



ASIC

Australian Securities & Investments Commission

FinTech, Platforms and Wraps – The Future of Wealth Management Technology

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CHECK AGAINST DELIVERY

Introduction: The importance of culture

Culture is a set of shared values and assumptions within an organisation. It reflects the underlying ‘mindset of an organisation’, the ‘unwritten rules’ for how things really work. It works silently in the background to direct how an organisation and its staff think, make decisions and actually behave. Because culture lies at the heart of how an organisation and its staff think and behave, it is an important driver of outcomes for investors and financial consumers.

Culture matters to ASIC because poor culture can be a driver of poor conduct – and we regulate conduct. Companies should be interested in culture because many studies have found that good culture is good for business and generating long-term shareholder value.

Poor culture, on the other hand, can lead to misconduct and result in significant financial costs, including the cost of remediation, compensation and fines.

As a conduct regulator, we consider a positive culture as one that supports doing the right thing and good outcomes for customers.

When we find organisations that do not care that their delinquency culture is hurting consumers, then we must be firm and take action to deter this behaviour.

Poor culture, together with poorly designed financial incentives, can be an indicator and a driver of poor conduct. Identifying poor culture can help with detecting not just

individual instances of misconduct, but broader, more systemic problems. ASIC will be continuing to speak to boards and our regulated population about culture and we will be looking at our existing regime to determine whether it can be improved to address culture.

Innovation

Innovation in the fintech sector presents new challenges in this space. Innovation is not a new phenomenon, but its scale, breadth and potential, facilitated by technology, certainly is. A key trend in all of this is the development of technology enabled platforms that combine both demand and supply to disrupt existing industry structures.

ASIC is certainly seeing innovative business models in financial services. Think about business models like marketplace lending, crowd funding, robo-advice, payments and blockchain technology – these are just a few examples of the potential disruptive developments we're seeing. Many champions of these new technologies are not incumbents already operating in our markets but rather start-up businesses.

A major difference between the innovators/start-ups and incumbents however is that start up innovators often have limited resources: in terms of time, money and access to professional advice.

As new players, innovators may also lack experience of interacting with ASIC. Further, by their nature, innovative business models often need to be analysed carefully to see where they fit in the regulatory framework. These business models can test regulatory boundaries, creating uncertainty about how existing laws should be applied. Where we can, we work with the entity to help their business and cut red tape.

The recognition of the growing importance of the fintech sector and our plans to proactively engage with the sector were just some of the motivators that drove ASIC to establish the Innovation Hub, which aims to help innovative fintech start-ups navigate our regulatory system.

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.

ASIC's Innovation Hub

Our Innovation Hub is made up of five important elements. The first element is engaging with other fintech initiatives, including physical hubs and co-working spaces that have been established for startup businesses. We are making senior ASIC staff available at places like Stone and Chalk from time to time to answer questions.

The second element of ASIC's Innovation Hub is streamlining ASIC's approach to facilitating business for new innovative business models. Innovative businesses are able

to request informal assistance from ASIC. If the innovators 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 the informal signposts or pointers we provide should help businesses prepare more complete, considered applications for licences or for relief from the law. We think that this will make the application processes run more smoothly.

Another element is the establishment of a new area 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 creation of a senior internal taskforce. This Taskforce includes Senior Executive Leaders from many teams in ASIC and is chaired by my fellow Commissioner John Price. We will 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 marketplace lending, crowd-sourced equity funding, robo-advice, 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. DFAC is made up of industry, consumer and academic representatives.

In the first twelve months of operation, ASIC's Innovation Hub worked with 93 entities, with 66 receiving informal assistance. As a result, 15 previously unlicensed innovative businesses have received a new financial services or credit licence since March 2015.

The Innovation Hub has established relationships with international regulators in Europe, North America and Asia to discuss innovation developments and policy proposals.

Managed Discretionary Accounts

I'll now turn to Managed Discretionary Accounts, or MDAs.

MDAs have increasingly gained traction in the Australian market over recent years. The MDA market in Australia is growing and this trend is predicted to continue at an increasing pace. A recent research report by Morgan Stanley suggests that the MDA industry will heavily disrupt traditional asset manager business models over the next four years.

As we approach what is potentially the beginning of a new chapter for MDAs, ASIC has undertaken a review of our regulatory policy for MDA's.

The existing regulation of MDAs is largely contained in a class order and in some No Action Letters that were first issued as far back as 2002. The age of the No Action Letters creates uncertainty about the conditions we impose on MDAs and whether they are still valid.

Providers of MDAs under the No Action Letters are required to comply with different standards to those operating under the Class Order relief. We need to reflect on whether there are still valid grounds for this distinction.

There are other problems with the No Action Letters, such as ASIC not being able to ascertain which licensees are providing MDAs because these licensees do not require specific AFSL MDA authorisations. As a result there is a sector of the market that is largely opaque to ASIC.

For investors, there is a discrepancy between the documented licence authorisations and the services provided.

ASIC has recently reviewed the financial requirements for responsible entities of managed investment schemes (including IDPS-like schemes) and IDPS operators and AFS licensees that operate custodial or depository services. We have consulted on a proposal to increase the financial resource requirements for MDA providers to ensure that these requirements correspond with the requirements that apply to responsible entities of managed investment schemes and for platform operators.

We believe that it is important that MDA providers maintain adequate financial resources to operate their MDAs effectively and compliantly. However, we acknowledge that in some respects the risks for investors in MDAs are unique because the investor retains the beneficial ownership in the client portfolio assets.

Another potential area of risk within the MDA sector is MDAs investing in higher-risk investment products. Some MDA providers have discretion to invest in and trade in contracts for difference and other leveraged OTC derivatives on behalf of their clients. An investor can suffer significant losses in a short period of time and may end up with losses that exceed the value of the investment in their portfolio. Because the MDA provider makes discretionary investment decisions on behalf of the investor, the investor may not be aware of the positions held or of any losses, margin calls or other adverse events they are exposed to.

The MDA provider is required to outline the key risks of the MDA in the FSG and investment program but MDA investors are not given the PDSs for the underlying products and may not appreciate the risks involved when the MDA provider invests in highly leveraged products.

ASIC is keen to ensure that MDA investors are adequately informed about the specific risks if their MDA provider has discretion to invest in products with unlimited recourse.

An MDA provider can be subject to many conflicts of interest in the course of providing an MDA. Most enforcement matters that ASIC has investigated in relation to MDAs (aside from matters relating to unauthorised provision of MDAs) involve inadequate management of conflicts of interest by MDA providers and advisers.

Our experience is that some MDA providers do not prioritise their client's interests. Disclosure is often generic because the specific conflict has not yet arisen and at the time of signing the agreement the client may not have considered the implications of the

disclosure about conflicts of interest. Because the MDA provider can make transactions without reference to the client, the client may not be made aware of the conflict at all.

To address these concerns ASIC intends to provide more detailed regulatory guidance about the management of conflicts of interest for MDA providers.

Disclosure of fees and costs

Guidance around the quality of fees and costs disclosure for superannuation and managed investment products is another important area of focus for ASIC. Our objective is to address issues we have identified in this area that lead to inconsistency and under-disclosure of fees and costs, including underreporting of fees and costs associated with investing indirectly through interposed vehicles.

Accurate and consistent fees and costs disclosure is important for investors to make informed decisions about their investments. It also helps ensure that there is fairer competition between product issuers in the market.

After an extensive consultation, we made amendments to Corporations Regulations to clarify the regulatory requirements for fees and costs disclosure and in November 2015 published a revised version of our main guidance to industry in Regulatory Guide 97. We have been engaging with industry during the transition period to answer questions to help with the implementation of the revised requirements. We encourage you to contact us if you have any questions too during the remainder of this period.

These measures will assist trustees and responsible entities in ensuring that the fees and costs disclosed to investors are accurate and that fees and costs are disclosed more consistently across the industry.

We are continuing our engagement with industry to develop industry guidance that complements our regulatory guidance. We think industry guidance can help make further improvements.

We generally expect that the level of disclosed fees and costs may increase as issuers' disclosure of fees and costs becomes more accurate and more consistent. We think that this is would be appropriate as it means that investors are being better informed about the level of fees and costs that they are charged.

After the transition period, we expect to undertake compliance reviews to check how well issuers are complying with the disclosure requirements. In the first few months, up to 30 June 2017, we will take a facilitative approach. During this period, ASIC will take a measured approach should errors be identified in compliance with the requirements. This is provided if there is evidence that the issuer has acted in good faith to attempt to comply. At the same time, if we identified deliberate gaming of the disclosure requirements, we will take the appropriate enforcement action, including issuing stop orders and media release naming the issuer and reasons for the stop order.