Shelter from the storm

FCA regulation can be disproportionately onerous for UK financial services start-ups. **Seonaid Mackenzie** details how regulatory incubators can help

Outsourcing is widely used by companies the world over. Either they do not have a particular capability in-house or they do not need it on a full-time basis - employing a third-party can minimise costs.

A regulatory incubator, or a regulatory umbrella, supports start-up businesses through the initial regulatory phase until they can be directly regulated in their own right. The process is not dissimilar to that of business incubators. The primary focus for a UK regulatory is the requirements of the Financial Conduct Authority (FCA).

No person can conduct regulated activity in the UK without being authorised or classed as an exempt person. A business can be exempted by becoming an appointed representative of an authorised firm (the principal).

Effectively, a client becomes an appointed representative of the incubator, which in turn accepts responsibility for all of its regulated activities.

Regulatory incubation is not new. It is 10 years since Sturgeon Ventures was founded to apply the principle to start-up fund managers - regulatory cover would be provided until they could seek authorisation in their own right.

Over the years, the business model has been more widely adopted: Midmar Capital, Gallium Fund Solutions, Mirabella Financial Services and Linear Investments are some of the other practitioners in the UK - known as FCA Umbrella or Regulatory Hosting Platforms. The range of services has expanded as has the types of incubator.

POST-CRISIS

In the wake of the financial crisis, regulatory incubation gained traction with individuals leaving established City firms to set up their own enterprises. They needed supervisory support and proof of concept before becoming directly authorised (see box, below).

Regulatory incubation is risky. Firms and individuals taken on as appointed representatives must be vetted and monitored closely; otherwise regulators can impose heavy penalties.

The responsibility is substantial and, in extreme circumstances, malpractices must be reported to the regulator.

As the economy recovers, I expect to see the entrepreneurialism of the UK financial services industry with more and more start-up businesses needing help with regulation.

Seonaid Mackenzie is founder and managing partner of Sturgeon Ventures

LEADING THE WAY

Why a company would use a regulatory incubator depends on the circumstances. One of the most prominent benefits is speed to market. Becoming an appointed representative means a company can start operating without an in-house regulatory capability or a licence from the regulator.

Wimmer Financial is an international corporate advisory firm specialising in natural resources and real estate. Since it was launched in October 2007 it has been an appointed representative of Sturgeon Ventures. Regulation had not been a core competency for the company and it did not need a full-time compliance department. Founder Per Wimmer did not understand what regulation entailed. The regulatory incubator allowed the firm to gain the competency, which could see it licensed in its own right at some point in the future.

Northridge Advisory has used a regulatory incubator since its inception in 2013. Flexibility and authorisation to work in markets that would otherwise be off-limits was key for founder Jamie Adams, an investment banker with 19 years' experience at Nomura, Piper Jaffrey and Hawkpoint. Building a regulatory resource in-house would have constrained the areas advice could be given on.

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