

22 July 2016

Mr Richard McMahon
Acting Senior Manager
Deposit-takers, Credit and Insurers
Australian Securities and Investments Commission
Level 5, 100 Market Street
SYDNEY NSW 2000

By email: InnovationHub@asic.gov.au

Dear Mr McMahon,

RE: Consultation Paper 260 - Further measures to facilitate innovation in financial services

Thank you for offering an opportunity to comment on this **Consultation Paper 260 - Further measures to facilitate innovation in financial services** ("CP260"). This submission is made on behalf of MIntegrity, a specialist regulatory consulting firm that works collaboratively with market participants, operators and regulators to raise integrity standards across the industry (www.mintegrity.com.au).

Our submission, as outlined in the table in Appendix 1, provides comments that are designed to help ASIC in developing appropriate policies as they relate to the facilitation of innovation in financial services. In particular, we have attempted to include where appropriate information relevant to compliance costs, impacts on competition and also other impacts, costs and benefits.

MIntegrity would welcome an opportunity to provide ASIC with further information around the proposals that have been presented in CP260 and we look forward to further consultation with the industry where necessary.

Yours sincerely,

Andrew Tait

Co-founder | Managing Director | MIntegrity

Appendix 1:

Table: MIntegrity - CP260 Comments

ASIC Proposal	Question	Response
<p>A1 We are considering the options set out in paragraph 31. Our preferred option is Option 4 (i.e. a combination of Options 1–3).</p> <p>In this proposal, we are seeking your general feedback on our approach to further facilitating innovation in financial services.</p> <p>We are consulting in more detail on particular aspects of our proposals in Sections B and C.</p>	<p>A1Q1 Do you agree that we should put in place additional measures to facilitate innovation, or maintain the status quo? Please provide reasons.</p> <p>A1Q2 What benefits do you consider will result from our proposed approach?</p> <p>A1Q3 What disadvantages do you consider will result from our proposed approach?</p> <p>A1Q4 Are there any other options we should consider to meet our regulatory objective of further facilitating innovation, while ensuring that appropriate protections apply to all financial consumers?</p>	<p>A1Q1 Yes we believe that ASIC is positively supporting the Australian economy in terms of research and development in the financial services sector.</p> <p>A1Q2 The Sandbox exemption will allow FinTech start-ups to get to market quicker and at a lower cost, whilst providing Australia with the opportunity to become a main player in the global FinTech space.</p> <p>Alternative formats and information technology methods will improve financial options for the Australian public.</p> <p>A1Q3 The options will not assist with a range of other regulatory hurdles facing Fintech start-ups (including KYC, ACL and responsible lending obligations). Although many of these are not within ASIC's powers, it highlights the need for a cross-regulator approach to these matters.</p> <p>A1Q4 We believe that extending the scope of financial services allowed in the sandbox would further facilitate the situation to allow for innovative financial products to be offered to clients.</p>

ASIC Proposal	Question	Response
		<p><i>Digital devices used by clients</i></p> <p>We suggest that ASIC considers adding guidance on the presentation of disclaimers and disclosures given the variety of devices used by retail clients in the current market. Smartphones and ipads carry the biggest risk in terms of misleading and deceptive presentation. The format of financial advice could be covered here in relation to scaled advice specifically where a small screen precludes full information on one page or splitting of information that may be perceived in a manner not intended by the licensee.</p> <p>Formatting and appropriate font size as well as ensuring that the message is not lost where the client has to scroll through multiple pages to receive the same message as one full screen of a standard PC screen.</p> <p>The anti-money laundering and counter terrorism legislation would be additional considerations that are key in terms of investment through Fintech start-ups. Criminal organisations may target these easier methods of advice provision and investment if these requirements are not included in a coordinated manner.</p>

ASIC Proposal	Question	Response
<p>B1 We propose to provide additional guidance on how we assess submissions about a responsible manager’s knowledge and skills under Option 5 of RG 105. This will include:</p> <p>(a) more detail about what we expect a prospective AFS licensee to include in its submission; and</p> <p>(b) examples of situations where we generally would (or would not) consider that a responsible manager has the appropriate knowledge and skills (see Example 1 to Example 4 below).</p> <p>Note: We are not proposing to change how we assess submissions under Option 5 of RG 105 in this proposal.</p>	<p>B1Q1 Do you agree with this proposal? Please give reasons for your answer.</p> <p>B1Q2 Do you think the examples provided below are helpful? If not, why not?</p> <p>B1Q3 Subject to the other proposals in this paper, is there anything else you think we should cover in our updated guidance on Option 5 of RG 105?</p>	<p>B1Q1 This further guidance will improve clarity in the market. Examples and detail will enhance the situation for both AFSL and non-AFSL holders.</p> <p>ASIC is not proposing to change the way it assesses these submissions. It is, however, proposing to give more detail about what it expects a prospective AFS licensee to include in its submission, and give examples of where it would consider a responsible manager has (or does not have) the appropriate knowledge and skills.</p> <p>B1Q3 No other suggestions here.</p>

ASIC Proposal	Question	Response
<p>B2</p> <p>We propose to amend RG 105 so that a small-scale, heavily automated business would be able to meet its organisational competence obligation by nominating responsible managers in the following two categories: (a) responsible managers (as currently defined in RG 105) that have knowledge and skills that are relevant to some, but not all, aspects of the financial services the business will provide; and (b) an appropriately regulated and experienced professional third party that will provide sign-off for the remaining aspects of the business's financial services.</p>	<p>B2Q1 Do you agree with this proposal? Please give reasons for your answer.</p> <p>B2Q2 What sort of professionals should ASIC accept as responsible managers that provide sign-off?</p> <p>B2Q3 Are there any other situations where this type of flexibility should be available?</p> <p>B2Q4 Are there any risks associated with this proposal? If so, what are they?</p> <p>B2Q5 Please estimate any cost savings that a new business would expect to realise from this proposal.</p>	<p>B2Q1 We believe that a more flexible assessment of Organisational Competency would assist the industry by allowing for new technical capabilities (such as in the case of Robo Advice) and class licenses that don't yet exist (such as in the case of Crowd-Funding).</p> <p>B2Q2 ASIC could accept an individual meeting the requirements of RG 105 to be a Responsible Manager or otherwise a third party as stated.</p> <p>B2Q4 ASIC would preclude conflicts of interest if it specified that the Responsible Manager should not be an employee, agent or in any way linked to the Sponsor. Conflicts of interest can preclude any benefit from engaging a professional third party. Adopting similar guidelines on the Independence of Experts and Managing Conflicts of Interest, to those outlined in ASIC RG100.67 – RG100.77, may help reduce the risks associated with the appointment of third parties that provide the contemplated sign-off.</p> <p>B2Q5 Cost savings may include the income, benefits and superannuation payable to a fully employed Responsible Manager and the training associated with this role. However the cost of hiring the third party could</p>

ASIC Proposal	Question	Response
		be significant given the onerous nature of the sign-offs necessary.
<p>B3 We propose that a professional third-party responsible manager providing sign-off under proposal B2 would be required to examine all the relevant material and certify that the AFS licensee is materially compliant with ASIC-administered legislation.</p> <p>We propose that:</p> <p>(a) sign-off would be required every 12 months, or on significant changes to the AFS licensee’s operations; and</p> <p>(b) the AFS licensee would need to lodge a copy of the sign-off with ASIC. Responsible managers who provide a sign-off that contains false or misleading statements may commit an offence under s1308 of the</p>	<p>B3Q1 What sort of sign-off should a third-party responsible manager be required to provide?</p> <p>B3Q2 Is an annual sign-off appropriate?</p>	<p>B3Q1 The requirement in s989B(3) of the Corporations Act based on paragraph 52 of the CP 260 requires a third party responsible manager to lodge with the statement and balance sheet, an auditor's report with ASIC containing the information and matters required by the regulations. The third party responsible manager is required to prepare a statement of opinion on the effectiveness of internal controls used by a financial services licensee. Regulation 7.8.13 sets out requirements for auditors of AFSL holders. Currently the draft CP 260 is requiring a standard required of auditors and internal Financial Services teams of standard large corporations. For small start-ups this could pose a financial strain of compliance. The cost of obtaining such a sign-off from a third party responsible manager may preclude the exercise of trying to encourage innovation.</p> <p>We suggest a less onerous form of sign-off would be more appropriate for small start-ups in terms of cost and availability. However the sign-off would simultaneously need to demonstrate an appropriate level of understanding of the business, internal controls, financial position e.t.c.</p>

ASIC Proposal	Question	Response
Corporations Act.		<p>We suggest that where the start-up has engaged accounting and financial professionals, the third party responsible manager could in part leverage off sign-offs already provided for the period in relation to profit and loss.</p> <p>B3Q2 Yes annual sign-off or upon material change is appropriate in our view.</p>
<p>B4 We propose that proposal B2 will only apply to AFS licensees that:</p> <p>(a) provide financial services to no more than 1,000 retail clients; and</p> <p>(b) only give advice on, or arrange for another person to deal in, liquid financial products, non-cash payment facilities, and products issued by a prudentially regulated business.</p>	<p>B4Q1 Do you agree with our proposed restrictions on the types of business eligible for this flexibility? For example, is a limit of 1,000 clients appropriate?</p> <p>B4Q2 Are other restrictions—such as an exposure limit on investment products—also warranted?</p>	<p>B4Q1 Yes we consider these limits to be appropriate and understand the need for the limitations in place. This could be re-visited at a later stage once the exemption in in practice after a 12 month period.</p> <p>B4Q2 We do not consider the facilitation of clients dealing in products issued by a prudentially regulated business, as high risk. Hence exposure limits on investment products would not add value in our view given that these products are issued by prudentially regulated businesses and not the testing business itself as per the terms of the sandbox exemption.</p>
<p>C1 We propose to give conditional, industry-wide relief to allow new Australian businesses to test certain financial services for one period of six months without</p>	<p>C1Q1 Do you agree with this proposal? Please give reasons for your answer.</p>	<p>C1Q1-Q4 Yes we do agree and note the following points:</p> <ul style="list-style-type: none"> An expansion of the types of Financial Services that start-up companies may test in the Sandbox;

ASIC Proposal	Question	Response
<p>needing to obtain an AFS licence. We refer to this as the 'regulatory sandbox exemption'. We propose to place the restrictions and conditions outlined in proposals C2–C9 on the licensing exemption to ensure that: (a) the risk of poor consumer outcomes is minimised; and (b) activities carried out under the exemption are limited to early-stage testing (i.e. concept validation). We will continue to consider requests for an individual exemption by businesses that do not meet the terms of the industry-wide relief.</p>	<p>C1Q2 Do you agree the exemption should only apply to new Australian businesses? If not, who else should be eligible, why and on what conditions?</p> <p>C1Q3 Please estimate any cost savings that a new business would expect to realise from this change.</p> <p>C1Q4 Please estimate any additional costs or savings that consumers might be expected to incur as a result of this change.</p>	<ul style="list-style-type: none"> • At the expiration of the 6 month Sandbox timeframe, we believe that start-ups should be allowed to continue trading should the relevant licence application still be under review, in order to minimise disruption of business. Allowances and processes will need to be in place for this to occur. Given the cost and expense of hiring staff, locating premises, building technology and otherwise completing the tasks necessary for the launch of a new Fintech business, there would be value in allowing a business to continue to trade while ASIC considers its regulatory applications (including applications for relief which may be required to deal with existing laws which do not allow the new business to operate as proposed). If the approval is not forthcoming then the exemption can expire. • The practicalities of allowing for a streamlined licensing process that allows for the 6 month period, complaint and dispute resolution processes, and Service Level Agreements for ASIC would aid the situation; • Provisions to extend the Sandbox time limit beyond the 6 months if they fail to meet licensing requirements within that 6 months due to reasons outside their control, such as delays in engagement with ASIC or other

ASIC Proposal	Question	Response
		<p>affiliated Legal or Government bodies;</p> <ul style="list-style-type: none"> • Implementing a progressive training and qualification program for Sandbox participants to meet the Responsible Manager requirements themselves rather than incurring ongoing supervision and thus increased cost from 3rd parties; • The development of guidelines and standard assessment criteria for Sandbox sponsors to remove sponsor profit incentives and expand Sandbox access to a much wider set of the Community nationally. • Consumers may incur costs such as lost revenue resulting from negative investment returns or inappropriate advice. Savings might include less fees and more creative methods of obtaining advice and investing.
<p>C2 We propose that the industry-wide AFS licensing exemption should only apply to:</p> <p>(a) giving financial advice in relation to listed or quoted Australian securities, simple managed investment schemes and deposit products; or</p> <p>(b) arranging for other persons to deal in</p>	<p>C2Q1 Our industry-wide proposal only covers giving financial advice and arranging for other persons to deal in a financial product. Do you believe there are other financial services that should be covered by the licensing exemption? If so, what risks would a wider exemption create</p>	<p>C2Q1 Many Fintech companies would not be able to utilise the sandbox exemption because of the limitation on its application. This would be a disadvantage faced by Australian Fintech start-ups to those in other jurisdictions which do not have similar limitations placed on the nature of the product that can be tested using the new regime. The sandbox exemption is of limited application and does not allow for designing and taking to market a new financial product developed by the start-up.</p>

ASIC Proposal	Question	Response
<p>the products in C2(a). We will continue to consider requests for an individual exemption by businesses using a different business model.</p>	<p>and how could these risks be mitigated? C2Q2 Our industry-wide proposal only covers services that relate to listed or quoted Australian securities, simple managed investment schemes and deposit products: (a) Are there any other products that should be covered by the proposal, such as non-Australian listed or quoted securities or general insurance contracts? If so, why and on what basis? (b) Should the exemption cover services in relation to a wider range of products where the testing business only deals with wholesale clients? If so, what product classes should be included?</p>	<p>In the UK, businesses can test innovative products, services, business models and delivery mechanisms in a live environment without immediately incurring all the usual regulatory obligations. However we agree that insurance products would be excluded from the sandbox playing field. C2Q2(c) Additional risk to consumers could be mitigated by having a cross-jurisdictional review including anti-bribery and corruption, anti-money laundering, privacy and misleading and deceptive conduct laws and regulation covered.</p>

ASIC Proposal	Question	Response
	(c) If you believe the exemption should be extended to less liquid or more long-term arrangements, how could any additional risk to consumers be mitigated?	
<p>We do not propose to provide industry-wide relief to existing AFS licensees. We will continue to consider requests for relief by existing licensees on a case-by-case basis.</p>	<p>C3Q1 Do you agree with this proposal? Please provide reasons for your answer.</p> <p>C3Q2 Are there issues related to innovative services from existing licensees that could be dealt with on an industry-wide basis? If so, what are they?</p>	<p>C3Q1 – Yes we agree with this proposal. FinTech start-ups will be applying for an AFSL during the 6 month period. Existing AFSL holders will have more onerous requirements imposed on them in the short term in some respects but the recipients of the sandbox exemption will have the benefit of the exemption for a relatively short time period.</p>
<p>C4 We propose that the AFS licensing exemption in proposal C1 should only apply where the testing business:</p> <p>(a) provides services to no more than 100 retail clients, each with a maximum</p>	<p>C4Q1 Are the retail client exposure limits we have identified appropriate?</p> <p>C4Q2 An alternative approach would be for the exposure limit of retail</p>	<p>C4Q1 and C4Q2. We believe a graduated approach would be more appropriate. If ASIC provided a tiering of retail clients’ assets and the consequent exposure limits, this would be an improved way of providing a more sensitive approach to the industry allowing for varying levels of risk appetite.</p>

ASIC Proposal	Question	Response
<p>exposure limit of \$10,000; and (b) ensures the total exposure of all clients (wholesale and retail) is less than \$5 million.</p>	<p>clients to vary depending on each client's total net assets: (a) How easy would it be to comply with a more graduated exposure limit? (b) Would any benefits with this approach outweigh the resulting complexity for the testing business? (c) Are there any risks with a graduated approach?</p> <p>C4Q3 Are there other ways that we could facilitate innovation while limiting the risk of loss to any one individual?</p>	<p>However we also understand ASIC's position whereby the costs far outweigh the benefits in many respects. Greater flexibility here could be balanced against the fact that long-term investments have been excluded.</p>
<p>C5 We propose that the AFS licensing exemption in proposal C1 should only apply if the testing business maintains adequate compensation arrangements.</p>	<p>C5Q1 Do you believe that testing businesses will be able to obtain professional indemnity insurance to compensate retail client losses?</p> <p>C5Q2 What other compensation arrangements could be used by</p>	<p>C5Q1 The position of consumers who may have claims against the business if they suffer loss as a result of investing with a sandbox-exempted business is not clearly set out in CP 260. If it is the intention that consumers will not have the same rights as they would have under the law (for example, the ability to access remedies which would be available if the Fintech was fully regulated) then this would require clear disclosure along with a description of the consumer's rights</p>

ASIC Proposal	Question	Response
	<p>testing businesses (e.g. group cover or mutual fund schemes)? What practical issues exist with other compensation arrangements?</p>	<p>in the absence of full regulation. A mandated disclosure that the business is operating subject to the sandbox and the consequences would be one way of addressing this issue.</p> <p>Testing businesses may not be able to afford professional indemnity insurance. However given the limitations on the scope of the sandbox exemption and the limit to the exposure for retail and wholesale clients, this may reduce the costs of insurance. More investigation and specialist advice in this area would be required. Feedback from Fintechs would be desirable on this point. Australian insurance companies tend not to be very focussed on creative products for these situations and the risk might be too high to be able to price an appropriate product for testing businesses.</p> <p>C5Q2 Group schemes and mutual fund schemes have many advantages. However over-diversification and fees associated are generally high given annual expense ratios. Members of a group scheme or mutual fund who have invested in the sandbox, would be claiming simultaneously if there was a major or systemic problem with the business and its services. Insurance liabilities and reinsurance costs would consequently need to be factored into the solution.</p>

ASIC Proposal	Question	Response
<p>C6 We propose that the AFS licensing exemption in proposal C1 will apply only if the testing business:</p> <p>(a) is a member of an ASIC-approved external dispute resolution scheme;</p> <p>(b) complies with the modified disclosure requirements; and</p> <p>(c) complies with the best interests duty and conflicted remuneration provisions as if the business were an AFS licensee.</p>	<p>C6Q1 Are the compliance conditions we have identified—in relation to dispute resolution procedures, disclosure and conduct (i.e. best interests duty and conflicted remuneration)—appropriate? If not, please provide reasons.</p> <p>C6Q2 Are there any other consumer protections that should apply to clients of testing businesses? If so, what are they?</p>	<p>C6Q1 Yes we think that these requirements are necessary for any business offering financial services to the public.</p> <p>C6Q2 Please refer to C5Q1.</p>
<p>C7 We propose that the AFS licensing exemption in proposal C1 will apply only if the testing business is ‘sponsored’ by an organisation (‘sandbox sponsor’) recognised by ASIC. We propose that sandbox sponsors will be not-for-profit industry associations or other Government-recognised entities.</p>	<p>C7Q1 Do you support the requirement for a testing business to be ‘sponsored’ by an industry organisation? Please give reasons for your answer.</p> <p>C7Q2 What types of entities should</p>	<p>C7Q1-Q5</p> <p>Start-ups in the sandbox will need to maintain consumer protection, such as dispute resolution, compensation arrangements and disclosure obligations and will need to obtain “sponsorship” from an ASIC-approved organisation.</p> <p>The industry would benefit from a clear mandate from ASIC in relation to sponsorship of start-ups. Sponsorship would ideally be granted without a fee for</p>

ASIC Proposal	Question	Response
<p>The ASIC-approved sponsors would be named in the licensing exemption (and could be updated from time to time). We expect sandbox sponsors to only sponsor testing businesses if: (a) that business is operated by fit and proper persons; and (b) they have conducted a preliminary assessment that the testing business's proposed business model is reasonably sound and does not present significant risks of consumer detriment.</p>	<p>ASIC approve as sandbox sponsors?</p> <p>C7Q3 How should ASIC ensure that a sandbox sponsor is only sponsoring appropriate testing businesses?</p> <p>C7Q4 What circumstances should a sandbox sponsor take into account when sponsoring a testing business so that the business can rely on the licensing exemption?</p> <p>C7Q5 What costs, if any, would testing businesses incur in obtaining sponsorship?</p>	<p>service. Sponsors would otherwise have a vested interest that may create unequal opportunities for some start-ups. There is also a possibility that sponsors could choose to sponsor start-ups with interests in existing members and start-up companies could influence the market if they are in a superior position.</p> <p>The number of potential sponsors in the market place could limit competition in the sector. These factors could be considered in the final Consultation Paper if ASIC considers necessary.</p>
<p>C8 We propose that a testing business will need to:</p> <p>(a) notify ASIC that it intends to rely on the AFS licensing exemption in proposal C1 from a specified date;</p> <p>(b) provide evidence of sponsorship from a</p>	<p>C8Q1 Do you agree with this proposal? Please give reasons for your answer.</p>	<p>C8Q1 Yes we agree. Given the exemption granted we believe that the testing business would need to advise ASIC, provide a declaration as per (c) and that a short report is justified so that ASIC can learn from the experiences of these businesses to develop further fine-tuned guidance in the future.</p>

ASIC Proposal	Question	Response
<p>sandbox sponsor (see proposal C7); and (c) declare that it has reasonable grounds to expect that it can operate its business for a period of six months from the specified date.</p> <p>We also propose to require that testing businesses give us a short report about their test following completion of the testing period.</p>		
<p>C9 We propose that ASIC will have the power to withdraw the AFS licensing exemption in proposal C1.</p>	<p>C9Q1 When should we exercise our power to withdraw the licensing exemption?</p>	<p>C9Q1 The advertising of financial services in Paragraph 101(b) is particularly useful.</p> <p>We believe that ASIC could assist by specifying that it has the power to withdraw the exemption where there has been any breach of Anti-Money Laundering and Counter Terrorism laws, Anti-Bribery and Corruption laws, Misleading and Deceptive Conduct laws, regulations and guidance from Regulators.</p>