

20 May 2016

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Australian Securities and Investments Commission

By Email: brooke.stewart@asic.gov.au

OUR REF:

**COMMERCIAL-IN-CONFIDENCE**

**CP 254 – Regulating Digital Financial Product Advice**

Dear Ms Stewart,

I enclose the attached submission to ASIC on behalf of Fintech Australia Inc. In our opinion the comments we have made below will provide more clarity for digital adviser providers, and provide them with more flexibility to operate their businesses and provide affordable advice which is in the best interest of their clients. The result will be a larger digital advice industry and more Australians seeking advice.

Online digital advice is significantly different to personally delivered advice in a number of important respects:

- Advice is generally provided iteratively, subject by subject, rather than holistically; e.g. debt reduction, asset protection, optimising superannuation;
- The client directs the desired scope and comprehensiveness of the advice; not the advice provider;
- The quality of the advice is entirely dependent on the accuracy of the information provided by the client; the digital advice provider has limited ability to verify that information

There is considerable variety in the nature of the digital advice services; some limit their services to strategic financial planning advice, i.e. no product advice or dealing. Others provide only financial product advice and dealing only. Some provide both. Some digital advice services cover only part of the financial planning advice spectrum, e.g. superannuation only or non-super only.

The differences in offering are highlighted by the broad set of views that our members raised when preparing this response. This would suggest that any regulation needs to be flexible enough to deal with very different types of technology and digital advice business models as well as the future advances that the technology and business models may make.

It should be noted that in its recent feedback, the UK FCA stated “among respondents there was significant agreement that regulatory requirements can inhibit firms from using a more innovative approach in how they communicate information to consumers.” The FCA appears to have recognised that this is fundamental to the industry's attempts to innovate and proposes to provide further guidance in Spring 2016 (See <https://www.fca.org.uk/static/fca/article-type/feedback%20statement/fs16-02.pdf>).

While ASIC's recent guidance for personal digital advice is helpful, additional guidance is required to recognise and support the unique features of online digital advice in a number of areas which are outlined below.

Please do not hesitate to contact the writer if further information or clarification is required.

Yours sincerely

A handwritten signature in black ink, appearing to read "Simon Cant". The signature is fluid and cursive, with a large initial 'S' and a long horizontal stroke at the end.

President, FinTech Australia

**A1 PROPOSED REGULATORY GUIDE**

<b>We propose to release draft Regulatory Guide 000 Providing digital financial product advice to retail clients (RG 000) to assist digital advice providers in complying with the law.</b>	
A1Q1	<p><i>Overall, is the proposed guidance helpful? If not, why not?</i></p> <p>The proposed guidance is helpful for the digital advice industry. Most importantly, it conveys a message that ASIC is comfortable with the concept of digital advice in principle, subject to meeting regulations. In addition, it helps new entrants understand their regulatory obligations, and assists the industry in understanding how ASIC believes the law should be applied to digital advice.</p> <p>We would like to see the guidance go further. In particular, we recognise that there are different types of advice (and in particular digital advice). Advice can be strategic, investment-only, or scaled in different ways. It would be helpful if the guidance applied ASIC's views to these different types of advice wherever possible. [Claire: Feel free to elaborate].</p>
A1Q2	<p><i>Is our proposed guidance (in Section D of the draft regulatory guide) helpful in assisting digital advice providers to provide scaled advice that is in the best interests of clients? If not, why not?</i></p> <p>The guidance is helpful, and we would like to see it go further. While it distinguishes between scaled and comprehensive advice, we would like to see the guidance applied to all combinations of scaled general advice, scaled personal advice, comprehensive general advice, and comprehensive personal advice. Scaled advice also exists in a spectrum from one-issue advice through to full comprehensive advice.</p> <p>We believe that comprehensive digital advice may be provided as general advice without triggering the personal advice best interest duty and disclosure requirements. We understand that existing digital advice platforms are operating within the existing regulations regarding personal and general advice, and as such this may be the basis for any additional interpretation, but we would like further guidance of what ASIC considers to constitute general advice in a digital context.</p> <p>Some digital advice providers will want to determine the scope of the advice themselves based on the information they have received, or based on the type of advice they have the expertise to provide. Other providers will prefer to give their clients the opportunity to identify the scope of the advice based on their needs (or what they think their needs are). We would like to see both models accommodated.</p> <p>As such a broad scope of advice to be provided could be issued prior to any specific advice being given. In the context of:</p> <ul style="list-style-type: none"> <li>• “Explain to the client from the outset what advice is being offered and what is not being offered” – Some Digital Advice providers offer the same type of advice to all clients (for example providers who provide only investment advice). In other cases, the digital advice provider won't be able to determine the scope of the advice until the client has provided more information, at which time the provider will know what type of advice is appropriate for this client. By way of comparison, a human adviser might read the client's information and then contact the client to confirm the scope of the advice. We request that ASIC clarifies the words “from the outset”, specifically relating to the</li> </ul>

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broader scope of advice that can be offered, and further state that the scope be stated “at an appropriate stage of the process” or similar.

In addition we do not agree with the following:

- “Filter out clients for whom the advice being offered is not suitable, or who want advice on a topic outside the scope of the advice being offered” – If a client wants advice on say 2 topics, we believe they should be able to obtain that advice from 2 advisers (whether digital or human), each of which covers one of the topics. The client should not be filtered out, rather they should be informed of the limitations of the advice and that they might want to obtain additional advice elsewhere. The same comment applies to clause RG 000.96.
- “Inform the client about the upfront and ongoing costs of the advice before the advice is given (ie in an FSG) and also before the advice is implemented (ie in a SOA) – There may be more appropriate places to disclose fees in a dynamic online experience rather than FSGs and SOAs. Furthermore, it would be impractical to make any statements about fees in a FSG apart from a generic statement such as the ability charge various types of fees.

In general we believe the disclosure requirements between digital and face-to-face advice should remain the same in principle. However, flexibility as to how that disclosure is issued may require more consideration within a digital context, which may mean a different means of providing FSGs and SOA. For example, within the US context, a general statement of disclosure is issued in the agreement between the platform and the client (in much the same way that a PDS might be used) but this broad disclosure applies to the specific advice that is given to the client, tailored for the individual, and scenarios like live market data versus static model portfolios.

While we agree that an FSG and SOA provide a means for the client to refer to the advice that is being given, having the flexibility to disclose information at a relevant point in a dynamic process may make more sense for a client. By way of example, in a digital context this could be a very simple automated update as a Record of Advice.

**B1 RESPONSIBLE MANAGER REQUIREMENTS**

**We propose to require that a digital advice licensee has at least one responsible manager who meets the minimum training and competence standards for advisers.**

**To assist existing AFS licensees that may not have a responsible manager who meets these standards, we propose a transition period of six months.**

B1Q1

*Do you agree with this proposal? Please give reasons for your answer.*

In principle we are comfortable with the proposal. We agree that if RMs are responsible for the advice, they should have to meet the education requirements that would otherwise apply to Financial Advisers.

	<p>We recognise the specific case of early stage businesses not having the resources to employ an in-house Responsible Manager (RM). In such cases we would like ASIC to acknowledge that is comfortable with an outsourced RM.</p>
B1Q2	<p><i>Do you agree that, if the changes proposed in the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 become law, at least one responsible manager should:</i></p> <p><i>(a) meet the new higher training and competence standards (i.e. have a degree or equivalent, pass an exam, complete a professional year and undertake continuing professional development); and</i></p> <p><i>(b) comply with the proposed ethical standards (i.e. comply with a code of ethics and be covered by an approved compliance scheme)?</i></p> <p>We agree that if RMs are responsible for the advice, they should have to meet the education requirements that would otherwise apply to Financial Advisers.</p>
B1Q3	<p><i>Are there any aspects of the proposed higher training and competence standards in the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 that should not apply to at least one responsible manager of a digital advice licensee?</i></p> <p>Not that we are aware of</p>
B1Q4	<p><i>Is the proposed transition period of six months long enough for existing AFS licensees to comply with the requirement to have a responsible manager who meets the minimum training and competence standards? If not, why not?</i></p> <p>We interpret this to mean ASIC is proposing that an early stage licensee should have 6 months in which to appoint an internal RM, and should be able to outsource the RM function in the meantime. We agree that such a transition period is appropriate, and would recommend that it is extended to 12 months. This will provide the licensee with the flexibility to operate at a lower cost while testing its business model.</p>
B1Q5	<p><i>Please provide feedback on any costs or benefits that may apply to your business under the proposal.</i></p> <p>The transition period will provide the business ability to operate at a lower cost in the initial stages while developing its business model.</p>

## C1 MONITORING AND TESTING OF ALGORITHMS

<p><b>We propose to issue guidance on the ways in which we think digital advice licensees should monitor and test the algorithms underpinning the digital advice being provided.</b></p>	
C1Q1	<p><i>Do you think we should be more detailed in our guidance on the ways in which we think digital advice licensees should monitor and test algorithms? If so, what additional guidance should we provide?</i></p> <p>The level of guidance provided is adequate.</p> <p>We question the requirement to reconstruct the algorithm. We believe that the licensee's responsibility is to demonstrate that the advice is reasonable and in a client's best interest, and</p>

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not how the advice was derived. By way of comparison, human advisers are not required to demonstrate the thought and calculation process they used to deliver advice in the past. They only need to demonstrate that the advice was reasonable and in the best interest of the client. So we do not understand why this requirement is being imposed on digital advice providers.

For example, in the case of automated investment advice, the 'algorithm' is equivalent to the research process, portfolio construction model or the personal advice process used by traditional product/advice providers. For traditional advice providers, none of this know-how or the processes behind the products are individually regulated or audited by the licensee and would presumably remain exempt. This extends beyond advice and can be applied to investment strategies such as systematic hedge funds that invest using proprietary algorithms.

We would question why there is a need to regulate, 'audit' and give an opinion on a digital algorithm but that this should not apply for the advice triage processes used by most traditional financial advice practices, or the hundreds of manual research models based on free cash-flow, value, momentum etc.

In all cases, we believe the suitability test and 'best interest duty' should override and render such an audit redundant. We are concerned that the guideline may wrongly be viewed and used as a specific regulatory stamp of approval for the complete digital offering.

In addition - the proposed requirement of being able to reconstruct SOAs up to 7 years into the future is not workable from a technology perspective. We are happy to discuss this point further, however believe that such discussion is not required due to our fundamental belief that there should not be a requirement to reconstruct the algorithm in any case.

In Clause RG 000.105, many (although not all) of our members believe that if the error can be isolated in some way, then the suspension should only apply to cases where the error would impact the results. For example, if it was found that an error only affected cases where the client is over the age of 60, then there should be no restriction on continuing to provide advice to clients aged 59 and below.

We propose that the algorithm should still be allowed to operate as long as the cause of the error is understood, and the error can be isolated and turned off.

The error could come about for a range of reasons. It could be sudden regulatory change (such as a Federal budget); a share market crash; a global financial crisis; a change in interest rates; or a recommended financial product (including share trading platform) suddenly being taken off the market. Or it could be a genuine error in the algorithm coding.

By way of an example: a digital adviser has 5 model portfolios of ETFs. One of these portfolios (eg aggressive) contains a particular ETF that becomes delisted from the ASX. The digital adviser becomes aware of the de-listing. In considering their options they conclude that they can: (1) Develop a new model portfolio and build this into their system. This will take 10 days to implement. OR (2) Make a minor tweak which will filter out aggressive clients. This will take 1 day to implement, and will enable them to continue offering advice to people falling into the

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	other 4 model portfolios in the meantime. Option 2 is preferable. However, as it reads, RG 000.105 would force the platform provider to take Option 1.
C1Q2	<p><i>Please provide feedback on any costs or savings to your business as a result of this proposed guidance.</i></p> <p>If the comments in C1Q1 above are taken into account then no material additional costs will be incurred.</p>
C1Q3	<p><i>Do you think we should introduce a self-certification requirement which would require digital advice licensees to certify that their algorithms have been adequately monitored and tested?</i></p> <p>We do not believe that Self Certification will be effective in improving monitoring and testing. It is form over substance. It will, however, add significant costs to the digital advice industry. Therefore we are not in favour of Self Certification.</p>
C1Q4	<p><i>Should we require independent third-party monitoring and testing of algorithms? If so, in what circumstances would this be warranted?</i></p> <p>We do not believe independent monitoring and testing should be introduced. It will add a significant layer of costs to the digital advice industry. The result will be higher barriers to entry and less entrants.</p> <p>Human advisers are measured and monitored on the advice they produce, not the thought process that went into that advice. We believe that the same should apply to digital advice. We agree that digital adviser providers should have internal processes to control their advice (ie monitor and test their algorithms), and that this can be adequately managed internally.</p> <p>We believe this requirement might be suitable for a licensee which had produced repeated and material types of errors (that is, not one algorithm error resulting in a number of incorrect SOAs, but rather errors in many lines of code discovered at different times for different scenarios, demonstrating an systemic inability for the provider to manage its algorithm) in its advice, and would be suitable for ASIC to impose as part of an Enforceable Undertaking or as License Conditions.</p>

In addition to the specific questions raised in the Consultation Paper, we would like to make these comments:

#### Inconsistent Information

RG 000.99 refers to inconsistent information. Inconsistency can sit on a spectrum. For example – A client states in one place that their income is \$100,000, and in another place that it is \$200,000. this is clearly inconsistent, and in such cases we agree with RG 000.99.

Inconsistencies can also be subtle and subjective. For example – In one place the user may state that they are a teacher. In another place they may state that their salary is \$300,000, and in another place they state that they are a school teacher. Another example could be income of \$500,000 p.a., expenses of \$50,000 and assets of only \$100,000. In both these examples, it is possible but not probable that the information is correct. Many of

our members (but not all) believe that it is impractical for a digital adviser to identify every one of these possible inconsistencies, especially if a large amount of data is being collected from the client. The number of checks to perform could be in the thousands. Nor do those members believe a reasonable client would expect a digital adviser to be able to identify such inconsistencies.

We request that ASIC is specific about the types of consistency checks that should be performed, and that they are checks that a reasonable client would expect a digital adviser to perform.

#### Disclosure

The guidance requires that all disclosure is provided via a FSG or SOA. Digital advice can be a dynamic process, and there are often more relevant times for disclosures to be provided than in these static, lengthy, multi-topic documents.

For example, if a client answers questions to indicate that they have an aggressive risk profile, a warning could appear at that time (and added to an 'activity' listing), rather than in an SOA/ROA.

We believe that disclosure should be provided at the appropriate time, not necessarily in a document that will be delivered at a different time. We would like to have more discretion as to the time when disclosure is provided.

#### The iterative nature of digital advice

We would also like to see the guidance cover iterative advice. One example is where a user runs a scenario, then updates their input data, then runs another scenario. The user might iterate many times before arriving on their preferred answer. These iterations might involve changing their risk profile, goals, or spending for example. In this situation, would ASIC expect an SOA to be produced after each iteration? Or only after the user has settled on their preferred scenario? It might be cumbersome for the user if they are issued with multiple SOAs. In contrast – if a client sees a human adviser, then they might have a conversation and discuss some “what if” scenarios without an SOA being provided after each scenario is considered. While some digital adviser providers might want to provide an SOA after each iteration, we do not believe it should be a requirement.

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