



ASIC

Australian Securities & Investments Commission

Financial innovation: ASIC's role and how it affects you

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CHECK AGAINST DELIVERY

Introduction

Good morning, everyone. Thank you to Norton Rose Fulbright for inviting me to speak today.

The topic of this year's Symposium, financial innovation, is indeed a highly relevant one. Like the world around us, our financial services and markets are being transformed by innovation. This presents both opportunities and risks for industry, and for regulators.

For industry to successfully realise any opportunity in a sustained way – and this especially applies to opportunities from financial innovation – they must not lose sight of the foundation of their success.

It is here where industry and regulators have a common interest – in seeing innovation that fosters investor and financial consumer trust and confidence.

In terms of the risk, digital disruption and financial innovation-driven complexity from products, markets and technology were identified by ASIC in our *Strategic Outlook* for 2014–15 as two of the challenges ASIC faces in delivering on our regulatory strategic priorities of:

- promoting investor and financial consumer trust and confidence, and
- ensuring fair, orderly and transparent markets.

Today, I want to talk from a regulator's perspective about how the opportunities from financial innovation can be harvested while the risks are mitigated. In particular, I'll talk about:

- making innovation work for the consumer, and

- ASIC's new innovation hub to help encourage innovation in our financial services and markets.

Making innovation work for the consumer

Now to my first topic – making innovation work for the consumer. Here, I'd like to talk about:

- putting the customer first to succeed, and
- responsible product design.

Putting the customer first to succeed

For me, what makes digital disruption and our rapidly growing financial technology (FinTech) industry exciting is that it provides business with new ways of creating and sharing value with their customer. Disrupters are offering new forms of:

- intermediation – like crowdfunding and peer-to-peer lending which provide access to capital
- disintermediation – here, digital currencies come to mind, and
- services – such as 'robo' financial advice.

Sustainable success by both disrupters and incumbents involves providing a demand-driven offering that puts the customer's interests at the core of what they do and embeds putting the customer first into their operations. For example:

- having a culture that targets products and services to the right customers, not just any customer, and
- putting the customer first, both when things are going well but also when they are not.

This is especially important because the business of financial services usually involves a relationship with customers over a medium or long term. These relationships must have an eye to the long-term best interests of the customer if they are to engender and maintain trust and confidence.

Responsible product design

Talking about targeting products to the right customer takes me to my next topic – responsible product design.

This was considered in the Murray Inquiry, which noted that:

'To promote positive consumer outcomes, product issuers and distributors should take greater responsibility for the design and targeted distribution of products.

This should strengthen consumer confidence and trust... and reduce the number of cases where consumer behavioural biases and information imbalances are disregarded.'

Behavioural biases

Behavioural biases often affect investor decision making. For example, in the investment world:

- investors tend to have a bias towards default options
- investors tend to prefer a small reward today over a larger one later
- investors tend to disengage when faced with complexity and too many options, and
- investors are influenced by nudges, framing and, most importantly, their relationship with the person delivering the message.

Behavioural biases in consumers have often been exploited in the name of free enterprise. A lot of marketing is designed to appeal to those biases. However, in some cases, the exploitation takes on a sinister motive and comes at the expense of consumer trust and confidence.

Having the customer-centric focus I mentioned earlier recognises – in product design and distribution processes – that exploiting these biases may destroy trust and confidence. At ASIC we want to see:

- products designed to provide utility for the target consumer market for which they are intended
- consumers having access to financial products that will meet their needs
- products operating as investors and consumers have been led to expect they will, and
- when consumers are sold products, they can take on the level of risk associated with the product in an informed manner.

Peer-to-peer (P2P) lending

ASIC's recent experience with emerging P2P lending models provides an interesting case study on innovation and product design. At a high level, P2P lending facilitates individuals and sometimes businesses borrowing from retail and wholesale investors through a platform. There is no bespoke regulatory regime for P2P lending in Australia. The different business models used for P2P lending will require different regulatory approvals. Many may be managed investment schemes, often with an associated credit facility that requires the operator to also hold an Australian credit licence – however, not all are. Some models may actually involve operating a financial market. This would require the platform operator to hold an Australian markets licence or be covered by an exemption.

If you are unsure what approvals or waivers from the law you need, we recommend talking to ASIC. Early engagement makes the process more efficient for you and for us. Our new innovation hub, which I will talk about later, may also help with this.

So once a P2P lender is up and running, what does it mean to be regulated by ASIC?

To pick up on some of the points I made earlier about investor and consumer trust and confidence, I'd like to talk about disclosure and transparency. As with any new type of

financial product, ASIC is keen to ensure that retail investors have a proper understanding of P2P before they decide to invest in it.

Disclosure – whether legally mandated through a PDS or by other means – is an important part of helping investors understand what they are getting. It is essential that disclosure covers key risks and benefits in a balanced way, as well as explaining clearly how the P2P platform works.

Advertising is another area that ASIC is focusing on. Advertising can be very powerful in influencing investors and consumers. Advertising of P2P products, like any other financial product or service, must not be misleading or likely to mislead.

For example, promotional materials for a P2P product should not inappropriately compare the product to a traditional banking product. The risk that an investor takes on in a P2P product is far different to those in a banking product. This includes:

- credit risk from borrowers
- risk of losing their entire investment, and
- a risk of failure of the product provider.

To avoid being misleading, or potentially misleading, promotional material relating to P2P products should be clear, accurate and balanced. ASIC has published good practice guidance on advertising by product issuers and distributors in Regulatory Guide 234 *Advertising financial products and advice services including credit: Good practice guidance* (RG 234).

ASIC's innovation hub

Now, to my final topic, ASIC's innovation hub. Financial innovation presents both opportunities and risks for ASIC and the industry.

At ASIC, we are keen to do what we can to help industry take advantage of the opportunities on offer, provided it does not compromise investor and financial consumer trust and confidence.

We have recently launched an innovation hub to help make it quicker and easier for innovative start-ups and FinTech businesses to navigate the regulatory system that we administer. There are five components to our hub which we will be establishing over the coming months:

- First, we will participate in other FinTech initiatives, such as Stone and Chalk, where appropriate. We want to work cohesively with government and industry in this area. We will closely monitor any other new initiatives and offer our assistance where we can.
- Second, we will streamline ASIC's approach to facilitating business for new business models. For example, by looking to streamline common application processes, including applying for or varying a licence and in granting waivers from the law.

- Third, we will look at making ourselves more accessible to new types of businesses. For example, by developing a portal on our website – a one-stop shop for innovative businesses to access information and services directly targeted at them.
- Fourth, within ASIC, we will adopt a coordinated approach to applying any reforms that may apply to innovative businesses in the future.
- Lastly, we will establish a Digital Finance Advisory Committee with members from a cross-section of the FinTech community to help inform how we focus our efforts in this area.

We are committed to doing what we can to facilitate – and make ourselves more accessible to – innovative businesses that genuinely benefit consumers.

Conclusion

Ladies and gentleman, thank you for your attention today.

I'd like to leave you with something that has been a recurring theme in my speech today. To successfully realise the opportunities from financial innovation, both industry and regulators have a common interest in seeing innovation based on investor and financial consumer trust and confidence.

When this occurs, we can all enjoy the benefits of sustainable growth in our financial services and markets.