates ►Financial institutions	Total points
UK	2	3	1	3	9
California	1	1	6	2	10
New York	3	2	7	1	13
Singapore	4	7	2	6	19
Germany	6	4	5	5	20
Australia	5	5	3	7	20
Hong Kong	7	6	4	4	21

Relative rank: 1=highest, 7=lowest.

Source: EY. 2016.

Innovative Regulatory Environment

While in the past the rigid regulatory system of the UK had been blamed for disrupting the development of the UK fintech industry, the effective regulatory reform and facilitation of public-private partnership driven by the government in recent years have succeeded in promoting the fintech industry as a new engine for growth in the UK. Most of all, in April 2013 the UK government divided the financial regulatory system into two parts: the Prudential Regulation Authority (PRA) for the purpose of supervising systemically important financial institutions, and the Financial Conduct Authority (FCA) for supervising the conduct of other financial institutions.

The core objectives of the FCA included improving consumer protection, the prudentiality of the financial system, and the competitiveness of financial services. During the process of restructuring the global financial markets after the global financial crisis, the FCA focused on the potential of the innovative fintech

industry as a remarkable way of improving the benefits of consumers in the financial market and has actively supported fintech startups and introduced creative ways of regulating new and innovative products.⁶ While the traditional role of financial supervisory institutions had been limited to overseeing any illegal conduct by businesses in the market, the interactive approach of the FCA to regulation has provided the best soil for the remarkable growth of the fintech industry with innovative ideas and services. The Project Innovate Initiative of the FCA has been considered one of the most successful policies in support of innovative fintech businesses. With the purpose of providing direct support to innovative businesses and improving related administrative procedures, the Initiative has changed the role of financial supervisory institutions from rigid supervisors to creative supporters of innovative businesses.⁷ Under the initiative, the In-

⁶ Caroline Binham. 2016. "UK regulators are the most fintech friendly," *Financial Times*. (September 12)

⁷ Speech by Christopher Woolard. 2016. "UK FinTech: Regulating for innovation," FCA. (February 23)

novation Hub was introduced as a team dedicated to supporting new and established fintech businesses for authorization so that innovative fintech startups or existing businesses with innovative ideas could have easier access to the market by mitigating regulatory risks while maintaining the adequate level of stability in the financial market.

Innovation Hub

In October 2014, the FCA launched a new program called Innovation Hub which

provides dedicated support for innovator businesses to be able to introduce innovative financial products and services with less regulatory costs and burden.

In order for a business to be eligible for the support of this innovation hub, it must prove that the specific product or service includes innovative factors significantly different from existing ones and that the innovation offers considerable benefit to consumers (see Table 2).

Table 2. Eligibility Criteria for Innovation Hub

Criteria	Key question	Positive indicators
Genuine innovation	- Is the innovation ground-breaking or significantly different?	<ul style="list-style-type: none"> - Desk research produces few or no comparable examples of innovation. - Independent expertise believes that it is genuinely innovative. - Step-change in scale
Consumer benefit	- Does the innovation offer a good prospect of identifiable benefit to consumers?	<ul style="list-style-type: none"> - The innovation is likely to lead to a better deal for consumers e.g. through lower price or higher quality. - The business has identified any possible consumer risks and proposed mitigation. - The innovation will promote effective competition
Background research	- Has the business invested appropriate resources in understanding the regulations in relation to its own position?	<ul style="list-style-type: none"> - The business has sought to understand their obligations as far as appropriate.
Need for support	- Does the business have a genuine need for support through the Innovation Hub?	<ul style="list-style-type: none"> - The business has no alternative means of engaging with the FCA. - The innovation does not easily fit the existing regulatory framework.

Source: FCA. 2016. Criteria for Innovation Hub.

The support provided by Innovation Hub consists of three stages: pre-authorization, authorization, and after authorization. At the stage of pre-authorization, regulators help fintech businesses understand the risk and cost of acquiring authorization. Since the regulator provides accurate information on the requirements for acquiring authorization and assists businesses to prepare for this, the process significantly reduces regulatory risk and cost. In many cases, fintech startups struggle with understanding complex financial regulatory systems and

cannot easily afford an expensive compliance system. Hence the consulting and assistance provided directly by the regulator is more than beneficial for fintech startups in reducing regulatory risk. Once a business submits an application for authorization, the application goes through a special authorization process available only to those participating in the innovation hub program. After authorization, the regulator provides additional supervision and support up to a year.

While new fintech businesses benefit from these programs, it is also very helpful for the regulator since they can receive direct feedback on the effectiveness of the regulatory system from participating businesses. Overall the interactive communication throughout the entire process of introducing and operating innovative products and services among diverse actors in the market enables effective operation of the fintech ecosystem.

Rethinking the Aim of Regulation

The most interesting feature of the UK government's fintech support policy is that the regulator who supervises the financial market provides direct and customized support to businesses which are under its supervision so that those businesses can easily understand the regulatory system and comply with less time and cost. Overall, based on this supportive attitude of the regulator, the interactive exchange of opinion and information among the government, companies, investors, and developers provided a good soil for establishing a strong and effective fintech ecosystem in the UK.

Considering that the core purpose of financial regulation should include stabilizing the financial market and also increasing the benefit to consumers by promoting innovation and competition in the market, the fintech support policy of the UK government provides a fine example for financial regulators as the continuing economic downturn is causing a desperate need for innovation in the market. **KIEP**