ASIC and financial innovation

A speech by John Price, Commissioner, and Mark Adams, Senior Executive Leader
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Introduction

Good evening everyone. It is great to have so many of you here. Your interest clearly reflects the level of interest in the financial technology (fintech) sector.

I am John Price and I am a Commissioner at the Australian Securities and Investments Commission (ASIC). I am responsible for leading ASIC's Innovation Hub initiative. I am joined by Mark Adams, Senior Executive Leader, Strategic Intelligence. Mark coordinates the internal team that is driving ASIC's Innovation Hub-related work. We also have a range of senior ASIC staff here to help with answering questions and to be available for a chat after this session.

Outline

Mark and I will speak for about 35 minutes and then take questions for about another 25 minutes.

I'll cover ASIC's regulatory role and why there are specific financial services laws, and then discuss the ASIC Innovation Hub initiative. Mark will then take you through the financial services regulatory framework in some more detail and a range of topics and issues that we know that many of you are interested in. We hope to give you some things to consider as you develop your business which may include applying for a licence.

This is ASIC's first significant presentation to the fintech sector since the start of the Innovation Hub – we plan to do more of these presentations and be available at fintech events over the coming months. Further sessions may be more targeted, for instance on licensing obligations, ways of raising funds as a startup or we may dive deeply into particular business models, like marketplace lending or roboadvice.

As Mark and I have a bit to cover, can I suggest we hold questions until the end.

Part 1

ASIC's role

As you are probably aware, ASIC's role in Australia is as a regulator of our financial services and markets – and this covers not only our various exchanges and markets but also those who develop, sell and advise on investment and credit products.

We monitor the conduct of these people (gatekeepers) and we take action – including enforcement action – where we detect misconduct.

Our goal is ensuring that the financial services and markets we regulate operate to fund the real economy and drive economic growth. In doing so, we contribute to improved standards of living for all Australians. But we can only achieve this if investors, financial consumers and those needing capital to build their businesses have trust and confidence in our financial services and markets.

We are working towards our goal through our strategic objectives to:

- promote investor and financial consumer trust and confidence
- ensure fair, orderly, transparent and efficient markets, and
- provide efficient and accessible registration and licensing.

We believe that industry and regulators have a common interest in seeing innovation that fosters investor and consumer trust and confidence.

Of course, ASIC is only one of the regulators of financial services, other regulators include Australian Prudential Regulation Authority (APRA), Australian Taxation Office (ATO), Australian Transaction Reports and Analysis Centre (AUSTRAC) and the Reserve Bank of Australia (RBA). Each regulator has a different mandate and set of objectives. APRA is the prudential regulator of financial institutions, including banks, insurance companies and superannuation funds. The RBA focuses on financial stability and monetary policy. AUSTRAC is the anti-money laundering and counter-terrorism financing regulator. There is often an overlap in priorities between regulators and we work together and share information if and when needed.

So why does this regulation of financial services exist?

Why regulation?

'Why can't I just run my business without all these special laws?' you may ask.

The central reason is that regulation promotes trust and confidence in the financial system. Without this trust and confidence in the system, investors, consumers and participants in the financial services sector, including fintech startups, are less likely to participate in it. The recent Financial System Inquiry final report also noted two specific reasons why the financial system is deserving of sector-specific regulation:

- more so than other sectors, the financial system has the ability to create or amplify economic shocks in our economy, and

- the significant harm to consumers that may result from complex financial decisions, or from dishonest and predatory practices, requires specialist rules to promote fair treatment.

I will now turn to digital innovation and the disruption it is having on financial services.

Our experience with Innovation

We are right now seeing innovative business models in financial services – marketplace lending, crowd funding, roboadvice, payments and blockchain technology are just a few examples of these potential developments.

Innovation is not a new phenomenon, but its current scale, breadth and potential, facilitated by technology, certainly is.

The major differences between the innovators/startups and incumbents are that innovators often have limited resources – in terms of time, money and access to professional advice.

As new players, innovators may also lack experience in interacting with ASIC. By their nature, innovative business models need to be looked at carefully to see where they fit in the regulatory framework. These business models can sometimes test legal boundaries. The good news is that there is some flexibility in the regulatory obligations we look after, and ASIC has some discretion in the way we do things. Where we can, we work with the entity to help their business and cut red tape.

For example, we have some powers to grant waivers from the law or modify the law if it is impractical or inappropriate. This is not something new – ASIC, over time, has issued many instruments of relief and waivers, and not just for fintechs and startups.

ASIC’s Innovation Hub

These are some of the motivators that drove ASIC to establish an Innovation Hub to help innovative, fintech startups navigate our regulatory system.

This is also consistent the Government’s deregulatory agenda. ASIC is looking to reduce red tape and improve our engagements with fintech businesses – rather than to change the key principles of what we do.

ASIC is committed to encouraging innovation, particularly where it can lead to better market and consumer outcomes. But it is important to note that the Innovation Hub will not compromise the fundamental principles of financial services regulation or the licensing process as reflected in ASIC’s strategic objectives. We need to maintain confidence in our financial system, including fintech.

ASIC’s Innovation Hub: Five point approach

Our Innovation Hub has five elements:

- The first element is engaging with other fintech initiatives, including physical hubs and co-working spaces that have been established for startup businesses. For example, Stone and Chalk, and here at Tyro.We intend to make senior ASIC staff available at places like Stone and Chalk from time-to-time to answer questions. We will closely monitor new initiatives and assist where we can.

- The second element of ASIC's Innovation Hub is streamlining how we facilitate business for new innovative business models. Innovative businesses can request informal assistance from ASIC. If innovators can meet some eligibility criteria, we will provide guidance about key regulatory issues that they should consider as they set up their business. We expect that these informal signposts or pointers should help businesses prepare more complete, considered applications for licences or waivers from the law. We think that this will make the application processes run more smoothly.
- The third element is establishing a new page on our website – a one-stop shop for innovative businesses to access information and services targeted at them.
- The fourth aspect of our Innovation Hub is the establishment of a senior internal taskforce. This taskforce includes senior staff from many teams in ASIC and is chaired by me. We want to take a 'One-ASIC' approach to new business models. The Innovation Hub Taskforce will also play an important co-ordination role in some of ASIC's new policy work, including on crowd-sourced equity funding, roboadvice, as well as any work that will follow from the Financial System Inquiry's recommendations on innovation.
- Finally, we have established the Digital Finance Advisory Committee, or DFAC for short.

What we have done so far

Our work on the Innovation Hub is well underway. We have set up a co-ordination team with members from across ASIC which is responsible for assessing the help requests we receive through the Innovation Hub.

These requests will be passed onto the subject matter experts in stakeholder teams where:

- the request relates to a genuine innovation, and
- the person has thought about their business model and obligations in enough detail.

The Innovation Hub webpage provides much more information, including the criteria we will use to decide whether to provide assistance. You can also subscribe to updates from ASIC.

DFAC held its first meeting in August. Its membership is made up of industry, consumer and academic representatives, some of who are here tonight. The meeting was also attended by observers from other regulators, and again, some are also here tonight. DFAC very usefully provided advice on tonight's presentation.

I now want to give you quickly a flavour of the level of engagement we have had so far.

Preliminary assistance

The coordination team is tracking matters that relate to innovative businesses – so far we have 35 entities listed on our register. We have had 42 external meetings and received a large number of requests for assistance to date. As you can see from the table there is a broad range of business models represented in this group. We have not provided assistance to all entities that have requested assistance – only to those that have met the criteria.

What we expect of you

I want to quickly touch on what we expect from you when you apply for assistance from the Innovation Hub.

First think about the timing of your request – you need a well-developed business model – you should know what your business will be, who your customers are, what services you'll be providing and how you'll be providing it.

We also want to know why you think your business is innovative, what differentiates it from other firms – in particular traditional businesses in the market. Our focus is to assist startups that have the potential to provide benefits to consumers – so please tell us what the benefits of your business are. And finally, have a go at understanding the regulatory issues yourself before you approach us.

Explore our website and do your analysis and tell us what your thoughts are. If we think you have missed something we'll tell you. And with that I'll hand over to Mark Adams, who will go into more detail about some of the issues we're seeing with some of the innovative business models so far. Thank you.

Part 2

Good evening all. As John said – our aim is to provide you background and general things to think about (or pointers) as you develop your business model and consider operating a financial services business.

Starting a business

I don't intend to go into any detail on the process of starting up a business other than two points:

- First, lots of handy information is located at ASIC's dedicated webpage, the Small Business Hub. There you will find information on business name and company registration and some guidance about choosing a business structure.
- Second, remember registering your business name does not give exclusive rights over the name – for do that you need to register a trademark with IP Australia.

Financial services framework

So, let's now get into the financial service framework and related issues.

Generally, if you carry on a financial service business or engage in a credit activity in Australia, you will need to hold a relevant ASIC licence or be authorised by a licensee. Similarly, if you operate a financial market you will need an Australian market licence.

So what are these kinds of businesses? It all turns on what is a financial service, what is a financial market and what is engaging in credit activities?

A financial service covers a broad range of activities, including the provision of financial advice or dealing in financial products and the operating of a managed investment scheme.

I will touch on 'what is financial advice?' later on when considering roboadvice, but let's just consider dealing, operating a managed investment scheme (MIS) and 'what is a financial product?'.

You are probably all familiar with the concept of a dealer as someone who trades a financial product on behalf of someone else, for example, a stockbroker. But the concept also includes 'arranging', which covers someone who provides a service that is more than administrative in the buying or selling of a financial product. For example, some online aggregators and price comparators are arranging. So, you may need to consider whether you are dealing.

When might you be operating a MIS? The easier case is when you operate a scheme where investors pool their money to invest in underlying products or assets. The more difficult situation is if you are operating a 'common enterprise'-like scheme – this is where investors may not pool money but enter an arrangement where their individually-owned assets are managed in a common way for financial benefit. Some fintech models may be an MIS, for example, many marketplace-lending services are established as MISs.

What is a financial product? It is a very broad definition that covers financial investments, financial risk-management products and non-cash payment facilities. In particular, these concepts include shares, bonds, MISs, derivatives, general insurance, life insurance contracts, superannuation, and foreign exchange contracts that are not immediately settled.

A financial market is generally a platform that facilitates secondary trading in financial products. This covers ASX and Chi-X, but also a range of alternative trading platforms. There are significant requirements that apply to a market operator.

I need to also touch on whether you are engaging in credit activities with a consumer. In general, you are providing such a service when you operate as a credit intermediary in relation to the provision of consumer credit (a little like dealing in financial products) and when you are providing credit that includes consumer leases (a little like being the product issuer). The rules ASIC administers cover loans to individuals, not businesses.

Before I move on, a crucial issue is whether you provide you financial services or products to retail or wholesale clients. Basically, retail is anyone who is not wholesale. You should start from the idea that most individuals are retail clients. There are exceptions for services to high-wealth individuals.

There is a lot more detail contained in ASIC's regulatory guides accessed via our website. However, it is critical to know if your business model requires authorisation.

Licensing – some issues

Let's assume you intend to operate a financial services or consumer credit business.

One alternative that may be available to you, rather than holding a licence, is to operate your business as an authorised representative of an existing licensee.

In this case, you may still have some specific obligations under the law (depending on your business, such as, being a financial adviser) but you will not need to obtain a licence. In this situation, the licensee is the entity that will set the compliance expectations for what you do – because the licensee is responsible for your business and you are providing services on their behalf. This will be a matter of commercial agreement. ASIC is not able to provide referrals to potentially interested licensees.

A number of existing fintechs have entered the market under this arrangement.

Many fintechs query whether they should be subject to many of the obligations under the law ASIC administers. This is something you can also manage to some degree. For example, the financial services licensing regime is able to be tailored in its application. In particular, it depends on:

- What service do you wish to provide. For example, you may wish to limit your business to a dealing in financial products.
- What products your service will relate to. For example, you may wish to limit it to financial investments but not derivatives and insurance products.
- Lastly, you may wish to limit your services to wholesale rather than retail clients

So, the more you limit the business, the easier it may be for you to get up and running. You can then develop a track record before considering expanding your financial service through a licence variation.

Another issue that fintechs raise about licensing is what kinds of skills and experience is expected of their staff to operate the business – just what is expected of 'responsible managers'?.

Let me say a couple of things about this issue:

- ASIC looks to an applicant to nominate senior staff with direct responsibility for significant day-to-day decisions about their financial services and that hold the relevant skills and experience for this purpose (i.e.: 'responsible managers').
- ASIC offers five options for these responsible managers to demonstrate the relevant skills and knowledge. The first four options relate to a combination of relevant qualifications or assessment and experience. The fifth option allows for an applicant to explain why they think their nominated responsible managers have the knowledge and skills for the services and products their role relates to. Whether you can rely on option five to demonstrate competency will turn on the particular facts. ASIC is prepared to exercise its discretion under option five.

Licensing process

So, you have determined you wish to apply for an Australian financial services (AFS) licence or credit licence. Here is a little about the process and what you need to do.

Make your application online. All information provided is treated by ASIC as confidential. Important information you will be asked to provide with your application includes:

- a description of your business model
- a table of organisational competence, which details the relevant knowledge and experience of your nominated responsible managers
- supporting material in relation to your nominated responsible managers, including business references, a police check, a bankruptcy check, and educational certificates, and
- Information about your financial resources, this may include a balance sheet and cash flow projection.

The system then checks to see if the form is adequately completed and relevant documents are submitted. If they are not, the application will be rejected because ASIC does not have sufficient information to begin assessment of the application.

The licensing team then undertakes an assessment to consider whether you are competent to provide the kind of financial service requested. The more details about your business you provide us in the initial application the easier it will be for us to understand and assess.

You may be asked to provide additional supporting information. You will be asked to provide this quickly so that the assessment process can continue efficiently.

As for timing, we set ourselves a service charter outcome of determining 70% of applications within 60 calendar days and 90% of applications within 120 calendar days. This is based on complete and timely submission of relevant information with ASIC.

Let me proceed to cover some issues that ASIC has identified relevant to particular kinds of business models or issues raised with us by the fintech sector to date.

Roboadvice

Let me start with roboadvice or automated advice.

Roboadvice has the potential to offer Australian consumers good quality, low-cost, financial advice. There is a lot of current interest in roboadvice models from new market entrants and from existing licensees (e.g.: banks and superannuation funds).

We have set up an internal Roboadvice Taskforce with members across ASIC to look at roboadvice issues. We may also issue some additional tailored guidance soon.

One of the first regulatory issues is whether your proposed model is designed to provide factual information, general advice or personal advice.

ASIC has already released a considerable amount of guidance on the topic of what is factual information, general advice and personal advice, as well as scaled advice. However, let me make some very general points:

- To be factual information the information has to be objectively ascertainable information and its accuracy cannot be reasonable questioned. ASIC has also provided waivers from the law to clarify that simple calculator and risk profile tools are not the provision of advice.

- To be financial advice it ordinarily involves an opinion or recommendation intended to influence a person to make a financial decision. General advice does not consider a person's individual circumstances or objectives. Personal financial advice does. If you were to say buy or sell 'ABC' shares to a wide range of investors – this will be general advice. If you tell an individual buy or sell 'ABC' shares where you have considered some of the person's circumstances or financial objectives – this will be personal advice.

Proposed roboadvice providers should carefully consider what kind of service they intend to provide.

Many of the proposed roboadvice providers we have seen plan to provide scaled or limited personal advice. For example, they only want to provide an online investment advice service and not provide a more comprehensive advice service. This is possible, but some key points are:

- The standards that apply to roboadvice and advice delivered by a human are identical.
- When a roboadvice provider is offering scaled advice it must be clear to the consumer at the start of their interaction with the roboadvice provider:
  - what advice is being offered and/or what advice is not being offered, and
  - what are the limitations of the advice (e.g. we have not considered your debt position).

Whether it is scaled or complete personal financial advice, the advice provided must be in the best interests of the consumer. There is no time to go through what all of that means. However, we expect to see a considered triage process. Any roboadvice model that results in all consumers receiving similar advice will raise a very serious red flag for us.

Now let me proceed to market place lending.

Marketplace lending

We note that marketplace lending has the potential to deliver benefits to borrowers and investors – potentially lower interest rates for some borrowers and perhaps a new investment opportunity for investors that gives them exposure to personal loans or business loans.

The product may have a number of potential risks to investors. These risks highlight the importance of good disclosure and sound compliance arrangements. Some of these issues include:

- whether investors will understand the nature of the product (including confusing it with a banking product)
- the importance of adequate credit assessments of borrowers by the operator – and recovery steps by the operator where a borrower fails to make payments, and
- the inherent conflict of interest of the operator matching borrowers to investors.

Just a few quick points on ASIC's approach to regulating the new sector:

- Based on the kinds of marketplace lending structures we are seeing to date, operators will need to hold an AFS licence to operate a MIS and a credit licence.
- We plan to publish guidance to assist industry to understand their obligations and things they may do to manage identified risks.
- We have published information on our consumer website, MoneySmart, to assist investors and borrowers to better understand marketplace lending, including its key risks.
- As for Roboadvice, we have also set up an internal working group that will help monitor developments.

Now let me touch on a related subject of crowd-sourced equity fundraising.

Crowd-sourced equity fundraising

Now, we know there is a lot of interest in what is happening on the proposed framework for crowd-sourced equity fundraising that allows investment by retail clients. This interest is both from potential intermediaries that want to operate such platforms and from businesses that may wish to raise capital via this route (including fintechs).

I note the law already permits fundraising without a prospectus. This includes offers to wholesale clients only and personal offers to no more than 20 individuals. Today, there are already crowd-sourced equity fundraising platforms operating in the wholesale market.

However, as for retail-related crowd-sourced equity fundraising, the Federal Government announced in August that it plans to proceed with a Bill later this year for a crowd-sourced equity fundraising framework that covers offerings by public companies. They also consulted on a possible crowd-sourced equity fundraising framework that covers proprietary companies. The final framework and timing will be a matter for the Government and parliament.

Whilst the details of a crowd-sourced equity fundraising framework for retail offerings are not known yet, the Government has indicated the essentials of the framework for crowd-sourced equity fundraising and public companies. These include:

- Providers of the crowd-sourced equity fundraising platform will need a special kind of AFS licence. These providers will be responsible for monitoring compliance for investments made via the platform.
- Issuers will need to prepare disclosure documents that are less burdensome than a prospectus. What is uncertain is whether all such issuers will need audited financial statements.
- Investors will be limited to investing no more than $10,000 per issuer and $25,000 per annum.

So, watch this space. The last business model I would like to briefly touch on is payments.

Payments

Firstly, the payments sector in Australia is one in which a number of the financial regulators all have an interest in – such as the RBA, APRA and AUSTRAC. ASIC will work with them to maximise efficient engagement with payments developments and applications.

ASIC has had a long history of dealing with providers of payments services such as stored value card providers and bill payment service providers. ASIC is monitoring e-wallet and blockchain technology developments.

Let me make a few points on payments:

- We would like to see that retail clients of payment service providers have common contractual rights and protections over and above the general consumer law protections. To this end, ASIC strongly encourages all such payment providers to sign up to the voluntary ePayments Code that ASIC administers. This code provides a consumer protection regime, including:
  - provision for disclosure of the terms and conditions of the payment facility
  - minimum expiry dates and disclosure of expiry dates
  - liability for unauthorised transactions, and
  - complaints procedures.
- On digital currencies, ASIC takes the view that they are not financial products as there is no right to payment in official currency. Our view was noted in the report of the recent Senate Inquiry. This does not mean that products or services in relation to digital currencies may not be under ASIC's remit (e.g.: derivatives in relation to digital currencies or a market that allows trade in derivatives over a digital currency). ASIC continues to review developments in this area.
- The other aspect of digital currencies is the underlying blockchain technology. This has potential to be truly disruptive. For example, for payment services such as remittance arrangement, and for settlement and registration arrangements for trading in shares and maybe other kinds of financial products. There are lots of commercial and practical issues that may arise in addition to regulatory issues. One example is who, if anyone, should be accountable for the provision of a financial service that makes use of this technology. In any case, ASIC intends to stay engaged on this – together with its regulatory peers.

Questions?

Remember, look at our webpage and consider seeking informal assistance – here is the webpage address asic.gov.au/for-business/your-business/innovation-hub/ – but you simply need to go to ASIC's webpage and search for Innovation Hub. You can contact us through our dedicated innovation hub email address.

So let's open it up for questions.