MED MSMEs
Policies for inclusive growth
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Discussion Paper (GP) – United Kingdom Alternative Finance

Key Facts

SBA 6 Sub-dimension:
6.1.2

Country:
United Kingdom

Results & Impact:

- Leading global FinTech Hub
- Revenue: EUR 7.7 billion (£ 6.6 billion) per year
- Jobs created: over 76,500
- Investments (H1 2019): EUR 16.34 billion (£14 billion) (beating US & China) up from EUR 3.85 billion (£3.3 billion) in 2018
- Over 1600 FinTech Firms (to be doubled by 2030)
- Online Alternative Finance Volume: EUR 7.22 billion (£6.19 billion) in 2017 (35% YOY)
- P2P Volume: EUR 2.57 billion (£2.2 billion) in 2017 (66% YOY)
- Equity based Crowdfunding: EUR 38.51 (£33 million) in 2017 (22% YOY)
- FCA's Innovation Hub: over 500 businesses were supported
- FCA Sandbox: 100 tested products
- FinTech Adoption Rate: 42% (global avg. of 33%)

A. Policy Level

Realizing the importance of the alternative finance market and the urgency of keeping up with the fast pace of the technological changes, UK back in 2010 initiated setting up the foundations for regulating the Financial Technology (FinTech) sector. Regulators worked hand in hand with the private sector (innovation offices/hub, regulatory sandbox) in developing the proper regulatory environment to facilitative innovative solutions to MSME finance while at the same time safeguarding data security, protecting investors and preventing abuse. Several interventions being led by the Financial Conduct Authority (FCA) were put in place, earning UK to be labeled as "*the best place in the world to start and grow a FinTech Firm*".

BACKGROUND

- 2014: the FCA established the Innovation Hub and Regulatory Sandbox (the first in the world) to support FinTech Firms and enacted the Peer-to-Peer Regulatory Framework.
- 2015: UK established the first of worldwide Payments Systems Regulator: 1. Challenger banks and FinTechs would gain access to the payments systems on fair terms, 2. Payment Systems would utilize innovation in the interest of both consumers and businesses. And in 2016: Bank of England launched FinTech Accelerator.

B. Programme Level

Fintech offers a feasible solution to the MSME financing puzzle for several reasons such as: 1. ***Higher efficiency and lower costs*** 2. ***Mitigating information asymmetry*** 3.) ***More diverse sources of funding.***
Realizing such revolution, the UK Government took some serious actions to regulate the market from the beginning in order to create a balance between innovation and financial risk and stability. The UK government has identified four leading areas in UK FinTech: payments, platforms, software and data analytics.

C. Action Level

The Innovation Hub and Regulatory SandBox: Launched by the FCA to support FinTech firms to comply with financial services regulation. The main benefits of the Sandbox could be summarized as: 1) allowing new products to be tested, 2) reducing the time and cost of getting new ideas to markets, 3) improving access to finance for innovators 4) ensuring appropriate safeguards are built into new products and services. Regulatory Sandboxes help innovative FinTech businesses to develop compliant protype products, an important step toward reducing regulatory burden on new firms. The sandbox provides access to regulatory expertise and a set of tools to facilitate testing. The tools include restricted authorisation, individual guidance, informal steers, waivers and no enforcement action letters. The FCA oversees the development and implementation of tests and closely work with firms to ensure consumer safeguards and develop related regulations accordingly.

Peer-to-Peer Lending: UK is considered to be the first jurisdiction to establish P2P regulatory framework to protect investor's money and to provide rules and directions on how to manage the platforms. The framework mainly covers: 1. Capital adequacy requirements 2. Client money rules 3. Cancelation rights 4. Information disclosure rules 5. FCA reporting requirements 6. Administration in the event of failure 7. Dispute settlements and resolution process.
In December 2019 new rules for the UK P2P Lending Platforms will come into force that includes the following: 1. no investor is allowed to invest more than 10% of their investable assets 2. Platforms are required to conduct ""appropriateness tests" on investors and their knowledge and experience with P2P lending.

Crowdfunding: FCA has not officially announced or published provisions that are applicable to investment-based crowdfunding, however it is generally perceived that it does fall under the same provisions applicable to P2P lending and requires FCA authorizations. FCA stipulates that investment-based crowdfunding platforms are: 1. required to conduct "appropriateness tests" on investors and their knowledge and experience with crowdfunding 2. Investors are only allowed to invest less than 10% of their net assets in the relevant investment.

Innovative and Revolutionary Step Change

- Credit Data Sharing: The enactment of legislation that requires banks to share SMEs credit data and to refer SMEs they declined for finance to designated alternative finance platforms.
- Agreements signed between the UK Government and Hong Kong, South Korea, Singapore and China to build links between governments, regulators and the private sector in order to open up international markets. Australia is next.

D. Key Success Factors

- **Regulatory Sandbox** that enables regulators to identify gaps in policies and regulations or to highlight potential barriers to entry and innovation, from which regulations were enacted that created an environment for competition and innovation to occur.
- The creation of a **RegTech Industry** that combines both regulatory and technical knowledge in order to better identify and set up regulation that not only stops bad things from happening but also does not stop good things from happening. RegTech acts mainly as an intermediary or a facilitator to use new technology to comply with existing or future regulatory requirements.

This document has been prepared with financial assistance from the European Union. The opinions expressed herein are those of the authors and may not represent the position of the EU.