



Project Innovate: Feedback from roundtables

Executive summary

1. On 11 July 2014 we published a call for input¹ asking for written responses on Project Innovate, an initiative that is designed to help both start-ups and established businesses to bring innovative ideas into financial services markets. We also received feedback directly through six roundtables that we hosted in July and August.
2. The roundtables were organised for three different groups of participants: small innovators, non-regulated businesses and existing regulated firms. In each session we asked participants to define innovation, to tell us about challenges that the regulatory system imposes on innovators, and to give us their feedback on our proposed Innovation Hub and Incubator functions.
3. The main discussion points raised by participants are set out below. We will use this feedback to inform our decision on which areas will be addressed through Project Innovate.

Defining innovation

- Innovation solves a customer need; innovation is creating value through change; innovation is challenging the idea that 'this is how it's always done'.
- Innovation can either be disruptive or incremental; the latter type is more common but the former can be more valuable. Project Innovate should include both types of innovation in its scope.
- The FCA should consider innovation in business models and processes as well as technological innovation.
- It is important to ensure that the innovation has a positive effect on consumers, which may not always be the case.

Challenges and experiences

- Regulations are complex and costly to understand, leading to a significant drain on resources for innovators in financial services and creating uncertainty for investors.
- Start-ups would like more of an opportunity to informally discuss possible issues with the FCA before submitting the formal application to become authorised.
- Awareness of the FCA and what it does is very low for start-ups and technology businesses not focused on financial services.
- It is difficult for regulated and non-regulated businesses to receive feedback from the regulator on an innovative product or service before launch. This encourages a risk-averse approach, which stifles innovation.

¹ <http://www.fca.org.uk/static/documents/project-innovate-call-for-input.pdf>

- Innovator businesses sometimes find it hard to obtain a bank account. This appears to be a result of banks' concerns following fines received for breaches of anti-money laundering rules.

Designing an Incubator and Innovation Hub

- The website should be streamlined and improved - for example, to make it easier for start-ups to understand how to get authorised.
- The FCA should organise drop-in sessions to allow innovators to engage directly with the regulator. The FCA should also host surgeries and workshops on common themes and issues relevant to innovation in financial services.
- For innovators (both regulated and non-regulated), the FCA should provide more clarity on whether an innovative product/service being considered for launch is compliant with regulatory requirements.

Introduction

1. On 11 July 2014 we published a call for input asking for written responses on Project Innovate, an initiative that will help both start-ups and established businesses to bring innovative ideas into financial services markets.
2. We proposed to create a function to help innovative financial businesses get through our authorisations process. We also proposed to create an Innovation Hub for regulated and unregulated businesses with innovative ideas and engage relevant wider FCA expertise to understand the issues and opportunities raised.
3. To get input directly on our proposals, during July and August 2014 we hosted six roundtables at our London office. We invited applications to the roundtables from:
 - **Small innovators** who are seeking authorisation, or have recently become authorised.
 - **Non-regulated businesses** that engage with the financial services sector but will not be seeking authorisation.
 - **Existing regulated firms** who have a strong interest in engaging with an Innovation Hub.
3. In this document, we set out the key messages we received from the 84 participants, who provided us with ideas and feedback on three key themes, each one of which was explored by asking the specific questions set out below.
 - **Defining innovation:** How should innovation be defined? Can you provide examples of innovation? What criteria should we use to focus our resources on 'genuine, ground-breaking' innovation?
 - **Challenges and experiences:** What has your previous experience been with the FCA? Is there anything about the regulatory system that poses particular difficulties for innovator firms and businesses?
 - **Designing an Incubator and Innovation Hub:** What functions should the Incubator perform? What practical assistance do you think the Incubator could usefully provide to small innovator firms? Do you think it would be useful to establish an Innovation Hub function? What functions should the Innovation Hub perform? How can the FCA foster better engagement with the sector for these businesses?

4. This paper sets out the issues and ideas raised in our roundtables. We have not yet decided which areas will be addressed through Project Innovate, or how we might tackle them. The feedback received in these roundtables, as well as the written responses to our call for input, are being used to help us finalise our proposals. We will announce the final design later this year as well as our plans to tackle the issues that we have prioritised.
5. We will also publish a feedback statement later in the year, setting out our response to the written responses to our call for input.

Defining innovation

1. Feedback from small innovators

- Many participants suggested that innovation occurs when value is created from a change. It was noted that some innovations focus on changing an existing process or product, while other innovations change the way a market operates, or create new markets altogether. The word 'disruptive' was often mentioned, with many suggesting that while disruptive innovation is the most desirable, it will be difficult to judge in advance whether an innovation will turn out to be disruptive.
- Participants encouraged an open and flexible approach to what constitutes an innovative product or service. They told us that while innovations that customers experience directly (e.g. peer-to-peer lending or virtual currencies) receive greater attention, innovative B2B services (e.g. regulatory compliance software) are less visible, but can create important cost savings that may benefit consumers. Some noted that innovation does not need to involve new technology to be ground-breaking.
- Some participants told us that in designing criteria with which innovators will be selected for the Incubator, we should consider that innovations will not always need the regulator's support to succeed. Instead, the Incubator should focus on areas where an innovative service or business idea does not have a natural fit with existing regulation.

2. Feedback from non-regulated firms

- Participants suggested that innovation either improves products or processes within an existing framework, or it disrupts the way in which a market operates. Some suggested that innovations adopted by incumbent players have mostly been of the former type, driven by the need to cut costs. One participant noted that the timeframe for incumbent banks to replace outdated legacy IT systems could be as long as ten years.
- One participant highlighted that particularly innovative ideas will require consumer education before gaining traction. The challenge in the financial services sector is that innovators also have to educate the regulator about their innovation.
- Some participants commented that not all types of innovation are beneficial to consumers. One participant mentioned high frequency trading as an example of innovation that may be detrimental.

3. Feedback from regulated firms

- Participants noted the possibility for disruptive as well as incremental innovation. The point was made that innovation is not solely linked to technology, but also business models, product design, delivery of services and organisational purpose. Innovation can create new markets for products and services. All of this can benefit consumers, especially where the consumer decision-making process is simplified. In assessing benefits we were urged not to just focus on prices.
- Several participants indicated that most innovation in financial services is incremental, or a new way of doing something that already exists.
- Participants highlighted the fact that innovation can sometimes have a negative impact on consumers, with the example of single premium PPI raised. Participants indicated that we should also be open to innovative products and firms failing.

Challenges and experiences

1. Feedback from small innovators

- Participants commented on the effort it takes for small firms to research and understand regulatory requirements, noting that investors needed to be confident that a business idea meets regulatory requirements before committing funding. On the other hand, they felt a regulator might be more likely to authorise a firm that already has secured funding, or that possessed historical data on which to conduct due diligence.
- Many participants commended us for our willingness to change, demonstrated by the changes made to new bank applications process and also through Project Innovate. In general, participants recognised that the FCA, Cabinet Office, Treasury and HMRC had created a very supportive environment for fintech, particularly in comparison to other jurisdictions.
- Participants reported that start-ups tend to have a negative view of the FCA before engaging with the authorisations process. Many see us as unapproachable. Some also noted that small firms felt intimidated by the whole process and worried that innocent mistakes in the application process would have a negative impact on future interactions with the regulator. Many wished for a safe environment in which they could explain their ideas face-to-face and receive feedback before submitting their formal application.
- Participants that had already completed the authorisation process noted that applying for authorisation felt like a 'black box' – firms submit their application forms, pay the relevant fees and receive a yes/no verdict six months later. They noted that there is little opportunity to discuss and clarify aspects of the application during the process. Some participants commented that the application process was too slow. Many asked for greater transparency up-front about how long an application will take and a guide as to what aspects would be likely to either slow down or speed up the process.
- Participants that had previously engaged with our authorisation process praised the quality of FCA staff and the support they received. Some commented that we should do more to dispel myths regarding the authorisation process.

- It was generally agreed that the language of regulation is often impenetrable. Application documents are written in technical legal language, making it very difficult for firms to understand which permissions they should apply for, or whether they need to be authorised at all. Many participants were critical of the authorisations section of the website, which they felt was poorly structured, and the paper-based nature of the application process.
- Participants were concerned that the authorisation process was not tailored to the size of the applicant, noting that small start-ups selling a niche product needed to go through the same authorisation procedures as larger firms targeting a wide market.
- Some participants said that the authorisation process assumes that applicants can and will rely on compliance consultants to help them through the application process. Using consultants, however, is a problem for start-ups. Aside from their cost, explaining an innovative business model to an intermediary who will draft the application may result in misunderstandings that create problems further down the process. It is difficult for start-ups to evaluate the quality of the advice they are receiving and some participants questioned whether consultants have any incentive to take steps to speed up an application.
- Innovator businesses sometimes find it hard to obtain a bank account. This appears to be a result of banks' concerns following fines received for breaches of anti-money laundering rules. However, participants noted that some of the firms who have been rejected by a range of banks are in fact low risk from a money laundering perspective.

2. Feedback from non-regulated firms

- Participants told us that regulation created a particular set of co-ordination problems for non-regulated businesses. When pitching an innovation to regulated firms (e.g. back-office software to automate compliance processes), innovators need to provide some guarantees that we will not raise concerns about the service. This is difficult for non-regulated firms, as there is no formal channel through which they can engage with the regulator and receive some form of reassurance that their service does not raise regulatory concerns. Clients with a named supervisor can and often do ask for feedback on services the client proposes to purchase from an innovative vendor, but – if forthcoming – we can be slow to respond or non-committal.
- Participants told us that this lack of certainty creates a risk-averse climate among regulated firms, who are likely to resist purchasing services that may raise compliance risks and would prefer buying them from established (but more expensive and less innovative) service providers. Many directed their frustration towards banks (and large regulated firms more generally), rather than towards the regulator, noting that some of them used regulation as an excuse for rejecting innovation.
- Participants generally noted that we have improved our approach since transitioning from the FSA and that we are much more open and willing to engage, with these events a good example of that. Participants who have dealt with regulators around the world also agreed that with the possible exception of BaFin, the FCA is the most 'online' regulator.
- On language and clarity, participants commended the use of Plain English in policy documents and other communications, and noted that this was a marked difference from the FSA.

3. Feedback from regulated firms

- The current regulations were viewed by participants as outdated and complex, with the rate at which they are changing proving to be overwhelming. For smaller firms in particular, this constrains the amount of resource that can be spent on innovative ideas, although it also lowers research and development (R&D) spending even for firms with large compliance departments. Some saw the Handbook as inaccessible.
- Participants felt that we do not engage early enough with firms and provide limited feedback or reassurance, generating uncertainty that can stifle innovation. There is a fear of being reprimanded for attempting something new. There was a perception that many often relied on having a strong relationship with an individual in the FCA, creating an unfair advantage for established firms. The approach taken across FCA divisions and individuals was also seen as inconsistent.
- The situation has improved since the FCA developed from the FSA, with our approach to taking over the regulation of consumer credit cited as an example of how the regulator had changed positively. It was felt that more can be done to adapt to market developments and changing times more quickly, with examples given of digital signatures and crypto-currencies. Our tone could also be more supportive and guidance would be more useful if less abstract and if it used more examples of good and bad practice. The definition of what constitutes advice was cited as an example of where firms are still not clear where they stand despite attempts by the regulator to resolve this. One participant observed that many firms will simply ignore regulations that they cannot understand.
- Unpredictability of the Financial Ombudsman Service (FOS) was cited as a barrier to innovation. Participants were particularly concerned that FOS can rule against firms even where they have complied with the relevant FCA rules.
- The interactions between regulatory regimes across different jurisdictions, such as UK, EU, and US, was cited as a reason why firms might prefer to stick with existing, 'safe' products, and why venture capitalists might be more attracted to less heavily regulated sectors of the economy.

Designing an Incubator and Innovation Hub

1. Feedback from small innovators

- Participants were strongly supportive of us increasing our engagement with innovative start-ups. They suggested the idea of regulatory drop-in sessions hosted at fintech hubs, such as Level 39 and different accelerator programmes. FCA staff could answer queries face-to-face and provide advice to firms considering authorisation. Participants recognised that to avoid giving advantages to particular commercial organisations, we may want to host these sessions ourselves. Some participants also suggested that we should recruit an individual well known in innovation circles as a figurehead, noting that this would cement our commitment to innovation and allow the FCA to be represented in industry forums by a single representative.
- Participants made a number of suggestions regarding the authorisations area of the website. They suggested that the website should contain more multimedia, such as videos, 'hover-over' definitions of jargon and legal terms, and online (as opposed to paper-based) application forms. Many wanted the website to have a better search functionality, to use case studies, and to feature an expanded FAQs section. With regards to an online application form, some participants suggested opening up our Application Programming Interface (API) to allow development of solutions that could include submitting their application through third-party websites or apps. Some participants also suggested that firms should be able to complement their application submissions with videos and slides.
- Participants strongly supported the Innovation Hub facilitating knowledge sharing about the application process. Participants suggested that the Hub could organise seminars and Q&A on variety of authorisations-related topics, and post videos and answers online. Some also suggested a mentor system, where innovators who had already been through the process would provide guidance to innovators who were considering applying. Some participants suggested the creation of a FCA Wiki, where the fintech community and FCA staff could contribute to solve common queries about the authorisations process and other aspects of regulation. Finally, some participants suggested that we should develop specialisms within the Contact Centre, so that specific queries about authorisation could be addressed by specialist staff.
- Many suggestions provided by participants related to introducing a sliding scale approval process for innovative businesses. For example, there could be a points system for getting authorised, through which innovators and their stakeholders can measure a firm's progress on obtaining authorisation. Some participants also suggested a wider palette of FCA compliance 'badges'; 'FCA Approved' would remain the pinnacle of the FCA authorisations process, while 'FCA Aware' or 'FCA Engaged' badges would be awarded to firms meeting defined milestones along the authorisations process, with a view to achieving the 'FCA Approved' status within a defined timeline.
- Some participants suggested that we should provide an 'approval in principle' option for firms who meet the majority of our requirements and would find it easier to comply with the outstanding requirements if we recognised their progress. For example, a start-up may meet all approval requirements with the exception of capital requirements. The funds needed to meet the capital requirements are provided by investors, who would be more willing to do so if the firm already had an 'approval in principle', thus solving a chicken-and-egg problem faced by some start-ups.

- Some participants suggested that application fees could be staggered. Instead of paying £5,000 at the beginning of the application, a firm could submit, for example, £1,000 along with its application pack, receive feedback on the application, make any necessary corrections and then submit the corrected application with the remainder of the fee.

2. Feedback from non-regulated firms

- Participants' main request was for us to provide feedback to non-regulated firms about whether a service to be marketed to regulated firms raised regulatory concerns. Participants suggested that ideally we would be able to provide some form of approval acknowledging that a service did not raise concerns, noting that even a non-binding, heavily caveated 'nod of approval' would be helpful. In this context, participants suggested the Innovation Hub could play a facilitating role between supervisors and non-regulated innovators.
- Many participants wanted the Hub to organise training events and surgeries on authorisations as well as a broader range of regulatory issues. Participants suggested that the Hub could provide a platform for networking between start-ups and more established firms. In general, participants thought we should do more to make start-ups aware of our existence and role. They suggested that the Hub should be helping start-ups understand whether they need to be regulated; in this context, translating the Regulated Activities Order into Plain English would be an important step in the right direction.
- However, participants also warned that, for the Hub to add value, it could not act as a silo within the FCA. They stressed the importance of the Hub promoting an innovation-friendly environment across the FCA and advocating changes to our approach that would support consumer-friendly innovation.

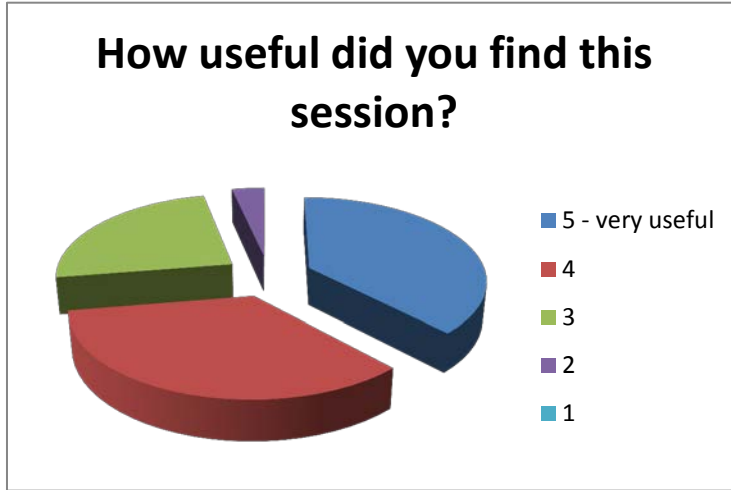
3. Feedback from regulated firms

- Participants felt we sometimes appear to be engaged in a 'war' with the firms that we regulate. We were asked instead to cultivate a tone that is more open and collaborative, which would then encourage firms to innovate. The Innovation Hub should help firms navigate the regulatory regime and guide them to appropriate contacts within the regulator. This should include using a wider range of communication channels such as Skype, as well as bringing together FCA experts to host coaching sessions for innovative firms. Correspondence with firms should use more Plain English and the FCA website should help firms to comply with regulation by providing more examples of good and bad practice.
- Participants felt that the Innovation Hub should be a knowledgeable group of individuals that are able to flag up when rules become out of step with reality, as well as provide informal approval for innovative products. The Hub should focus on existing firms as well as start-ups, as their innovations can benefit a large group of existing consumers. Some suggested that the Hub should run surgeries on common challenges faced by innovators and provide a 'safe' environment in which ideas and issues can be shared. This would lead to the Hub acting as a liaison between innovator firms and the rest of the FCA, as well as identifying challenges and trends that could enable us as a whole to be more forward looking.

- Firms are keen to remain engaged with the initiative and urged us to maintain the momentum on the project, with a particular plea to make sure that it does not lose traction in the next 12-18 months and 'disappear', as with previous FSA initiatives. It was also agreed that many firms would be willing to pay a fee for access to services provided by the Innovation Hub.

Annex 1: Feedback on the engagement approach

As part of a commitment to continuous improvement, we sought feedback from all roundtable participants on the approach taken to the sessions and the value gained from their attendance. Feedback was overwhelmingly positive, with 97% of respondents agreeing that the approach taken was engaging and appropriate. Further feedback was also positive, as shown below.



Almost three-quarters of the respondents gave a very positive response (4 or 5) when assessing how useful the session was.

The feedback was even more positive when respondents were asked whether they had been given the opportunity to contribute, with 90% responding with either a 4 or a 5.



The written feedback on the sessions from participants and the recommendations made for improvements will be taken into account when we are planning our future ongoing engagement with innovators.

We would like to thank the participants for giving up their time to attend our roundtables. The roundtables were a crucial source of ideas and feedback for us as we finalise the design of Project Innovate.