Innovation and regulation

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CHECK AGAINST DELIVERY

I'm excited to be speaking to the financial technology (fintech) community in Adelaide – especially as the scale and pace of innovation in the fintech sector today present unique regulatory challenges. At ASIC, we are committed to promoting innovation and the benefits it generates without compromising the proper regulation of financial products and services. In fact, we believe that sensible, appropriate regulation can improve demand for innovative services by increasing consumer trust and confidence in those services and the businesses that provide them.

We want to avoid instilling an 'us (fintech innovators) versus them (regulators)' mentality. We are encouraging fintech businesses to see regulatory requirements as part of putting customers' interests first, and building trust and confidence in fintech.

Introduction

I want to begin today by setting the scene. In the first part of my speech, I will highlight the increasing importance of the fintech sector, set out ASIC's regulatory objectives and introduce you to our Innovation Hub.

I will then delve into some examples which demonstrate our willingness to look at this developing area, consult with stakeholders and adjust our regulatory approach. In particular, I will be talking about ASIC's work in the areas of marketplace lending and digital advice.

I will also go into detail regarding our engagement with regulatory technology (regtech), including an announcement on how we plan to further our commitment to the sector.

Then, I will highlight the specific issues and barriers currently faced by fintech start-ups, and explain ASIC's proposals for addressing these issues. Finally, we can finish with any questions you may have.

Fintech sector and ASIC's Innovation Hub

The fintech sector

The following numbers demonstrate the increasing importance of fintech in Australia and around the world. In US dollars, the fintech sector represents:

- $20 billion in global investment[1]
- $300 million in Australian investment[2]
- $77 billion in US alternative finance
- $4.5 billion in UK alternative finance
- $350 million in Australian alternative finance[3]
- $19 billion of US assets under 'robo-advice',[4] and
- $20 billion of global savings for the financial sector via 'blockchain' over the next decade.[5]

Closer to home, the recently released fintech Australia census[6] found that our fintech industry is a young sector, with most fintechs in the early stages of business growth. Some statistics that caught my attention were:

- average revenue in the last month was $215,000
- expected revenue growth in the next 12 months is on average 201%
- the vast majority of fintechs are earning revenue, and 14% are profitable
- 40% of fintechs surveyed had at least one financial services licence, and
- the vast bulk of the fintech models are in the lending or personal advice/asset management sector, which mirrors the Innovation Hub's engagement with fintechs.

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[1] KPMG International and CB Insights, *The Pulse of FinTech: 2015 in Review*, 9 March 2016, https://home.kpmg.com/xx/en/home/insights/2016/03/the-pulse-of-fintech-q1-2016.html

[2] EY, *UK FinTech: On the cutting edge*, 24 February 2016, https://www.gov.uk/government/publications/uk-fintech-on-the-cutting-edge

[3] KPMG et al., *Harnessing Potential: The Asia Pacific Alternative Finance Benchmarking Report*, March 2016, https://home.kpmg.com/au/en/home/insights/2016/03/harnessing-potential-asia-pacific-alternative-finance-benchmarking-report.html

[4] The Changing Face of Financial Advice: 2015 and Beyond, Corporate Insight, December 2014

[5] Oliver Wyman et al., *The Fintech 2.0 Paper: rebooting financial services*, 16 June 2015, https://www.finextra.com/finextra-downloads/newsdocs/the%20fintech%202%200%20paper.pdf

[6] FinTech Australia and EY, *EY FinTech Australia Census 2016 Predicting and defining the fintech sector*, 3 March 2016, http://www.fintechaustralia.org.au/census

ASIC’s approach to new regulatory challenges

Our strategic objectives inform the approach that we take towards fintech regulation. These objectives are:

- confident and informed investors and financial consumers
- fair, orderly and transparent financial markets, and
- efficient registration and licensing.

As technology changes over time, it is natural to experience disruptions that challenge the existing regulatory framework. It is very important that ASIC does not stand in the way of technological change that may improve outcomes across the financial system. However, we also need to continue to target our strategic objectives to ensure good governance in the financial sector.

I will provide some examples that demonstrate our willingness to look at developing areas, and consult and provide adjusted regulations that demonstrate our approach to these issues. We do this to maintain the right balance between public and private interests.

ASIC’s Innovation Hub

In response to the challenges presented by fintech, ASIC established an Innovation Hub to assist fintech start-ups to navigate the regulatory framework.

This is, in part, a response to particular challenges faced by start-ups (including issues such as lack of experience with the regulatory framework and limited resources), but also a recognition that innovative products and services often do not fit clearly within existing rules and policy.

Our Innovation Hub is made up of five components:

- We engage with other fintech initiatives, including physical hubs and co-working spaces for start-ups.
- Eligible businesses can request informal assistance from us through our website. This guidance is intended to help new businesses consider important issues early on in their development.
- We have set up a dedicated website for the Innovation Hub, which provides tailored guidance for innovative businesses to access information and services relevant to them.
- We have established a senior internal taskforce to coordinate our work on new business models. The taskforce draws together dispersed knowledge and skills across ASIC. This taskforce is complemented by internal working groups on digital financial advice, marketplace lending, equity crowdfunding and blockchain.
- We have set up a Digital Finance Advisory Committee (DFAC), which provides ASIC with advice on this area. DFAC includes members from the fintech

community, academia and consumer backgrounds. Other financial regulators are observers on DFAC.

I would now like to highlight some statistics around ASIC, the Innovation Hub and licensing of fintechs.

Since its inception, the Innovation Hub has worked with 127 entities – 95 of which have received informal assistance – and held over 140 meetings with fintechs and other stakeholders. Since March 2015, ASIC has granted 23 new Australian financial services (AFS) licences and Australian credit licences (credit licences), as well as six licence variations. This figure includes those applications which had been submitted to ASIC at the time the Innovation Hub was announced.

Looking closer at our latest statistics around the licensing of fintechs – on average, without formal assistance, it takes 205 days for a licence applicant to receive a draft licence. This includes the time taken for applicants to respond to ASIC's questions, which on average is around 50 days. However, fintechs who have engaged with the Innovation Hub prior to submitting their application get approved for a licence, on average, in 110 days – or nearly 45% faster than if they hadn't engaged with the Innovation Hub. My message, then, is simple. Come and speak to our Innovation Hub before you go to lawyers about getting a licence. You will be likely to save yourself a lot of money and time.

I would also like to note that, in the greater majority of cases where a fintech entity has been licensed by ASIC, we have utilised, in their favour, our discretion to help get the licence across the line – particularly as regards the skills and experience requirements that normally apply.

ASIC has also established relationships with regulators in Europe, North America and Asia to discuss innovation developments and policy proposals.

There are many other Innovation Hub successes, including some important guideline papers that I'll mention shortly. I do want to highlight that, this year, ASIC entered into memoranda of understanding (MOUs) with the UK Financial Conduct Authority and with the Monetary Authority of Singapore. These agreements allow us to formally refer fintech start-ups to one another to receive informal assistance when attempting to expand abroad. Moreover, ASIC has signed fintech cooperation agreements with the Kenya Capital Markets Authority and the Ontario Securities Commission. This is an information-sharing agreement which includes sharing knowledge about establishing innovation hubs, regulatory sandboxes and providing tailored advice on emerging financial services that utilise technology (e.g. robo-advice).

Regulatory approach

ASIC has conducted targeted work in a number of specific areas of fintech – including marketplace lending, digital advice and regtech – to help develop these sectors.

Marketplace lending

Marketplace lending is an area we see growing quickly. Marketplace lending can offer an alternative source of funding to individuals and small to medium-sized enterprises (SMEs) rather than more traditional channels. For investors, this could also represent an opportunity to invest in an arrangement that gives more direct exposure to personal and/or SME debt. So far, the industry remains small in Australia, with around $50 million in loans to date. However, the number of entities looking to enter the industry is growing fast, as evidenced by the number of entities ASIC has engaged with through our Innovation Hub.

We have published Information Sheet 213 *Marketplace lending (peer-to-peer lending) products* (INFO 213), to assist industry. Our information sheet gives guidance to providers of marketplace lending products, and others providing financial services in connection with these products, to assist with issues such as obligations around disclosure, regulatory obligations and good practice examples.

We have also have set up an internal taskforce on marketplace lending that will help monitor industry developments. The group is made up of representatives from across various teams within ASIC to help coordinate our dealings with the sector and make sure the current regulatory regime remains fit for purpose. ASIC is also periodically surveying operators to make sure we have good data on the sector.

Digital advice

Digital advice (also known as 'robo-advice' or 'automated advice') is the provision of automated financial product advice using algorithms and technology and without the direct involvement of a human adviser. It can comprise general or personal advice, and range from advice that is narrow in scope (e.g. advice about portfolio construction) to comprehensive financial product advice.

The provision of digital advice has grown rapidly in Australia since 2014, with a number of start-up AFS licensees and existing AFS licensees developing digital advice models. This growth is expected to continue and ASIC supports the development of a healthy and robust digital advice model.

Based on our discussions in the market, we found that digital advice providers or prospective providers would greatly benefit from guidance in this space. As a result, ASIC has released Regulatory Guide 244 *Providing digital financial product advice to retail clients* (RG 244). This regulatory guide is a convenient starting point for those seeking to understand the rules in relation to providing digital advice. It brings together some of the issues that digital advice providers need to consider when providing digital advice in Australia, from the licensing stage right through to the actual provision of advice.

The regulatory guide builds on existing ASIC guidance and does not introduce new regulatory concepts. This is because the law is technology neutral, and the obligations applying to the provision of traditional (i.e. non-digital) financial product advice and digital advice are the same.

There are, however, some issues that are unique to digital advice providers, including:

- the experience and training obligations that apply for firms providing digital advice
- the ways in which digital advice licensees should monitor and test their algorithms, and
- the minimum steps that digital advice providers should take to comply with the law requiring them to act in the best interests of their clients.

Regtech

One other sector that ASIC is monitoring closely is regtech, which refers to the accelerating use of technology solutions to address regulatory requirements.

ASIC considers that the regtech sector has enormous potential to help organisations build a culture of compliance, identify learning opportunities and save time and money relating to regulatory matters. ASIC also sees potential in regtech to complement the work we already do and, as such, we are looking to increase our engagement with firms that are developing regtech products. In fact, we are already working on some pilot programs with regtech firms to test some of these ideas.

This brings me to an announcement that I am very excited to make today – ASIC will be hosting a regtech roundtable in February 2017.

The purpose of the roundtable is:

- to hear a variety of views on the development of regtech in the financial services sector
- to learn more about the opportunities regtech presents, and
- to gain an understanding of the barriers and hurdles impeding the progress of regtech – including what role, if any, ASIC can play in reducing those hurdles.

We encourage you to register your interest in this roundtable through our Innovation Hub website.

In addition to this roundtable, we're always happy to meet with existing businesses that wish to share their progress in the regtech space, as well as those seeking informal assistance in developing their businesses.

Regulatory sandbox exemption – What it might be

Issues for fintech start-ups

As part of our work on innovation, we have been meeting with industry stakeholders to understand the issues and barriers faced by new businesses seeking to enter the financial services market. Despite there being a lot of flexibility in the existing regulatory framework, we believe innovative start-up businesses continue to face three interconnected issues. These are:

- speed to market
- organisational competence (i.e. the training and experience needed for a licence), and
- access to capital.

The fintech census I referred to earlier found that fintechs have a broad range of issues and would welcome growth initiatives around not only access to capital but also tax relief and incentives, government-mandated open data protocols, and policy reforms that encourage increased employment of skilled workers. However, let me focus on the areas relating to ASIC that are most important to fintechs.

Speed to market

We are aware that the time and cost of taking a service to market to demonstrate consumer interest can be a significant issue for new businesses with limited resources. We have identified this as the ‘speed to market’ issue.

Under our current framework, a new business that is seeking to provide financial services must generally obtain an AFS licence from us (or act as a representative of an existing licensee) before it can test whether its products or services are viable or will attract investment. If changes to the business model are required, a business may need to spend more time and money before it can recommence operations – for instance, it may need to vary its financial services licence.

It has also been our experience that businesses with innovative business models frequently lodge novel and complex licence applications. These applications may take a longer time on average to process than more vanilla applications. This is another factor which can extend the time it takes for the business to take its service to the market.

However, as I noted earlier, fintech businesses that have engaged with ASIC’s Innovation Hub have experienced far shorter waiting periods in having their licence granted by ASIC’s licensing function.

Organisational competence

The law sets out organisational competence requirements for businesses that provide financial services. This is largely to ensure that individuals within the business have an understanding of their obligations. While innovative businesses may have staff with some experience in financial services, ASIC’s experience is that sometimes these staff members might not be suitably knowledgeable to meet the licensing requirements.

If that is the case, innovative fintech businesses need to either hire a responsible manager before they can commence trading (this can be costly and may have to be done at the expense of equity in the business) or ask ASIC to exercise our discretion this area. The challenge with preparing a submission for ASIC is that fintech businesses may have to prepare these without the benefit of detailed guidance or examples.

Discussions with industry have also highlighted that, for businesses that rely heavily on technology and automation, legal sign-off may be an increasingly important and appropriate part of their compliance with the regulatory framework.

ASIC therefore believes there is an opportunity for us to provide more information to fintech businesses to assist them in more promptly preparing their submissions regarding knowledge and skills, and the possible scope for third parties to sign off as responsible managers. We are working on these ideas now.

Access to capital

A separate but related overarching concern is the difficulty faced by start-up businesses in attracting investment or finance. This lack of access to capital exacerbates the ‘speed to market’ problem because it drives new businesses to proceed to market quickly to increase their chances of obtaining initial funding. Lack of capital also exacerbates the ‘organisational competence’ issue because there are limited funds to pay for experienced responsible managers (and incentives to defer compliance costs where possible).

We are not in a position to directly solve issues associated with access to capital. However, our regulatory sandbox initiative, which I will discuss shortly, may indirectly assist by increasing the appeal of investing in some fintech start-up businesses.

Proposed measures

In putting together options to assist in mitigating the speed-to-market and organisational competence issues, we have proposed some new measures which we also believe will promote good consumer and investor outcomes, and promote market efficiency.

ASIC published Consultation Paper 260 *Further measures to facilitate innovation in financial services* (CP 260) in June 2016. In this paper, ASIC proposed to:

- provide additional guidance and examples on how we exercise our discretion under existing policy to assess the organisational competence of a licence applicant
- modify ASIC’s policy on organisational competence of a licensee to allow some limited-in-scale, heavily automated businesses to rely, in part, on compliance sign-off from a professional third party to meet their competence requirements, and
- implement a limited industry-wide licensing exemption to allow start-ups to test certain financial services for six months (the ‘regulatory sandbox’ exemption).

We proposed these other measures to address particular issues faced by new, innovative businesses. Although there is already substantial flexibility in the Australian regulatory framework, we reached the view that some additional measures should be canvassed given the particular challenges faced by this sector, such as speed to market, difficulties demonstrating organisational competence and access to capital.

Regulatory sandbox exemption

The purpose of the regulatory sandbox exemption is the creation of a controlled environment to allow start-ups to launch prior to a detailed assessment of standard licensing requirements. The sandbox will allow businesses to test and adapt their services, and attract investment prior to authorisation. It will also encourage competition by reducing barriers to entry in the financial services market.

Importantly, the proposed exemptions will have various features built in to maintain consumer protection and confidence in fintechs.

Having just outlined our proposed measures to facilitate new innovative financial businesses, it should also be noted that there is already significant flexibility for innovative business models in the current regulatory framework, including through:

- modular financial services and credit licensing frameworks, under which narrower business models may have reduced compliance obligations
- the option for businesses to operate as a representative of an existing financial services or credit licensee, and
- ASIC’s discretion in relation to organisational competency based on submissions made to ASIC and ASIC’s policy framework, which allows ASIC to consider granting industry-wide or entity-specific waivers and issue no-action letters.

In reaching our final policy view, we will need to balance our belief in facilitating innovation with the need to promote good consumer and investor outcomes as well as market efficiency.

We are now getting very close to finalising out policy. ASIC has received 29 submissions in response to our consultation paper. The feedback we received from these submissions has been extremely helpful to us. We have taken these comments and suggestions on board as we work to finalise our proposals. We expect to have more to say on this topic before the end of the year.

Conclusion

As you will have seen, ASIC is addressing the regulatory challenges posed by fintech through targeted, tailored engagement with the fintech sector. Again, we will be hosting a regtech roundtable in early February next year and we encourage you to register your interest via our website. We feel this engagement is important for the reasons I have discussed throughout my speech – in particular, the pace of innovation, the need to balance innovation with consumer protection, the novel nature of many fintech business models and the limited resources which many fintech start-ups have to commit to obtaining advice about their legal obligations. We want to work with you to address these challenges.