The Kalifa Review: A Road Map for the Future of UK Fintech?

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The highly anticipated Kalifa Review of UK Fintech (the Review), led by former Worldpay CEO Ron Kalifa, was published on 26 February 2021. Its 106 pages — made up of a five-point plan of key recommendations and 15 sub-recommendations on investment in the UK fintech sector — have generally been well received. Business leaders, participants and others engaged in the fintech community will continue to digest these recommendations over the coming weeks. The key question for many will be how quickly the UK government moves to implement the Review's recommendations, and to what extent.

The Review identifies three broad threats to the UK's well-established fintech leadership position: (1) competition from overseas financial centres, such as Singapore, Australia and Canada, which are investing heavily in their fintech industries; (2) the regulatory environment resulting from Brexit, in relation to both the loss of the "passport" associated with being a member of the EU single market in financial services — which enabled London to act as a "gateway" to entering the EU market for many fintech businesses — and the ability of UK firms to attract and keep talented fintech workers from the European Union; and (3) the COVID-19 pandemic, which has considerably accelerated digital adoption globally and created openings for nimble jurisdictions to capitalise on fintech opportunities, prompting the UK to redouble its focus on the fintech sector.

The Review identifies three corresponding opportunities: (1) job creation across the UK, including new high-income, tech-based roles and the upskilling and retraining of the existing workforce; (2) investment to enable fintechs to achieve global scale through access to international markets whilst the UK continues to be a leader on regulation and standard-setting globally; and (3) inclusion and a sustainable recovery to allow citizens and small businesses to access more, better and cheaper financial services.

Below, we discuss some of the Review's key proposals. Additional proposals in the Review include a regulatory "Scalebox," a fintech visa scheme, national fintech clusters in the UK, and diversity, equity and inclusion issues in fintech.

Fintech Growth Fund

Possibly the most widely reported aspect of the Review prior to its full release was the recommended creation of a £1 billion growth fund, financed by domestic insurers, pension funds and private investors, in order to address an estimated £2 billion fintech growth capital funding gap at Series B level of financing and above. The Review identifies that the majority of investment into UK fintech companies over the last five years has come from overseas capital. For the UK fintech sector to grow, it is imperative that domestic investors (particularly institutional investors) are able and properly incentivised to invest in the sector. This includes being able to benefit from the application of appropriate regulatory concessions in favour of such domestic investors, such as revisiting constraints in the Solvency II regime to enable insurers to make longer-term investments in the sector and changes to the rules of defined contribution pension schemes to enable pension fund investment. The implementation of the fund would require the cooperation of UK regulators and trade bodies, but it would help drive UK economic growth by supporting one of its fastest-growing sectors.

The fund would be a domestic entity modelled on the UK Business Growth Fund. It would have a specialist fintech investment team with expertise in fintech business models and relevant regulatory implications, as well as the ability to provide operational support for scale and growth. The fund would publish its own private research on the fintech sector in order to promote UK fintechs at the scale and growth stages.

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The fintech industry has generally welcomed this recommendation. Its success and impact depends in large part on the extent that the fund could be a source of patient and enduring capital, allowing UK fintechs room for growth, differentiating it from other sources of investment where there is often greater focus on a quicker exit.

Early-Stage Investment in the Fintech Life Cycle

Whilst the UK has a vibrant start-up industry, the Review identifies that many early-stage fintechs are excluded from concessions available under various tax relief schemes, such as the Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Venture Capital Trusts. The current system also discourages financial incumbents from effectively partnering with fintechs because at ownership levels above 20%, the fintech may be subject to full or partial regulatory consolidation in the financial incumbent's group, depending on the way in which the incumbent has accounted for the investment and its degree of control in respect of the fintech. In addition, UK firms' technology spend related to innovation does not always qualify for significant research and development tax credits, which further inhibits investment by financial incumbents in fintechs.

In many cases, it is important for early-stage fintechs to raise sufficient funds to scale quickly. Accordingly, one of the key recommendations of the Review relates to expanding the application of the UK's existing tax incentive schemes, which would be expected to encourage this kind of early-stage investment. This expansion could lead to a wave of new investment in fintechs seeking funding.

Amendments to the UK's Listing Regime

Compared to other global initial public offering (IPO) markets, London has been less successful at attracting new issuers in recent years. Between 2015 and 2020, the LSE accounted for only 4.5% of global IPO listings, compared with 39% for the NASDAQ and the NYSE. The Review identifies that part of this underperformance may be the result of structural differences between the exchanges — for example, the fact that UK premium-listed companies are not permitted to utilise dual-class share structures favoured by many US tech companies, which are now permitted on several other global exchanges, including those in Hong Kong, Singapore and Shanghai. Another contributing factor may be the restrictive nature of investor guidelines in respect of preemption rights in the UK, which typically only permit a UK-listed company to raise up to 5% of its issued share capital over a 12-month period for general corporate purposes and an additional 5% for specified acquisitions or investments on a non-preemptive basis. The Pre-Emption Group temporarily relaxed these restrictions in April 2020 as a result of the emergency fundraising requirements caused by the COVID-19 pandemic, to permit a 20% threshold, but this relaxation ended on 30 November 2020.

According to the Review, more than a third of UK fintechs surveyed in 2019 were expecting to undertake an IPO within the next five years, so it will be important for the UK to capitalise on the current momentum in the tech IPO market to ensure that more of these IPOs occur domestically. This represents an even more important issue for the UK market, with the rise of special purpose acquisition company (SPAC) vehicles listed in the US and Europe that are targeting fintech businesses.

The recommendations for the UK listing regime proposed in the Review will need to be considered alongside the fundamental reforms proposed in the separate UK Listing Review, chaired by Lord Jonathan Hill, which was published on 3 March 2021. These proposed reforms include: (1) a reduction in the LSE's minimum 25% free float requirement or a switch to a value-based threshold; (2) the amendment of the listing rules to permit dual-class share structures, in line with almost all other major stock exchanges; and (3) the relaxation of the restrictions on issuing shares without pre-emption rights, as mentioned above.

Proposals for Regulatory Support for Digitalisation

The Review proposes that the UK government adopt a comprehensive fintech strategy to rationalise financial and cross-sectoral regulation under which UK fintechs operate. Fintechs currently face disjointed regulatory obligations, divided chiefly among financial regulation, data protection requirements and digital operational resilience regulation, all of which are overseen by different authorities and are subject to different frameworks. The sub-recommendations on policymaking highlight the following areas for potential regulatory development:

- **Develop a Standardised Digital ID Framework:** Many services provided by fintechs (including in the open banking space) are dependent on participants being able to identify each other remotely. The systems currently in place to enable digital identification are highly fragmented and subject to disjointed data protection regimes. They therefore create technical barriers to the provision of services by fintechs. Standardisation of digital identification processes would help remove these barriers and enable smoother provision of fintech services that are predicated on digital verification.

- **Support the Digitisation of Financial Market Infrastructure (FMI):** The Review argues that UK exchanges and clearing-houses should be subject to a framework which easily enables trading and the clearing of digital assets. Such FMI should also be able to adopt alternatives to their traditional methods of service delivery without being seen to be in breach of financial services regulations, including through the use of distributed ledger and blockchain technology in clearing and settlement. Businesses in this sector would welcome amendments to existing regulatory regimes governing the post-trade space to explicitly accommodate the use of this technology and mitigate the current regulatory uncertainty.
- **Introduce a New UK Regime for the Regulation of Cryptoassets:** The EU has started to develop a comprehensive regime governing the issuance of cryptoassets and the provision of investment services in relation to cryptoassets. The Review recommends that the UK government introduce rules on services related to cryptoassets but that, in contrast to the EU framework, UK regulation be "bespoke" and "innovation-driven." The Review argues that the UK framework should be based on the principle that services that would be regulated if provided in relation to a payment instrument or security should be regulated in the same way if provided in relation to a regulated cryptoasset. The Review further argues that the UK should also seek to implement any standards governing cryptoassets adopted at a supranational level (*e.g.*, through the Global Financial Innovation Network). This recommendation is consistent with the UK government's post-Brexit approach in not mirroring EU regulations governing fintech, such as in crowdfunding, but instead charting its own course and developing or relying on its own bespoke regulatory frameworks.