

28 July 2016

Mr R. McMahon
Acting Senior Manager
Deposit Takers, Credit and Insurance
Australian Securities and Investments Commission
Level 5
100 Market Street
SYDNEY NSW 2000
Via email: InnovationHub@asic.gov.au

Dear Richard,

Response to CP260 "Further measures to facilitate innovation in financial services"

Cuscal appreciates the opportunity to respond to the June 2016 Consultation Paper – CP260.

Cuscal is an end-to-end payment solutions provider that services more than 100 established and challenger brand clients with access to Australia's financial system and payments landscape. We are an Authorised Deposit Institution (ADI), the holder of an Australian Credit Licence and Australian Financial Services Licence, our Standard & Poor's credit rating is A+. We provide services to two of the major banks with the majority of our clients within the second tier banking and mutual sectors. Cuscal also connects a number of innovators and non-licence holders to the payment and banking ecosystem. By allowing our clients access to a range of services and products with significant scale, we enable them to compete on a more level playing field.

Our services cover the issue and processing of credit, debit and prepaid cards, transaction switching and processing across various networks including card schemes and eftpos, fraud and settlement services and operation of the RediATM network. We are a founding member of the New Payments Platform and we are heavily involved in the delivery of mobile payments (Apple Pay, Samsung Pay and Android Pay). Our business is highly technology focused, and we work with numerous business partners including many early stage fintech companies. By way of example, we have recently been appointed as the local processing provider for "Square", which is set to become a major player in the merchant acceptance of card payments in Australia.

We think any efforts to stimulate the development of the fintech industry in Australia will be a boost for competition, and assist the transformation of the Australian economy. We therefore support the initiatives which ASIC has proposed in CP 260 ("The Consultation Paper"). We hope that the views and comments provided below will assist ASIC in the formulation of its final position.

Additional Guidance on Flexibility and Organisational Competence (Proposals B1 to B5)

ASIC is considering providing additional guidance on how it assesses responsible manager ("RM") applications made under Option 5 of RG 105, where the RM does not have the experience or qualifications to satisfy the other options.

Cuscal agrees that the provision of additional guidance may provide some assistance to both early stage companies as well as established licensees, who are looking to replace RMs or appoint additional RMs.

We believe the examples provided will assist those licensees proposing to rely on Option 5 of RG 105 in appointing RMs who have very similar backgrounds and experience to those provided in the examples, but they will not provide certainty for most applications which will differ from the examples.

Due to the wide range of business models and equally large range of qualifications and experience amongst RM applicants, it will never be possible to provide enough examples to cover the majority of scenarios. Any examples provided, should therefore clearly demonstrate the principles that ASIC has relied upon in reaching its determination. This collection of principles can then serve as guidance on how ASIC may assess an individual application.

We feel that the presently drafted examples fall short of providing those guiding principles. We recommend additional commentary be provided in each of the examples (particularly examples 2 to 4) to further demonstrate *why* ASIC would exercise its discretion in the manner outlined. For example:

- **In example 2** the statement that ASIC "may be satisfied" with RM2 provides little guidance. What extra information could be provided that would make that satisfaction more likely?
- **In example 3**, has ASIC made the assumption that the applicant's experience in compliance has been only in wholesale products, or is its assumption that compliance experience must be too far removed from business decision making?
- **In example 4** the experience descriptions are extremely short and not likely to be representative of an actual application. What is it about the description of each experience that has led ASIC to the belief that RM1 is suitable and RM2 is unsuitable? What additional evidence might RM2 add to improve his or her chances of approval?

Small scale, heavily automated businesses (Proposals B2 to B4)

ASIC is considering allowing licensees to demonstrate competence over certain heavily automated aspects of business, by relying on sign off by third parties on those processes, rather than requiring the RM to demonstrate the specific competence.

Cuscal agrees with the principle behind this proposal. In particular we agree that compliance is generally best achieved where processes and decisions can be automated, removing the potential for errors that are inherent in manual processing.

We think that allowing a third party to sign off on the automated aspects of the process, will allow smaller companies to more readily demonstrate that they have the required competence over the remaining parts of their business.

We think more guidance will be necessary on the nature of the sign off which is required. For example we would expect that any professional providing sign off would have examined the systems and processes and would have tested, or verified the test results which demonstrate that the system performs in accordance with its specifications. We would expect that the professionals best qualified to provide this sign off would be experienced auditors, lawyers or assurance professionals.

We note that the costs of sign off by an independent auditor will be significant, although they may be lower than the employment of an additional responsible manager. We think that an annual sign-off is reasonable given the potential changes to regulation during each period. However, where the auditor is satisfied with the effectiveness of the licensee's change controls it should have the discretion not to retest the performance of the entire process or system annually.

Eligibility

1. **Scale:** We have reservations about the appropriateness of a single 1000 customer retail client cap. There can be significant expense associated with the automation of processes, and depending on the business model, automation may not make sense below a certain scale. For example, while a 1000 client cap may be appropriate for a business that provides detailed financial plans to customers at a high margin, it is unlikely to assist a comparison website service that relies on a high volume of customers at low margin.

We suggest that ASIC considers basing the cap on the total revenue from retail customers as opposed to the number of customers, or on a combination of the two.

2. **Products and services:** Cuscal considers that ASIC's proposal to limit third party sign off to liquid financial products, non-cash payment facilities and products issued by ADI's is appropriate at the introductory stage of this arrangement.

We note ASIC has selected these low risk products based on its assessment that there is an increased risk on inappropriate reliance on third party sign off. We think that the use of an independent third party for sign off is likely to lower the risk of poor conduct and non-compliance associated with the automated processes, in comparison to relying on internal review alone. Even if a licensee has an internal RM, or compliance manager who is competent to review the automated processes, it is unlikely they would have the same experience or apply the rigour of an independent auditor.

We suggest that ASIC consider extending the class of the products to which this arrangement applies, if the initial arrangement achieves successful outcomes.

AFS licensing exemption for limited service testing ("the Regulatory Sandbox") (Proposal C1 to C9)

Cuscal strongly supports the principle of a structured regulatory sandbox exemption. We agree that the current requirement for an AFS licence before a business can commence customer engagement is an impediment for start-up businesses, and makes it more difficult to attract capital and to engage with industry partners who may be essential for the fintech to deliver its services.

In our experience, there are few financial service start up business models that enable the start up to enter the financial services ecosystem on their own, without the support of established organisations operating within the sector. This is particularly true of start-ups within the payments industry, where any movement of money must occur within the clearing and settlement ecosystem overseen by the RBA. Entry into this ecosystem requires not only connectivity licences and capital, but proof of ability to meet the RBA's liquidity requirements.

Cuscal has historically provided support to a number of early stage companies, through our existing connectivity and through the support of our assets and licencing.

Access to these ecosystems is usually a prerequisite for the start up to market test its product or service. The reworking of initial obligations would make it easier for Cuscal and other entities who provide similar support, to assist start-ups with access to the financial ecosystem at an earlier stage .

Eligibility (C1 and C3)

ASIC has proposed that the exemption only apply to new Australian Businesses and not to existing Licensees.

We would agree that the impediments for an existing Licensee to expand the authorisations on its license should be substantially less than a start-up which needs to obtain an AFSL. For that reason we agree that the exemption should not be open to existing licensees or their subsidiaries.

We are less supportive of the proposal that the exemption only apply to "new Australian" Businesses. We believe that it is just as important to support innovation within existing businesses as innovation within start-ups. Small existing businesses will not necessarily have greater access to capital than start-ups. If an existing (non-licensed) business develops a product or service for which they would

need an AFSL, we do not think that they should be at a disadvantage in market testing that proposition in comparison to a start-up with the same proposition.

We also think it may be difficult to define what constitutes a "new" business, and that some existing businesses will find loopholes by establishing new entities for the purpose of gaining the exemption.

We also think that the exemption should be available to Australian registered subsidiaries of organisations domiciled internationally. This will provide a level playing field to overseas entrants wishing to test their services in the Australian market. We think that the innovation benefits to the whole industry of the level playing field will outweigh the benefits of providing a head-start to Australian grown start-ups.

Time Period (C1)

We agree generally with the concept of a time period for testing to occur. We think that with enough prior planning the majority of fin-tech concepts ought to be capable of testing within 6 months, however there will be financial products for which 6 months represents only the early stage of the product life cycle, and for which sufficient data will not be available in that time period to prove the concept.

We encourage ASIC give further thought to extending the time frame in certain circumstances where it is established up front that a 6 month time frame is not sufficient. We agree that the test period should not be open for extension once the testing business has commenced the market test, as this would likely open the floodgates for extension applications.

It is unclear what will happen to testing clients at the end of the test. While paragraph 73 of the Consultation Paper suggests that a testing business may be able to continue to service its clients, paragraphs 64 and 66 suggest that a testing business would need to stop operations following the test until it obtained the requisite licence.

We do not think that it is practical to require a business that has established a small customer base and is proceeding with a licence application to shut down its operations for an indefinite time period while it awaits the grant of a licence. We think this condition is not beneficial to clients and would make it very hard for some businesses to attract clients to its test. It may also severely restrict the type of services that will be suitable to test (see comments relating to "services restrictions" below).

We believe a better outcome would be that testing businesses who have applied for a licence and can demonstrate through their sponsor that they have proved their business model, should be allowed to continue to service the customers acquired during the testing period or be grandfathered for a period.

In order to provide sufficient protection during this transition period we suggest that ASIC could put in place a transition framework involving such elements as:

- Lodgement of a licence application;
- A conclusions document submitted by the sponsor, evidencing the successful testing of the model and the resolution of any compliance issues and complaints;
- The continued support by the sponsor during the transition period;
- Lodgement of a transition plan outlining how the business plans to transition to a fully licensed business, including how it intends to comply with the Responsible Manager requirements.
- A review meeting between ASIC, the sponsor and the testing business to consider the test results and the transition plan ;
- ASIC imposing any suitable conditions during the transition period.

Service Restrictions (C2)

ASIC proposes that the exemption apply only to advice relating to quotable Australian securities, simple managed investment schemes and deposit products; or arranging another person to deal in those products.

We note ASIC's rationale that the short nature of the test makes it more relevant to advice based services relating to simple liquid products, and not to the products themselves.

Cuscal considers that the proposal is overly restrictive. We think it will only be of benefit to a small proportion of fintech start-ups and will therefore have limited success in encouraging innovation in the sector.

We think that the benefit would be greatly improved if the exemption also applied to financial products, and we think our suggestions to allow the continued servicing of customers following the 6 months of testing would overcome the objection to including a greater selection of products and services. In particular we would not see any rationale for excluding non-cash payment products which is a highly innovative sector, in which Cuscal is heavily involved.

Conditions of Exemption (C4)

ASIC has proposed the exemption be limited to:

- a) 100 retail clients with a maximum exposure of \$10,000; and
- b) Total exposure for all clients (retail and wholesale) of \$5 million.

We can envisage business models that would struggle to fit into these limitations.

The retail client limit should apply to active customers, not to customers who have merely registered for a service. Even with this rider, our comments relating to the scale of testing businesses (B2 to B4) apply equally to this proposal. 100 active retail clients will not be sufficient volume to test a business model which is heavily automated and reliant on high volume and low margin. We would therefore suggest that individual and total financial exposure is a better limitation than client number.

We would also question how well the exposure limits would work for businesses providing financial advice. If the exposure refers to the total exposure as a result of financial advice (as opposed to the potential liability towards the testing business), then we think that \$10,000 is a very low limit and would severely restrict the type of advice available.

ASIC has requested submitting parties to consider the alternative of a graduated exposure limit based on client's total net assets. We think that while this could work for certain business models, it presupposes that the testing business would receive a client's full financial details. This is likely to only apply to those testing businesses providing wide scale financial advice. We think it would be more workable if testing businesses could apply either the maximum exposure of \$10,000, or a graduated exposure limit where a customer provides their net asset position. There should be no requirement for the testing business to verify the customer's financial position.

Our comments on these limits are even more pertinent, if the licensing exemption were to be extended to financial products (see "Service Restrictions" above).

Compensation Arrangements (C5)

ASIC proposes that the exemption proposal only applies where the testing business maintains adequate compensation arrangements.

Cuscal cannot comment on the likely availability or cost of professional indemnity insurance to a small start up with an untested business model, although we would suggest that if this insurance is not viable to individual businesses, it may be available to a sponsoring entity.

Other Consumer Protections (C6)

ASIC proposes that the exemption apply where testing businesses:

- 1) Are members of an EDR scheme;
- 2) Comply with modified disclosure requirements; and
- 3) Comply with best interest duty and conflicted remuneration principles.

Cuscal agrees that these are reasonable compliance requirements for a testing business. Generally, we would expect that any business model to be tested would need to comply with regulation (outside of specific licensing requirements). In particular we would expect all privacy and AML/CTF regulation would need to apply. This should be integral to the development of the service (or product). In the absence of those requirements any test would be unrealistic.

We note that the proposals are likely to have impact on reporting requirements of other regulators (particularly APRA, the RBA and AUSTRAC) and assume that ASIC is separately engaging with those regulators.

We agree that potential clients of the testing business need to be made aware that the service is provided on a test basis. Further, the disclosure must detail what will happen to the client's account or investment at the end of the test.

Sandbox Sponsorship (C7)

ASIC proposes that each testing entity be sponsored by a not-for profit industry association or other Government-recognised entity.

Cuscal supports the concept of "sponsorship" which we see as having the advantages of:

- Experienced third party consideration and feedback into the development of the model, likely improving its chances of success.
- Review and advice on the governance and risk and compliance measures that are in place.
- Experience in market testing, to plan the test and measure the outcomes objectively.
- Reduced burden on ASIC and associated time involved in approving commencement of market test.

We also support the concept of sponsorship on a fee-for-service basis where a testing business is not aligned to a particular association. We would expect that even if businesses are aligned to an association, there would be a need to charge a fee to recover the cost of advice and due diligence and potentially insurance.

Cuscal suggests that ASIC consider extending sponsorship beyond the not for profit sector. This would allow other parties in the financial sector to act as a partner for early stage startups, providing the same advantages of those listed above with the addition of potential to access additional capital to support the test. This would be of particular interest to private entities that could benefit by the ultimate services that the fintech would be providing. There would need to be some rules placed around this to ensure that the testing business was a legitimate independent business without directorship or ownership by the sponsor.

Under this model, we would propose that the sponsor again be able to charge fees, but only to recover the costs of the assistance.

If the licensing exemption were extended to financial products and private sponsorship permitted, Cuscal could be interested in acting as a sponsor.

We suggest that sponsor approval by ASIC cover such elements as:

- the organisational history of the sponsor (e.g. for private sponsors this could include time licenced, free from serious breach);
- the maturity of the sponsor's risk and compliance framework; and
- the existing of a testing framework, outlining the approach to due diligence, test planning and acceptance.

Integrity Measures (C8 and C9)

ASIC proposes that testing businesses:

- a) notify ASIC of its intention to rely on the exemption;
- b) provide evidence of sponsorship;
- c) declare reasonable grounds of expectation to be able to operate for 6 months;
- d) provide ASIC a short report at the end of the testing period, and;
- e) that ASIC have the power to withdraw relief.

Cuscal supports each of the integrity measures. In addition to ASIC's rationale for the provision of the short report, we would expect that the report would also assist ASIC's consideration of any associated licence application.

We suggest that ASIC also retain the ability to conduct its own verification of test outputs by directly contacting clients of the testing business. This could be a requirement for businesses that wished to continue providing the service or product between the end of the test period and the grant of a licence (our suggestion for C1).

We agree that the examples provided of circumstances for ASIC withdrawing the relief are appropriate. As ASIC is only likely to become aware of these events through complaints to itself or the external dispute resolution administrator (which may be unlikely given the number of clients), ASIC may wish to consider a requirement that each sponsor monitor complaint levels, and reports to ASIC in the event that complaints appear to indicate a systemic issue with the testing business.

Other Considerations – B2B Fintechs outside the AFSL regime

We are observing an increasing trend for participants in the financial service industry to be reliant on numerous business partners for different parts of their services, rather than providing their own end to end solutions. The number of fintechs currently developing software and data analytic products is testament to this trend.

We think this trend will continue as the pace of technological development makes it increasingly difficult for businesses to retain the range of specialist knowledge required to implement and maintain complex business systems and software.

The consequence of this trend is that licensees are becoming increasingly reliant on the risk and compliance controls developed by third parties, and although they are ultimately responsible for the compliance of their offerings to consumers, they are not always able to correctly assess how the third party controls will perform as part of a complete business process. In a digital environment, the suppliers within the financial service value chain may never see the client themselves although a failure in their service may cause the whole customer experience to fail.

While these B2B fintechs typically operate outside the scope of the AFSL regime, their outputs are nonetheless important to the compliance of the financial system. Although it is outside the scope of this consultation paper, we think there would be an industry and regulatory benefit if ASIC were to encourage education and engagement with this non-licensed industry sector.

We note that ASIC has referenced some measures which overseas regulators have taken to encourage innovation in their regulatory framework. We assume that ASIC is tracking the early outcomes of those measures, and that those outcomes will help inform its proposals.

We hope that ASIC finds our submission useful and we would welcome the opportunity to clarify any items or further discuss any of the comments provided in this submission. While we have not contributed directly to submissions of other industry bodies we would be happy to facilitate further discussion with those relevant bodies if that would be of assistance. Please feel free to contact Scott Jamieson, Senior Compliance Manager, Credit Cards on 02 8299 9660 or sjamieso@cuscal.com.au or myself on 02 8299 9069 or kmckenna@cuscal.com.au.

Yours sincerely,
Cuscal Limited



Kieran McKenna
Chief Risk Officer.